



Q&A: Bonds are for the bold?

For professional investors only | Marketing communication



Kaspar Hense
BlueBay Senior
Portfolio Manager,
Investment Grade team

Published November 2023

“Now we think bonds are for the bold, with yields much higher than they were.”

Bond yields have continued to rise in recent months, but the time to buy has arrived, argues Kaspar Hense.

Are we now at the top of the rate cycle and do you think investors should be looking to increase duration?

Three years ago, yields around the world had been close to zero and we had three years of consecutive negative returns in US Treasuries, which we have never seen before. Now we think bonds are for the bold, with yields much higher than they were.

The path to lower rates is still rocky, and huge returns in fixed income are still rather for the second half of next year. But yield compensation is already high, and we think from an asset allocation perspective, it is the time to buy. We expect most central banks to cut rates next year, starting with EM and then followed by developed markets.

Fiscal spending is rising in the US and there have been concerns about the level of treasury issuance that we require to fund it. Who's going to buy all these bonds?

The US budget deficit is certainly ballooning and indeed concerning. We think that interest rate payments will be one of the largest expenses of the US budget over the next years. They will rise up from \$1trn to \$2trn and increase by 10 percentage points as a share of overall tax receipts.

There is hardly any room left for discretionary spending as an automatic stabiliser, either. Discretionary spending really will become marginal to support growth.

On the other hand, though, we think the market has now adjusted to these very high issuance level. Even though we think issuance will rise from roughly \$1trn to \$2trn next year.

You also have to have in mind that there are ample of domestic savings parked in money market and in bank deposits and also in stocks. Money markets have grown to \$5.5trn. Fund deposits are currently at \$17trn. And domestic stocks or stocks, which are hold mainly domestically, of \$45trn, give you some buffer for the supply to be absorbed. Indeed, we expect some crowding outs at these higher yield levels.

How does leverage look for investment grade companies, and does the extra spread that investors get paid to hold these bonds over government bonds look attractive versus possible default risks?

Overall, we think that the clouds of a recessionary outlook will continue to darken the investor sky, but we think it will be rather a slow process of continuous deleveraging and low demand. Sufficiently strong or healthy labour markets and demand should keep economies afloat.

Investment demand is also high in Europe and will continue to support growth, which indicates a somewhat better fiscal outlook. That means we are indeed optimistic for investment grade credit overall, though careful on sector selection.

We like European banks with solid balance sheets and in our view, very manageable increases of non-performing loans. But we are still cautious on cyclical and capital-intensive sectors such as autos.

Looking at the different sectors that make up of the investment grade world, which ones do you and your team think are attractive?

We like some emerging market local debt, where yields are still double digit but inflation is already close to target and fiscal policies has not been exuberant. We also like, as I said, European banks on the corporate side, and we think that next year US agency mortgage-backed securities will be quite interesting, with yields up to 6.5% and falling rates volatility. Nonetheless, with refinancing rates high, we are focusing more on a bottom-up analysis than on asset allocation.

We do not like emerging market hard currency debt because overall valuations are not very attractive. But we like Romania, which has low government debt and trades twice as wet as the index, to give an example of our stock picking at this current juncture.

This document is a marketing communication and it may be produced and issued by the following entities: in the European Economic Area (EEA), by BlueBay Funds Management Company S.A. (BBFM S.A.), which is regulated by the Commission de Surveillance du Secteur Financier (CSSF). In Germany, Italy, Spain and Netherlands the BBFM S.A is operating under a branch passport pursuant to the Undertakings for Collective Investment in Transferable Securities Directive (2009/65/EC) and the Alternative Investment Fund Managers Directive (2011/61/EU). In the United Kingdom (UK) by RBC Global Asset Management (UK) Limited (RBC GAM UK), which is authorised and regulated by the UK Financial Conduct Authority (FCA), registered with the US Securities and Exchange Commission (SEC) and a member of the National Futures Association (NFA) as authorised by the US Commodity Futures Trading Commission (CFTC). In Switzerland, by BlueBay Asset Management AG where the Representative and Paying Agent is BNP Paribas Securities Services, Paris, succursale de Zurich, Selnaustrasse 16, 8002 Zurich, Switzerland. The place of performance is at the registered office of the Representative. The courts at the registered office of the Swiss representative or at the registered office or place of residence of the investor shall have jurisdiction pertaining to claims in connection with the offering and/or advertising of shares in Switzerland. The Prospectus, the Key Investor Information Documents (KIIDs), the Packaged Retail and Insurance-based Investment Products - Key Information Documents (PRIIPs KID), where applicable, the Articles of Incorporation and any other document required, such as the Annual and Semi-Annual Reports, may be obtained free of charge from the Representative in Switzerland. In Japan, by BlueBay Asset Management International Limited which is registered with the Kanto Local Finance Bureau of Ministry of Finance, Japan. In Asia, by RBC Global Asset Management (Asia) Limited, which is registered with the Securities and Futures Commission (SFC) in Hong Kong. In Australia, RBC GAM UK is exempt from the requirement to hold an Australian financial services license under the Corporations Act in respect of financial services as it is regulated by the FCA under the laws of the UK which differ from Australian laws. In Canada, by RBC Global Asset Management Inc. (including PH&N Institutional) which is regulated by each provincial and territorial securities commission with which it is registered. In the United States, by RBC Global Asset Management (U.S.) Inc. ("RBC GAM-US"), an SEC registered investment adviser. The entities noted above are collectively referred to as "RBC BlueBay" within this document. The registrations and memberships noted should not be interpreted as an endorsement or approval of RBC BlueBay by the respective licensing or registering authorities. Not all products, services or investments described herein are available in all jurisdictions and some are available on a limited basis only, due to local regulatory and legal requirements.

This document is intended only for "Professional Clients" and "Eligible Counterparties" (as defined by the Markets in Financial Instruments Directive ("MiFID") or the FCA); or in Switzerland for "Qualified Investors", as defined in Article 10 of the Swiss Collective Investment Schemes Act and its implementing ordinance, or in the US by "Accredited Investors" (as defined in the Securities Act of 1933) or "Qualified Purchasers" (as defined in the Investment Company Act of 1940) as applicable and should not be relied upon by any other category of customer.

Unless otherwise stated, all data has been sourced by RBC BlueBay. To the best of RBC BlueBay's knowledge and belief this document is true and accurate at the date hereof. RBC BlueBay makes no express or implied warranties or representations with respect to the information contained in this document and hereby expressly disclaim all warranties of accuracy, completeness or fitness for a particular purpose. Opinions and estimates constitute our judgment and are subject to change without notice. RBC BlueBay does not provide investment or other advice and nothing in this document constitutes any advice, nor should be interpreted as such. This document does not constitute an offer to sell or the solicitation of an offer to purchase any security or investment product in any jurisdiction and is for information purposes only.

No part of this document may be reproduced, redistributed or passed on, directly or indirectly, to any other person or published, in whole or in part, for any purpose in any manner without the prior written permission of RBC BlueBay. Copyright 2023 © RBC BlueBay. RBC Global Asset Management (RBC GAM) is the asset management division of Royal Bank of Canada (RBC) which includes RBC Global Asset Management (U.S.) Inc. (RBC GAM-US), RBC Global Asset Management Inc., RBC Global Asset Management (UK) Limited and RBC Global Asset Management (Asia) Limited, which are separate, but affiliated corporate entities. ® / Registered trademark(s) of Royal Bank of Canada and BlueBay Asset Management (Services) Ltd. Used under licence. BlueBay Funds Management Company S.A., registered office 4, Boulevard Royal L-2449 Luxembourg, company registered in Luxembourg number B88445. RBC Global Asset Management (UK) Limited, registered office 100 Bishopsgate, London EC2N 4AA, registered in England and Wales number 03647343. All rights reserved.

Published November 2023



RBC BlueBay
Asset Management