



A fresh opportunity from dispersion?

For professional investors only | Marketing communication



Andrzej Skiba
BlueBay Head
of US Fixed Income
RBC BlueBay
Asset Management

Published October 2023

“The turbulence in bond and credit markets has driven a wider range of potential returns in investment grade credit.”

Andrzej Skiba, Head of US Fixed Income, RBC BlueBay Asset Management, says rising issuer dispersion in investment grade corporate fixed income creates a fertile hunting ground for active managers.

The turbulence in bond and credit markets has driven a wider range of potential returns in investment grade credit. This dispersion is providing active managers with a compelling entry point to capture opportunities across sectors. Elevated dispersion is associated with a turning point in the economic cycle and particularly when macroeconomic conditions take a turn for the worse. Rather than just focusing on valuations and market conditions, investors consider the risk of rating downgrades and a pickup in defaults to guide their views.

This year’s recent market volatility has created divergent views among investors, particularly when they start to see signs of meaningful differentiation in the performance of individual sectors or rating groups. So, sometimes, rising dispersion is a symptom of what is already obvious within our investible universe, and sometimes, it’s a harbinger of what could happen, although there is no assurance.

Not a time to stay passive

Climbing dispersion in fixed income poses problems for those investors looking to ‘buy the market.’ Dispersion is a source of alpha for an active manager looking to identify mispricing and opportunities in sector underperformance where it is not justified. This is true at the individual issuer level and often even at the individual security level, and when compared to the rest of the universe. For the bottom-up investor, this is one of the core ways to outperform a benchmark over time.

We generally find that pure bets on market directionality, when you put your crystal ball and decide whether spreads go wider or tighter, the information ratio of those kinds of bets is lower than of issuer-specific, catalyst-driven opportunities where we find those have a much better rate of success over time. Yet many managers cannot take advantage of dispersion successfully, due to the inability to source the securities in a size that makes a difference. If you are running hundreds of billions of assets within your investment portfolio, it’s much more difficult to source issuers or sectors where you want to reflect on that dispersion or mispricing. In that case, you’re more reliant on beta drivers of the market.

Some sectors offer select pickings

Within sectors, in the spring of this year, when markets saw the blow-up of regional banks in the US, there had been a dramatic difference in their performance versus the global systemically important banks (G-SIBs). That created an opportunity for investors because they came from a point where regional banks before the Silicon Valley Bank (SVB) crisis were trading at spreads tighter than those of the 'money center' banks, that raise most of their funds from the domestic and international money markets, relying less on depositors for funds. In the aftermath of SVB and First Republic collapse, G-SIBs were trading around 200 basis points spread at the 10-year maturity point. In contrast, regional banks traded anywhere between 300 to 400 basis points. That dramatic increase in dispersion created an opportunity for investors to bet on the normalisation of trends in that space.

Another sector for opportunity is in the technology space. Here, the market has been assessing equity-related factors yet showing disagreement about their validity from a credit investor's perspective. Earlier in the year, there was significant pressure on names in the semiconductor space. To shift away from Asia, companies had to spend significant capital on building up the production capacity in the US, which led to unwelcome dividend cuts for equity holders. However, credit investors realised the companies cut dividends to benefit credit holders. They want to defend their ratings, and spend money on CapEx rather than share buybacks or dividends. Well, that's good from a credit perspective.

Finally, commercial real estate is one growth-sensitive area that should not come as a surprise, particularly in the segments of the Real Estate Investment Trust (REIT) universe that are office-related. Compared to last year, we have seen dramatic underperformance of those names, given the shift in the secular themes for office real estate. However, at the overall market level, it is almost not noticeable because office real estate names dominate a small portion of the REIT universe. Amidst the wreckage, some issuers have been unfairly penalized, creating investment opportunities ahead.

Will dispersion continue to climb?

Dispersion could pick up further down the line if the US economy takes a turn for the worse. What we saw earlier this year with regional banks versus money center banks would be magnified to a greater number of sectors, a greater weight of our investment universe, and more noticeable in dispersion statistics. There is no assurance that inflation will continue to moderate at the pace central banks require in the quarters ahead, and while the US economy has been relatively resilient, deteriorating conditions could continue to favour active managers. We must be vigilant because there is a big difference in the performance of our asset class between the more benign and the more negative scenarios.

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 October 2023



RBC BlueBay
Asset Management