



RBC BlueBay
Asset Management

Active Investing – adding value in European government bonds

For Professional Investors Only | Marketing Communication



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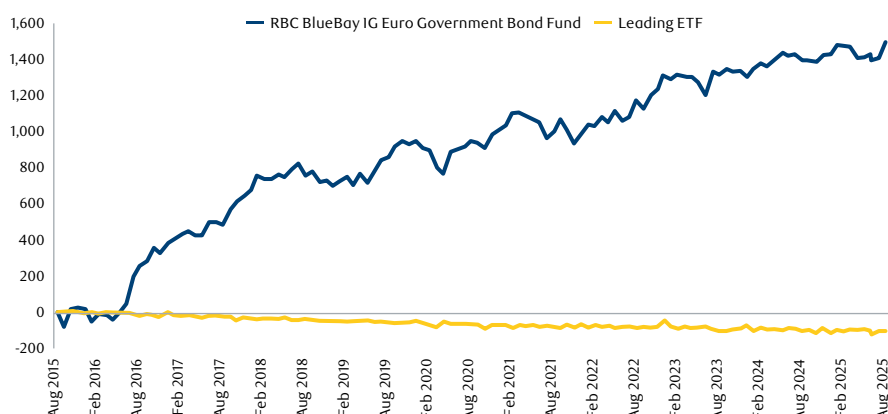
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“We strongly believe that it is possible to consistently generate strong alpha in the European government bond market, producing returns that are far superior to passive strategies and ETFs.”

The BlueBay European Investment Grade Government Bond Fund managed by the RBC BlueBay team, led by Mark Dowding and Kaspar Hense, was launched in 2010. The fund is actively managed with the aim of outperforming the Bloomberg Euro Aggregate Treasury Index Euro Unhedged (“Euro Government Bond Index”), which it has done in every single calendar year since inception.

We strongly believe that it is possible to consistently generate strong alpha in the European government bond market, producing returns that are far superior to passive strategies and ETFs. Over the last decade, the BlueBay European Investment Grade Government Bond Fund has generated over 140bps annualised outperformance net of fees, whereas the leading ETF has underperformed the benchmark by 10bps per year (Chart 1).

Chart 1: Alpha generation of RBC BlueBay IG European Government Bond Fund versus a leading ETF



Source: Bloomberg, as at 31 August 2025. All data is net of fees.

RBC BlueBay IG Euro Government Bond Fund = S-EUR Share Class; ISIN LU0995160891; TER 31bps.

Our opinion is that due to the distinct features of the Euro Government Bond Index there are many opportunities for our active management style to generate strong outperformance relative to both the benchmark and ETFs, even considering the lower fee levels of ETFs.

There are five main factors that we believe offer consistent opportunities:

- **Benchmark structure**
- **Politics and Policy**
- **Market inefficiencies**
- **New issue market**
- **Volatility and price distortion**

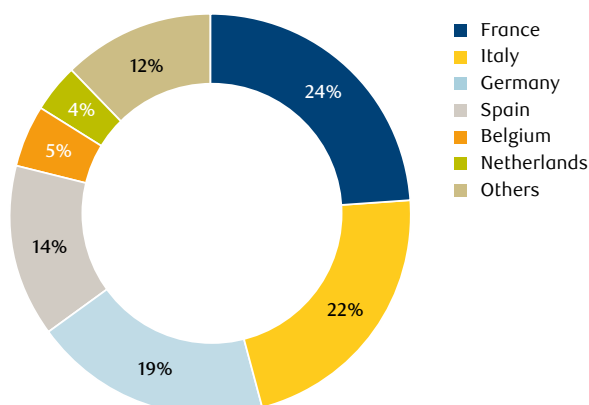
Benchmark structure

The Euro Government Bond Index is highly concentrated. There are 20 issuing countries in the benchmark, but the four largest issuers, France, Germany, Italy, and Spain make up 79% of the index weighting and the smallest 10 countries contribute only 3.4% (Chart 2). This means that in practice the bulk of overall returns are driven by the price movements in the securities of only four countries. Additionally, there are 552 securities in the benchmark, so an ETF will hold an investment in every single one of these, even if the weighting in the benchmark is only 0.01%.

“The credit quality of the Euro Government Bond Index is extremely high with an average weighted rating of A+; 23% of the index weighting is rated AAA and 33% AA at present.”

This is highly inefficient and incurs additional transaction costs due to the high volume of holdings that must be purchased or sold when the ETF receives subscriptions or redemptions, often daily. In contrast, the BlueBay fund currently holds only 97 bond investments and despite holding fewer than 20% of the benchmark constituents, the fund has a tracking error of only 1.58% and an Information Ratio of 1.34, so outperformance is being generated without major deviations from the benchmark return profile.

Chart 2: Index weighting by country



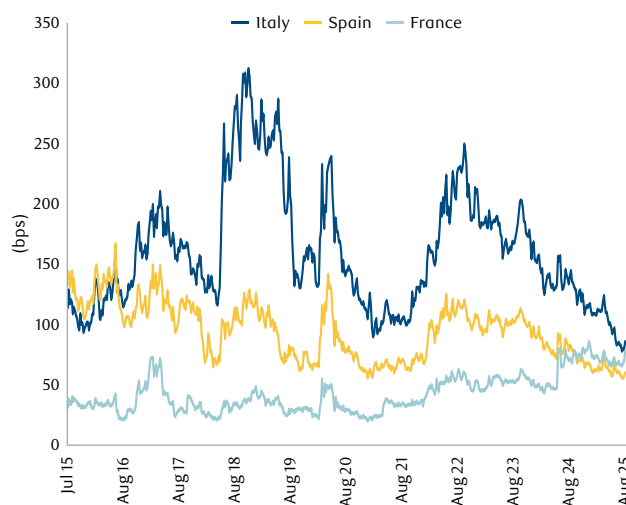
Source: Bloomberg, as at 31 August 2025.

Politics and Policy

The credit quality of the Euro Government Bond Index is extremely high with an average weighted rating of A+; 23% of the index weighting is rated AAA and 33% AA at present. Hence traditional bottom-up credit analysis for potential defaults, as used in corporate bond investment strategies, is of less relevance. There has never been a default in the IG Euro Government Bond Index. During the European sovereign debt crisis in 2012, when fears started to amount around the creditworthiness of several members of the European Union, the Head of the ECB, Mario Draghi, said he would “do whatever it takes” to preserve the Eurozone.

This commitment to prevent a Eurozone member defaulting on their obligations means that much of the alpha generation is created by a strong understanding of politics and policy and the impact on the spreads that investors demand to invest in a country’s debt at any one time. The movement in these spreads relative to the German benchmark, as shown in Chart 3, creates dislocations that offer many alpha opportunities.

Chart 3: 10-year government bond spreads versus Germany



Source: Bloomberg, as at 31 August 2025.

Market inefficiencies

The fixed income market is mostly an ‘over the counter’ market, which means that bond markets are less efficient than equity markets and more prone to mispricing risk. This can create opportunities for active managers who, through their analysis, are better able to understand these risks and how they should be priced. Information inefficiencies also exist, as price discovery can be opaque. Many fixed income securities comprise complex features such as callability, subordination or covenant protection, which all require expertise to value, and each of these features provides active managers opportunities to generate alpha.

Opportunities in the new issue market

As bonds mature, unlike equities, and on a regular basis there is a considerable turnover in the constituents of the index. Generally, over 10% of the issues in the benchmark will mature each year and so the capital is recycled. This generates opportunities for active investors as they are able to anticipate index changes as the index methodology rules are publicly available.

In addition, issuers regularly come to the primary market to raise new capital. To attract buyers, and to ensure these issues are fully subscribed, this issuance generally happens at a discount to outstanding bonds. As new issues are not included immediately in the benchmark, this allows active investors to buy these bonds ahead of index inclusion and ensure clients benefit from the pricing discount.

Market volatility and price distortion

Index trading by ETF managers and passive strategies, plus momentum strategies employed by hedge funds, can lead to volatility and/or pricing distortions. Prices can diverge from the fundamental value of the assets themselves. With government bonds this is often noted in bonds that are 'on the run' versus those that are 'off the run,' i.e. those that are currently the most actively traded by investment bank dealers versus those that are not.

Additionally, the bonds that are 'cheapest to deliver' into a futures contract can also witness abnormal demand in relation to their fundamental value. As active managers we can identify these distortions and position the portfolio either under or overweight to ensure returns are maximised.

Summary

As BlueBay has demonstrated with its long track record of alpha generation in the European Investment Grade Government Bond Fund, it is possible for an active manager to generate strong net outperformance relative to passive funds and ETFs.

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