Quarterly commentary / 30.06.2020
Vontobel Asset Management

Vontobel Fund - Euro Bond

Approved for institutional investors in: AT, CH, DE, ES, FR, IT, LI, LU, NL, PT, SE, SG (Professional Investors only)

Summary

- Government bonds continued their upward trend from the first quarter and picked up by 0.6% in the second quarter (up 5.0% in the first six months in local currency)
- We reduced our underweight in German Bunds as we added some ten-year exposure via futures.
- We reduced our 20-year Belgium exposure in order to set up a position where we benefit when the yield curve at the long end gets steeper.
- Governments in addition will continue to shore up their economies with special programs.

Market developments

"Gone today, here tomorrow" could have been the motto for the financial markets in the second quarter of the year. The massive price gains we witnessed seem at odds with the actual state of the economy, which performed poorly judging by dismal readings from leading indicators for manufacturing or consumption, for example. At times, both of these were lower even than during the 2008 great financial crisis. Nonetheless, equity markets that had plummeted in the first quarter reported a quarterly rise of 17.9% at the end of June (in local currency). While this means that markets fell by 5.1% in the first half of the year, many investors are likely to have breathed a sigh of relief, given that the pandemic is still raging. Government bonds also posted a good, albeit far less spectacular, performance. They continued their upward trend from the first quarter and picked up by 0.6% in the second quarter (up 5.0% in the first six months in local currency).

As many governments eased their tight restrictions, especially in Europe, the extent of the economic slump caused by Covid-19 gradually became apparent. The gross domestic product in industrialized countries is likely to have shrunk by more than 10% in the second quarter. This caused the labor market to nosedive, at least in countries with less robust government welfare systems, with unemployment in the US rising to 14%. Here and there, fears emerged that the crisis could develop into a 1930s-style depression. Yet massive stimulus packages from governments and central banks have put an end to this kind of horror scenario. Central banks decided to purchase increasing numbers of government bonds and – in the US – corporate bonds, a move that helped to calm the financial markets.

Yields on ten-year government bonds largely trended sideways in the past quarter. Central banks' bond purchases created downward pressure, whereas governments' debt-financed fiscal programs resulted in upward pressure. At 0.6%, yields on ten-year Treasuries remained close to their low point. Corporate bonds, by contrast, saw more fluctuation. Bonds from US debtors with solid credit ratings – recently on the US Federal Reserve's buy list – benefited the most from the financial market euphoria. Nonetheless, European corporate bonds, global high-yield paper and emerging market bonds also ended the quarter on a positive note.

Portfolio review

In the second quarter, we hardly changed our positioning. We reduced our underweight in German Bunds as we added some ten-year exposure via futures. At the same time, we reduced our 20-year Belgium exposure in order to set up a position where we benefit when the yield curve at the long end gets steeper. But we are still convinced that yields up to ten years have to stay low for even longer. Therefore, we have an overweight in credit exposure at the short end and keep our overweight of French and Dutch government exposure at the long end of the yield curve.

Performance analysis

In absolute terms, the fund gained 5% in the second quarter of 2020. Therefore, the fund recouped more than it lost in the first quarter and is up 1.1% for the first six months. By far the most dominant positive contribution to the absolute performance was stemming from our overweight in BBB rated credit exposure. The severe spread widening of our corporate and peripheral government bond holdings in the first quarter was followed by a massive tightening in the second quarter, as markets went back to a more normal trading pattern where liquidity was improving substantially.

Outlook

The global economy should stage a gradual, yet fairly quick, recovery according to our main scenario. If, as we hope, the pandemic takes a moderate course, this is likely to encourage consumer spending. Central banks will keep interest rates low, though Fed Chairman Jerome Powell is likely to continue to resist lowering the federal funds rate below zero. But we expect a certain degree of yield curve targeting by the Fed should yields start to rise too early. Governments in addition will continue to shore up their economies with special programs. The presidential elections in the US will be one of the main talking points in the fall, and the electoral campaign could spill over into the economy, especially regarding relations between the two economic superpowers US and China.

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Performance (in %)

Net returns			Rolling 12-month net returns			
EUR	Fund	Index	Start date	End date	Fund	Index
MTD	1.6	1.0	01.07.2019	30.06.2020	3.1	2.9
YTD	1.1	2.0	01.07.2018	28.06.2019	6.3	6.5
2019	8.0	6.9	01.07.2017	29.06.2018	1.6	1.7
3 years p.a.	3.6	3.7	01.07.2016	30.06.2017	-1.5	-3.4
5 years p.a.	3.5	3.3	01.07.2015	30.06.2016	8.3	9.1
10 years p.a.	4.2	4.3	Index: J.P. Morgan EMU Bond Inv Grade Index			
Since launch p.a.	4.5	4.6				
Launch Date		03.05.2007	Share class: I ISIN: LU0278087357			

Past performance is not a reliable indicator of current or future performance. Performance data does not take into account any commissions and costs charged when shares of the fund are issued and redeemed, if applicable. The return of the fund may go down as well as up due to changes in the rates of exchange between currencies.

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