RBC BlueBay
Asset Management

Going global in investment grade

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Published April 2024

Global investment grade government bond markets can result in a well-diversified portfolio with low credit risk. Kaspar Hense looks at why the current market environment means a wealth of investment opportunities for active managers.

Why global fixed income?

The most straightforward benefit of 'going global' is diversification, which means taking less risk than investing in domestic bonds but obtaining approximately the same yield. This is achieved through the use of a hedged benchmark, as typically, FX volatility is too high for fixed income. Therefore, the information ratio of a global fixed income product should be a better one than investing purely in domestic bonds.

Why active?

We believe that active management is the best way to capture a global opportunity set. The fundamental law of investing dictates that the broader this opportunity set, the higher the alpha, when manager skill is positive. We think that this is particularly true in global fixed income markets, which have low correlation to each other. Smaller markets in the global investment grade universe, such as Mexico or Hungary, tend to have very different volatility patterns to each other, and can have low correlation to core markets in the US or Europe.

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Why now?

Looking at the current market backdrop, we think that with rates at current levels, the time is right to invest in global bonds. The last 10 years provided a favourable environment for equities, however this is reversing to some extent. Yields, in general, were low, so it was cheap for companies to refinance. Additionally, fiscal measures (particularly in the US where debt-to-GDP grew from 65% to 130%) boosted growth during this period. However, going forward, debt repayments and healthcare and social security costs mean there will be less capacity for discretionary spending.

In Europe, countries such as France and Spain have witnessed a growth in debt-to-GDP, but in others, such as Germany and the Netherlands, it has come down. There will therefore be more fiscal spending in Europe over the next five years, and especially on the discretionary side. That opens up opportunities in the Euro area, where we think spreads are well supported this year, spending is increasing, and EU-financed debt will most likely come via the European Innovation Partnership (EIP).

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2024 is the year of the election, with nearly half the world's population going to the polls. This will offer a plethora of investment opportunities in fixed income markets. The South Africa election is set to take place in May, followed by Mexico's in June, the US election in November, and an as-yet-undecided election in the UK. These elections will drive markets, which will drive yields, which will drive breakevens, which will drive currencies via the measures taken by incumbent governments.

Why RBC BlueBay?

Wide dispersion in macroeconomic expectations means that volatility is set to continue in global markets. This environment is particularly attractive for our investment grade proposition – with plenty of alpha to capture – by what is a very stable experienced team of 20 years, using a proven strong disciplined investment process.

At RBC BlueBay, we have delivered above alpha target returns over the last 14 years, for all of our six benchmarked investment grade products, with information ratios close to 1 (above our 0.5 target), across nearly all time horizons. This demonstrates solid and consistent performance generation, and it has proved that we are able to generate excess returns in many different market environments, including challenging periods, such as the Global Financial Crisis ("GFC") and the pandemic.

We believe we can achieve this going forward, but with high yields to start with. While cash rates are close to 5%, yields on the benchmark are somewhat lower (4.5%) but can be locked in. We think inflation will remain high and volatility linked to inflation will continue to exist. For example, the race to the White House looks increasingly like Trump's but with tax cuts, a more restrictive immigration policy and increased trade protectionism this could be a challenge for inflation. In Europe, productivity is lower than the US, therefore wage pressures are likely to put pressure on inflation given the record low levels of unemployment.

Nonetheless, the cash rate will decrease over the next 12 months, by approximately 100bps. Locking in high yields now – via longer duration maturities – makes sense, even if yields are not coming down as much as some market participants think or as much as we saw after the GFC. We think it will be a slower process but that also means higher yields for longer, for global fixed income investors.

Conclusion

In summary, a global universe increases the frequency of alpha capture, allowing us to choose the most compelling investments and take advantage of different economic environments. As always, the important ingredients for active alpha are the right opportunity set, dispersion, proprietary analysis and strong fund construction and risk management.

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RE/0081/04/24

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