FINANCIAL MARKETS

Bonds: on the hunt for performance

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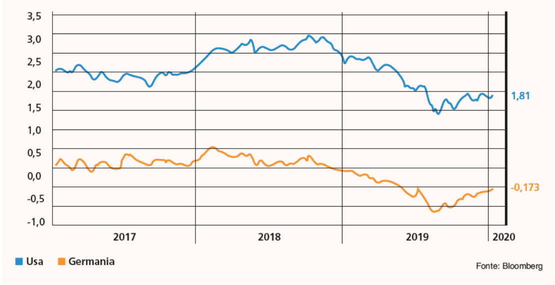
Despite a difficult investment environment and a combination of political and geopolitical, economic and monetary risks, even fixed income securities are still able to give some satisfaction.

Is investing in bonds still to be recommended? What does 2020 hold for us? Is it true that government securities all have negative returns? These are some of the questions that investors are asking at the beginning of the year. Currently, for example, the yield for 10-year European government bonds denominated in euros is currently around -0.19%, and on 30-year paper you can earn 0.33%. These are certainly not returns to dream about, and they will hardly satisfy even the most risk-averse investors.

Things are a little better with US government bonds, whose 10-year yield, which at least is in positive territory this time, stands at around 1.83%. However, the investor must be prepared to tolerate possible fluctuations in the exchange rate. The Fed has already expressed a negative opinion about a further cut in interest rates. Furthermore, Christine Lagarde has clarified that interest rates will remain stable (or lower) until the inflation prospects of the Eurozone "converge robustly to 2%". Meanwhile, returns are moving towards the psychological thresholds of 0% for euro bonds and 2% for dollar-denominated bonds. Nonetheless, there has been a continuous appreciation in bond prices over the past six months in apparent contrast to the yield trends.

Comparison of government bond yields (yield in %)



The Central Banks have slowly adopted the policy of permanent financial stimulus (TLTRO, targeted longer-term refinancing operations), Qe (quantitative easing) and other policies) which on the one hand has brought benefits, and on the other has produced a dependence on low interest rates. Sooner or later, a more consistent economic growth rate will require adequate interest rates, but who will dare to bring rates back to 'normal' levels given the current level of private and corporate debt? To complete the scenario, there is a feeling, often unfounded, that the macroeconomic framework is more fragile than it really is. It is seen as being at the mercy of politics (tariff wars, Brexit etc.) and of known geopolitical problems (Middle East, Venezuela, Korea, and the South China Sea). Along with this, there are fears that the stock market may go into a significant downturn, contrary to what is forecast.

So, what are clients to do if they are not inclined to accept the price fluctuations that are part of the world of equities? How can they find some return even in fixed income securities, while containing their risk as much as possible? Despite everything, it is possible. There are particularly dynamic, and therefore attractive, solutions which, in fact, allow one to reach a yield of up to 4.5% in High-Yield securities and above 2.5% for the Investment Grade classification. However, these solutions must necessarily be tailor-made in nature and entrusted to professionals in the sector, precisely in order to contain the possible risks.

This is the case of a recent instrument that invests in the iTraxx Crossover index, with a headline yield of 5.05% over five years. This is an instrument that provides a capital guarantee for up to 9 credit events, on an index that includes 75 companies with a Hy rating. In the unlikely event of experiencing more than ten defaults, safeguards are still provided that reduce the loss of capital as much as possible. On the other hand, if you want to lower the risk threshold still further, an Investment Grade version is available that provides a very attractive return with a five-year maturity, with a basket consisting exclusively of investment grade securities, iTraxx Main. Using a similar approach, the capital is guaranteed for up to 5 credit events.

These are just some of the solutions developed and offered by Veco Invest. They are effective and efficient, particularly for those wishing to diversify their portfolio and those in search of profitability niches in the bond market while also ensuring a sustainable level of risk. This is not so easy to achieve in this delicate phase in the market.