Rothschild & Co
Asset Management

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Still a window of opportunity for investing in target-date funds

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After the success of previous vintages, Rothschild & Co Asset Management is launching two new high yield(1) and investment grade(2) target-date funds. Three questions for Emmanuel Petit and Kristell Agaesse.

What is your take on the macroeconomic environment and the fixed-income markets?

After a phase of great instability on the fixed-income markets, the monetary tightening cycle appears to be coming to an end. At one time, we may have feared that this cycle would derail the economy, but the resilience we have seen has been a positive surprise on the whole. That being said, there are still some uncertainties on the outlook for how the economy will "land", and we do believe that a hard landing(3) scenario is likely, as financing conditions are clearly hawkish. Refinancing rates and key rates are likely to remain high for some time to come, and that will probably begin to weigh on the economy. Leading indicators are already pointing in that direction. Meanwhile, the deflationary cycle is already well underway in the US. However, it will be hard to stick to the hawkish stance if the economic environment remains resilient. In any case, it is noteworthy that visibility on monetary policies and the level of interest rates is now better than it was a year ago. Meanwhile, trends in risk premiums do not point to a significant worsening in refinancing conditions. Corporate default rates have risen and could very well continue to do so in the coming quarters. Toughening financing conditions, along with narrower margins, will no doubt undermine issuer solvency.

Why is this the right time for launching target-date funds?

The current investment window looks like an especially good time for launching target-date funds. The tightening cycle appears to have peaked, and the economy increasingly looks headed for a slowdown, but this is an attractive entry point for buy & hold strategies(4) in order to tap into carry on bonds offering yields not seen since 2011. This is the case of high yield, in particular. The average coupon has risen to a point where it now properly remunerates the risk assumed. Moreover, the asset class possesses a strong capacity to handle defaults. The market environment also makes investment grade issuer yields attractive once again. Investment grade is a way to remain relatively conservative and avoid the excess volatility that a recessionary cycle could trigger. Government bonds yields also offer a "cushion" that offsets the rise in risk premiums. Moreover, there is little probability of default by investment grade issuers on a five-year horizon. The large size of the pool of issuers with sound fundamentals makes quality bond picking(5) possible. It is against this backdrop that we have launched two strategies that are "pure" in the sense that they exclude perpetual bonds. One of these is exclusively investment grade, R-co Target 2029 IG, and the other is 100% high yield, R-co Target 2027 HY.

(1) High yield bonds are issued by companies or governments with a high credit risk. Their financial rating is below BBB- on the Standard & Poor's Standard & Poor's scale.
(2) Debt security issued by companies or governments rated between AAA and BBB- by Standard & Poor's.
(3) A hard landing refers to a marked economic slowdown or downturn following a period of rapid growth
(4) An investment strategy consisting in acquiring securities and keeping them until maturity.
(5) Selecting bonds one by one.

How does this type of strategy stand out in the current environment?

Since the September 2022 launch of our previous generation of target-date funds, in September 2022, rates have risen by 120 basis points and risk premiums have narrowed slightly[6]. Since then, the corporate investment grade market has returned 0.41%[7] vs. 3.97% by R-co Target 2028 IG[8]. Thanks to our bond picking, we have been able to generate *alpha*[9] on a steady basis, which illustrates our know-how on this type of strategy. This is something that ETFs, for example, cannot accomplish. Moreover, with its carry strategy and at current yields, a fund like R-co Target 2029 IG is an attractive alternative to euro funds. R-co Target 2027 HY, meanwhile, may be worth considering for an investor wanting equity exposure but who is scared off by the current economic cycle. Such an investor may be drawn to the visibility that this bond segment offers over a five-year timeframe. Moreover, while money-market yields may currently look attractive, investors have no visibility on their outlook for the coming years or even months. A target-date fund, in contrast, offers the advantage of "setting" a yield over a defined period. Moreover, these strategies are quite liquid and allow subscribers to exit whenever they choose. It is for all of these benefits that we believe these strategies make sense, especially in the current market environment.

(6) Source: Bloomberg, 29 September 2023.
(7) Markit iBoxx EUR Corporates Total Return EUR. Source Bloomberg, 29 September 2023.
(8) C EUR units. Source: Bloomberg, Rothschild & Co Asset Management, 29 September 2023.
(9) A measure of outperformance by a portfolio, a share or other security vs. its theoretical performance. Alpha is therefore a portfolio manager's ability to create value by being able to detect those shares or other securities that return more than they should over a given period, given their degree of risk.

R-co Target 2027 HY

Recommended investment period: until 31/12/2027.

Risk indicator: 3/7.

The synthetic risk indicator is used to assess the level of risk of this product compared with others. It indicates the probability that this product will incur losses in the event of market movements or our inability to pay you. The risk indicator assumes that you keep the product until 31 December 2027. The actual risk may be very different if you opt to exit before maturity, and you may get less in return. We have classified this product in risk class 3 out of 7, which is between low and medium risk, and mainly reflects its positioning on credit risk and fixed-income products with a maximum residual maturity of 31 December 2029. In other words, the potential losses associated with the future performance of the product are low to medium and, if the situation were to deteriorate on the markets, it is unlikely that our ability to pay you would be affected. As this product does not provide protection against market fluctuations or a capital guarantee, you could lose all or part of your investment.

Before investing, it is essential that you read the PRIIPS DIC and the fund prospectus carefully, and in particular the section relating to risks available on the Rothschild & Co website: am.eu.rothschildandco.com

R-co Target 2028 IG

Recommended investment period: until 31/12/2028.

Risk indicator: 2/7.

The synthetic risk indicator is used to assess the level of risk of this product compared with others. It indicates the probability that this product will incur losses in the event of market movements or our inability to pay you. The risk indicator assumes that you hold the product until 31 December 2028. The actual risk may be very different if you opt to exit before maturity, and you may get less in return. We have classified this product in risk class 2 out of 7, which is a low risk class and mainly reflects its positioning on credit risk and fixed-income products with a residual maturity of 1 year or less on 31 December 2028. In other words, the potential losses linked to the future performance of the product are low and, if the situation were to deteriorate on the markets, it is very unlikely that our ability to pay you would be affected. As this product does not provide protection against market fluctuations or a capital guarantee, you could lose all or part of your investment.

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R-co Target 2029 IG

Recommended investment period: until 31/12/2029.

Risk indicator: 2/7.

The synthetic risk indicator is used to assess the level of risk of this product compared with others. It indicates the probability that this product will incur losses in the event of market movements or our inability to pay you. The risk indicator assumes that you hold the product until 31 December 2029. The actual risk may be very different if you opt to exit before maturity, and you may get less in return. We have classified this product in risk class 2 out of 7, which is a low risk class and mainly reflects its positioning on credit risk and fixed-income products with a maximum residual maturity of 31 December 2030. In other words, the potential losses linked to the future performance of the product are low and, if the situation were to deteriorate on the markets, it is very unlikely that our ability to pay you would be affected. As this product does not provide protection against market fluctuations or a capital guarantee, you could lose all or part of your investment.

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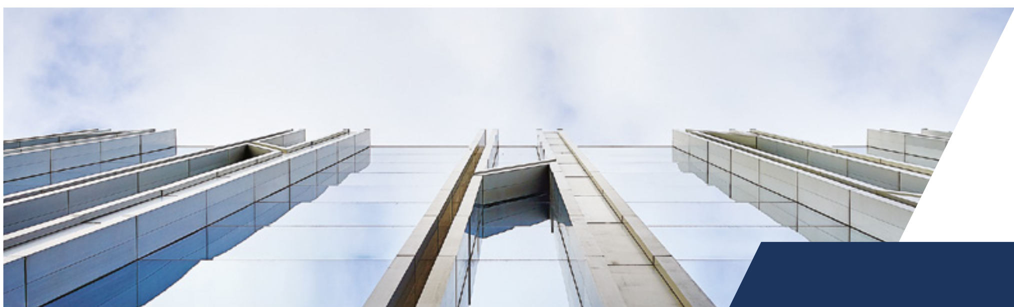

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