Monthly commentary / 30.06.2020
Vontobel Asset Management

Vontobel Fund - High Yield Bond

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

Market developments
Summer is upon us and we believe this season should continue to be risk on! In the last week or so, doubts may have developed as investors have closely focused on new virus hotspots in the US, China, and Latin America, which have popped up and were frenziedly reported on. There have been questions about the resurgence of the virus and a second wave that could eventually disrupt our markets recovery, especially as they have experienced a very good run of late. We remain confident, however, and we will highlight our rationale and thoughts below that the positive trend should continue undisturbed.

But first with the resurgence. We do anticipate clusters to emerge but they should stay well localized. We can avoid a second wave if governments aggressively contain the virus through testing, tracing, and isolating carriers. Encouraging good hygiene is also a good defense, such as hand washing, encouraging the wearing of masks, supporting social distancing, and environmental disinfecting. This is how the hotspots are being handled in Europe and Asia at this stage and it is encouraging to see that certain US states are also starting to embrace such practices. We think of the hotspots as small fires that can be extinguished, and we do not expect major lockdowns to re-appear again this year. They would rather be localized and well targeted by health authorities minimizing any economic impact. Whilst there may be temporary loss of momentum in certain areas, there should be continued economic improvements in other areas still lifting the economic aggregates. We therefore continue to see global economic activity continuing to improve, supported by selective government health responses keeping us in the V or more precisely the “Swoosh” recovery camp, and this until a vaccine is broadly available by the end of the year. We have previously reported that there is now a higher probability of at least some effective therapeutics to be available by the end of 2020. Such therapy should be available for hospital treatment use by the end of the year first, with a vaccine likely to be available to the wider population by spring 2021. The Astra-Zeneca Oxford joint venture remains quite promising and this would represent a welcome development that would surely help sustain higher retail and economic activity.

As clusters emerge, and as economies bottom, the latter should still receive both fiscal and monetary policy support with good coordination amongst policy makers providing effective bridges until therapy is widely available. In the US, for instance, it is expected that US policy makers agree to an additional one trillion US dollars in fiscal stimulus before the August recess, especially given the recent developments relating to Covid-19 there and the continued high number of weekly unemployment claims. The need for extending unemployment benefits has become more evident in the last couple of weeks. As for the US Federal Reserve, and as investor have started reflecting on potentially doubting the recovery following a rise in new cases, Chairman Powell has reinforced that the benefit from the easier policies will become evident over time to dispel any of these doubts. Their interventions will keep rates at the effective lower bound and to support this notion the Fed Chairman stated that they were “not thinking about thinking about raising rates”. They are thinking that the economy needs support from monetary policy for an extended period of time, and not just through interest rates, but also through asset purchases. Their aim is to go back to last February’s 3.5% unemployment rate, and we have just started repairing the system (see below regarding the shifting drivers of the credit market cycle). In Europe, and equally, the European Central Bank and policy makers are targeting market recovery and stability. Philip Lane, member of the Governing Council, recently declared that the increase in the Pandemic Emergency Purchasing Programme was being guided by improving monetary conditions and stabilizing financial markets with its exact figure being of secondary importance. Furthermore, the European Recovery Fund is now tantamount to early debt mutualisation steps with significant benefits for Southern or periphery economies as it will help avoid leaving a permanent scar on these economies. We see the proposed Recovery Fund as a continued catalyst for spread tightening, especially positive for periphery corporates and financial institutions.

Given that investors’ doubts could be increasing, we would now turn to the shifting drivers of market cycles, as such investor doubts typically correspond to an early stage recovery phase of a market cycle or repair stage. We have stated earlier that we do not expect broad or major lockdowns to be re-introduced. We can also rely on good coordination from policy makers to help us move from bottom to an early recovery stage. Presently, and after reaching bottom, corporates are doing their part to stay

alive rather than grow. The primary focus of hoarding liquidity and building cash levels is also giving way to debt repayments and balance sheet repair. The V or Swoosh shape recovery will transition us slowly but surely into a mid-stage bull market or recovery stage by year-end that should be supportive of riskier assets. As output rebounds, it is worth noting that consumption recovers much quicker than one thinks and a good precedent for this is the last Great Financial Crisis when consumption had already recovered to pre-recession levels by the third quarter of 2010. Today, we would argue that household balance sheets are in much better shape going into this recession. All this is providing a solid springboard for the recovery to gain momentum, with the repair stage we have entered bodying very well for developed market corporate bond spreads still.

Credit markets experienced another solid month of performance overall, but started to cool off towards the end of the month for US high yield as coronavirus cases mounted in Southern and Midwestern states. As such, US high yield underperformed other major US dollar and euro credit on spreads and excess returns as high yield tightened much less (-10 basis points) and delivered a sub-1% excess return. Lower quality CCCs tightened by 94 bps while Single Bs and Double Bs were basically flat with spread changes of +6 bps and +1 bps, respectively. Performing sectors included airlines (-178 bps), consumer products (-131 bps), automotive (-64 bps) and energy (-61 bps). Underperforming sectors include entertainment (+98 bps) and healthcare (+40 bps).

European high yield delivered a total return of +2.0% (in euros) as spread tightened by 42 bps to end the month at 541bps (OAS spread). The pound sterling high-yield market posted a total return of +3.0%. In terms of performance by rating bucket, triple Cs tightened by 191 bps, followed by single Bs at 58 bps, and BBs at 20 bps. European sub-financials and CoCos underperformed the European high-yield market. Emerging markets high yield performed strongly, returning +3.25%.

Portfolio review

Trading activity in the fund picked up in June. We continued to selectively add risk to borrowers with ample liquidity to survive a prolonged downturn, expected to benefit from state aid support, and/or rebound with a gradual reopening of their respective economies. Primary markets remained busy throughout the entire month in the U.S. while activity only picked up towards the end of the month in Europe. We participated in a couple of deals such as SIG, Level 3, Constellium and profine.

Total exposure to the high-yield credit markets slightly increased to 90%. US high-yield bonds represent 30% of the fund’s assets, while Europe accounts for 52%, including 12% in subordinated financials. Emerging market exposures amounts to roughly 6% of the portfolio.

Performance analysis

The fund’s return was well ahead of the reference index’s return in June. The outperformance was primarily driven by favorable credit selection in various sectors, particularly in basic industry, energy and transportation. Other positive return contributors was our overweight allocation to banking as well our short position in the senior financial CDS index. This was partly offset by our underweight allocation to automotive, which performed well during the month. Our cash balance position was also a drag on performance as the market rallied.

Outlook

We believe the portfolio is well positioned to generate excess positive returns for the remainder of 2020 predicated on a gradual recovery of the global economies in the second half of the year and into 2021 as well as on a favorable technical market backdrop. We are more heavily weighted towards Europe, which we think is lagging the US and has room for further spread tightening driven by the accommodative factors mentioned earlier. Finally, we are closely monitoring the health trends associated with the coronavirus, which are fluid and driven by timing for effective treatments and an eventual vaccine.

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Performance (in %)

Net returns			Rolling 12-month net returns			
EUR	Fund	Index	Start date	End date	Fund	Index
MTD	2.8	1.1	01.07.2019	30.06.2020	-5.1	-2.9
YTD	-7.5	-5.4	01.07.2018	28.06.2019	2.6	5.1
2019	10.2	11.1	01.07.2017	29.06.2018	0.8	0.1
3 years p.a.	-0.6	0.8	01.07.2016	30.06.2017	7.4	9.8
5 years p.a.	0.7	2.6	01.07.2015	30.06.2016	-2.0	1.3
10 years p.a.	n/a	n/a	Index: Customized ICE BofAML High Yield Index hedged EUR			
Since launch p.a.	3.5	4.6				
Launch Date		11.06.2012	Share class: I ISIN: LU0571066975			

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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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 rates of exchange between currencies. The value of the money invested in the fund can increase or decrease and there is no guarantee that all or part of your invested capital can be redeemed.

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