



R-co Valor Bond Opportunities, opportunistic strategy in global fixed income markets



Emmanuel Petit
Co-Fund Manager
Rothschild & Co Asset
Management Europe

While the policies of major central banks remain very accommodating, the rise in long-term rates in the United States has shaken the market since the beginning of the year. What is the opportunity set in this environment? Emmanuel Petit and Julien Boy share their analysis.

What are the recent developments in fixed-income markets ?

The most significant event since the beginning of the year has been the substantial rise in US rates. It reflects an adjustment of inflation expectations stemming from the combination of improving vaccination rates, massive support plans, and the prospect of an imminent reopening of the economy. The Fed remains nonetheless confident that this rise in inflation will only be temporary, thus maintaining its very accommodating monetary policy and ready to gradually act once tangible economic improvement and a significant recovery in the labour market materialize.

This is a matter of debate. Considering an average 2.7%⁽¹⁾ target over the next five years, Investors are anticipating a more structural inflationary cycle than expected by the US Central Bank. The question is who is right and whether the Fed will be pushed to start tapering⁽²⁾ and raise rates sooner than expected, or simply let inflation run its course. Moreover, its position is rather isolated. The central banks of Canada and Norway seem to be quicker to respond. As these countries record similar inflation levels to that of the US, one might wonder whether their decisions could be leading indicators of a potential shift by the Fed.

(1) Gradual reduction of the Fed's accommodating policy.

(2) Market expectation deducted from inflation-linked bonds, as of 10/05/2021.

R-co Valor Bond Opportunities

R-co Valor Bond Opportunities is a fund offering flexible and opportunistic management of the international fixed income markets. It consists of a core credit portfolio, combined with interest rate and inflation strategies. The management team has a great deal of flexibility in terms of geographical zones, maturities and ratings of securities, as well as a wide range of tools. The objective is to optimise the risk-return ratio of the portfolio in the different market phases.

Main risks: Risk of loss of capital, Discretionary management risk, Credit risk, Derivatives risk, Counterparty risk, Performance risk, Currency risk, Non-OECD countries (including emerging markets) risk, Equity risk, Extra-financial criteria (ESG) risk. Non-exhaustive list, please refer to the "Risk Profile" section of the fund's prospectus.

Are these contrasting views a risk to markets?

The risk lies within real rates. If inflation is kept under control, the Fed will keep its accommodative policy and real rates will remain largely negative, perhaps even more so than it is currently the case. This is supportive for risk assets and promotes the gradual absorption of accumulated debt. Spiraling inflation, could however lead the US central bank to miscommunicate. At the very least, we may see increasing market expectations of tightening monetary policies, which could create upward pressure on real rates and be particularly unfavourable for risk assets. The most likely hypothesis, in our opinion, is that the Fed will not hesitate to use its monetary tools to avoid a “fixed income crash” and limit volatility in real rates.

What is the impact on the Eurozone?

There are fewer inflationary fears in Europe. Market expectations are moreover rather in line with the ECB's outlook, and well below the 2% target. A tightening of monetary policy is therefore not on the agenda. However, rates are rising for the same reasons as they were in the US a few weeks ago, namely the acceleration of vaccination campaigns and the reopening of the economy, although the size and timing of the stimulus packages differ. European risk assets are supported by continuing negative real rates, but will not be immune to potential volatility in the US.

How have the fundamentals of the credit market changed?

Since the beginning of the year, credit markets have suffered from rising rates on the best quality issuers, where risk premiums are insufficient. The riskier issuers show a positive performance driven by a decrease in risk premiums. Nevertheless, this market remains interesting for four reasons.

Firstly, the negative real rate environment is favorable to risk taking. Secondly, valuations are at high levels but remain consistent with the outlook for default rates, which will remain low thanks to fiscal support. Thirdly, the reopening of economies will lead companies to generate cash flows and reduce their debt. Finally, central banks' bond buying programs provide technical support to the market.

After a 2020 year that allowed to benefit from a performance engine on credit, we are now betting more on the on the reflationary theme...

What is the opportunity set in this context?

The current market conditions offer the opportunity to build a balanced portfolio mainly invested in credit, notably High Yield⁽³⁾ or unrated bonds, with income and controlled duration. However, selectivity and *alpha*⁽⁴⁾ generation is key in 2021 considering valuation levels. R-co Valor Bond Opportunities also seeks to take advantage of relative value opportunities on yield curves, arising from the de-synchronization of economic cycles or monetary policies between different geographical areas. Following a year in which credit was a major performance driver, the reflation theme is back on the agenda in 2021, both in the US and globally.

The portfolio has benefited from the diversity of its underlying strategies in 2020, allowing it to generate positive performance at low volatility levels. ■

(3) High yield bonds are issued by companies or States with a high credit risk. Their credit rating is below BBB- on the Standard & Poor's scale.

(4) A measure of the outperformance of a portfolio, stock or security relative to its theoretical performance. Alpha therefore denotes a manager's ability to create value by being able to identify stocks or securities that are performing better than they should, taking into account their risk, and this for a given period.

Past performance is not a reliable indicator of future performance and is not constant over time.

	Since the beginning of the year	2020	2019	2018	2017	2016	Since inception ⁽¹⁾	1 year volatility
R-co Valor Bond Opportunities C EUR	3.43%	6.74%	-	-	-	-	11.83%	4.80%
EONIA Capitalised + 2.5%	1.03%	2.51%	-	-	-	-	4.44%	0.03%

(1) Date of creation: 28/08/2019.

Source: Rothschild & Co Asset Management Europe, 31/05/2021.

The figures quoted relate to past years. Past performance is not a reliable indicator of future performance and is not constant over time.

The performance figures take into account all costs charged to the fund but do not take into account costs borne by the investor.



Recommended investment period: 3 years

The level of risk of the UCITS is 4 (volatility of between 5% and 10%) and primarily reflects a discretionary management policy that exposes the portfolio to the fixed income markets in a diversified manner over the medium term. The historical data used to calculate this synthetic indicator may not be a reliable indicator of the UCITS' future risk profile. The risk category associated with the UCITS is not guaranteed and may shift upwards or downwards over time. A rating

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