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With R-co Target 2028 IG, Rothschild & Co Asset Management Europe launches its new generation of maturity funds

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Capitalising on its expertise in maturity funds, Rothschild & Co Asset Management Europe has launched a new fund invested in investment grade[1] bonds. This buy-and-hold strategy[2] offers better visibility on yield to maturity than a "conventional" fund and is designed to exploit the return to favour of less risky issuers. With 200 million in assets under management barely a month after its launch, R-co Target 2028 IG demonstrates both good timing and a clear appetite among investors for this type of strategy.

Is this the right environment to launch a maturity fund?

The timing looks right, as we had not seen such investment grade yields in more than 10 years and even back then, the environment was especially tense in the Eurozone. What about today? In recent months, central banks have completely reversed course in an attempt to rein in inflation momentum. The spike in interest rates has shaken the credit markets, with its main indicators pointing to intense stress, while risk premiums are pricing in expectations of a recession or even of systemic risk if they were to get much higher.

For the moment, we don't expect that to happen. In fact, this looks like a rather attractive window on the rates and credit markets, which feature good credit quality, while potential implied default rates look overdone. The market is pricing in 10% default rate over the coming five years in investment grade, whereas the historical average in a similar period is about 1%, peaking at 4% amidst the Lehman Brothers collapse[3].

What is your expertise in this type of fund?

We have a long-standing expertise in this type of strategy. We are now in our eighth generation of maturity funds. In 2008, when we launched the first one, we were among the pioneers. Over the years, we have continued to develop new solutions in both investment grade and high yield[4], depending on market opportunities.

Why focus on investment grade in the current environment?

We seek out the most opportunistic market windows. Rising interest rates last summer caused investment grade bonds to underperform high yield. The reason for this is that while investment grade is, by nature, more exposed to interest rates, high yield is more correlated to growth. And the doubts we have now are on the growth outlook. Against this backdrop, we are drawn more to investment grade companies' greater resilience, combined with their attractive valuations.

(1) A debt security issued by companies or governments rated between AAA and BBB-, based on the Standard & Poor's scale.
(2) An investment strategy consisting of buying securities and then holding them for some time in the portfolio.
(3) Source: Morgan Stanley, October 2022.
(4) High yield bonds are issued by companies or governments having a high credit risk. Their credit rating is below BBB- on the Standard & Poor's scale.

Moreover, we cannot rule out the possibility that volatility will rise further in the coming months, something that does not affect maturity funds. Note also that the main risk with this kind of strategy is issuer risk, i.e., the likelihood that it will default and be unable to repay the bond. In the current environment, investment grade seems to offer greater security. We also strive to protect ourselves through broad diversification and by working closely with our four analysts, who make an active bond-picking contribution.

Why did you not wait for a steeper rise in interest rates?

Investors naturally seek out the most favourable entry point, and current conditions in investment grade seemed to fit our management objectives. Moreover, keep in mind how long it takes to launch a fund. In June, when the decision to launch was made, we had already entered a monetary tightening cycle. Interest rates were going to rise, and the risk of recession was playing out. All these indicators suggested to us that the fourth quarter of 2022 would be a good time for this type of strategy.

What is your investment strategy?

The strategy is aligned with our goal of delivering a target return of 5% annual return and a maturity between January and December 2028. As a maturity fund, R-co Target 2028 IG has three stages in its lifecycle. Launch and portfolio construction last a little more than one year, after which the portfolio management phase begins, including monitoring the bonds, optimising risk-reward and reinvesting coupons in the case of capitalisation units. And, third, from January 2028, available liquidities will be reinvested on the money market until the fund is liquidated.

During portfolio construction, we can select bonds maturing until the end of 2029, in case of possible calls(5), although this possibility is far more limited than in high yield (between one and three months and up to one year for some bonds from financial issuers). Lastly, remember that the marketing window of this type of fund is short and it can be subscribed only during a set period.

How is the portfolio positioned?

Launched on 9 September, the portfolio already has 216 million euros in assets under management and is 90% invested. The core of the portfolio has 70 issuers and consists of bonds rated from A to BBB, denominated exclusively in euros and most from OECD countries. The fund's gross yield-to-maturity(6) is currently 4.8% (5.2% for the invested portion) with an average maturity of bonds of 5.9 years and a sensibility of 4.3. In accordance with the market breakdown, the portfolio is about 45% exposed to bonds from financial issuers (24% of which are banks), an asset class in which we possess in-depth capacities, with the rest invested in non-financial corporates(7).

(5) Early repayment of a bond.
(6) The gross yield-to-maturity is the worst possible yield that a bond can achieve without its issuers suffering an outright default.
(7) Source: Rothschild & Co Asset Management Europe, 7 October 2022.

The risk level of this sub-fund is 3 (volatility between 2% and 5%) and mainly reflects its positioning on private debt products while having a sensitivity between 0 and +8. The historical data used to calculate this synthetic indicator may not be a reliable indication of the sub-fund's future risk profile. The risk category associated with the sub-fund is not guaranteed and may change over time, either upwards or downwards. A rating of 1 does not mean that the investment is "risk-free". The capital invested in the UCITS is not guaranteed. Other important risk factors, not adequately taken into account by the indicator: liquidity risk, impact of techniques such as derivatives. The occurrence of one of these risks may result in a decrease in the UCI's net asset value. For more information about the risk profile and its main contributors, please refer to the prospectus.

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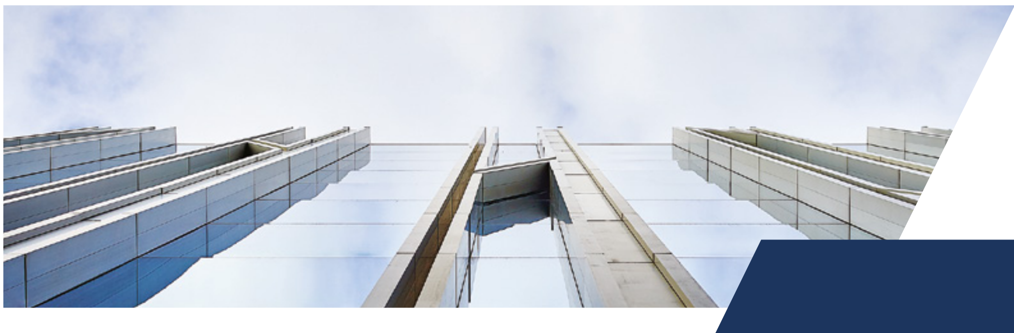

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