AXA WF Global Strategic Bonds
Back to basics

- The end of the cycle is near, and the probability of a recession has increased
- This naturally points us to better quality and longer maturity assets
- AXA WF Global Strategic Bonds returned 1.45% in June and 6.95% YTD (I USD, net)

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What's happening?

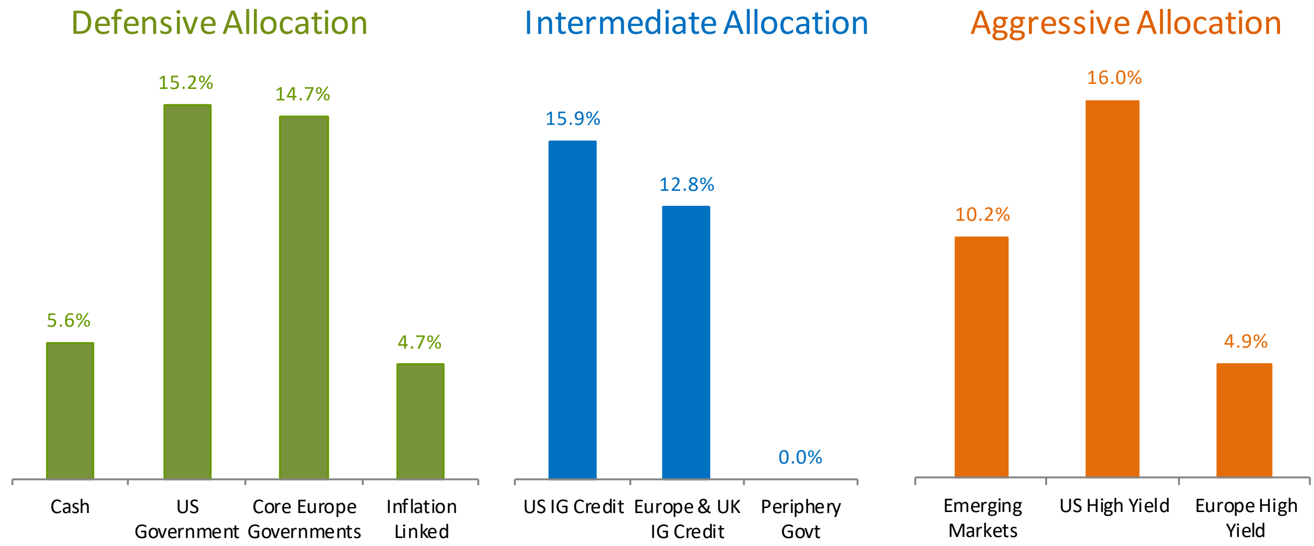
If the economists and strategists are to be believed, then the global economy is slowing and the probability of a recession in the next 12 to 24 months has increased. Whether its trade wars, higher rates from the Fed or the persistent lack of inflation, the trigger is never simple, but the natural reaction is to expect lower and looser monetary policy from Central Banks. We are seeing the current large amount of negative yielding assets (c.$12.5 trillion) change investors behaviour. With negative yields in Europe and relatively low yields in the US, investors face problems when trying to define "value" in bonds, particularly government bonds, causing many to hunt for yield in lower quality, credit bonds. In recent weeks, we have seen how difficult to sell illiquid assets (be it credit or equities) can be when forced to meet investor outflows. Prices quickly fall and, due to correlation with other risk assets, the benefit of owning less liquid, higher yielding assets soon evaporates.

Looking back over decades of financial history, this hunt for yield is typical end of cycle behaviour and we may well hear about more funds struggling to meet redemptions before the economic cycle turns again.

Portfolio positioning and performance

Thankfully, there is a better alternative. We are buying longer dated, positive yielding, high quality assets to keep things simple and liquid, whilst waiting for better opportunities and higher yields to arrive before going yield hunting again. Our position in long duration government bonds gives us exposure to a reasonably volatile, and therefore risky asset. However, the risk factor here is one of interest rate sensitivity (as opposed to credit risk), therefore benefitting from lower interest rates or expectations of weaker economic growth. We also like the beta and low correlation offered by long dated assets, whereby small moves in interest rates can create decent returns in months where risk assets (equities and credit) suffer.

Despite our highest ever duration exposure (5.5 years) and a -11% exposure to CDS (which will protect the fund if credit spreads move wider) our current positioning is not just about "safe haven" investments. We still have 10% in emerging market debt which is doing well, where we find increasing opportunities in EUR hard currency over USD. With 16% in US high yield, we have also benefitted from a 10% return in the market to date.



Source: AXA IM as at 30/06/2019

Year-to-date the fund is up 6.95%, whilst since launch the fund has returned 4.52% on an annualised basis (I USD, net) with a volatility of 3.11%.

Outlook

Our outlook: the fund is definitely more interest rate sensitive than previous periods and will benefit from lower interest rates over the coming months and quarters. Clearly, if markets start to price in interest hikes not cuts, bonds will move lower not higher in price. But given the current momentum, together with a weaker outlook, that is not the biggest concern for most investors in the foreseeable future. We think that the final stages of the economic cycle should bring more opportunities in the higher yielding credit risk part of the market but for the foreseeable future we take a more cautious approach and look to benefit more from lower government bond yields rather than credit spread tightening.

Global Macro View from the Fixed Income CIO: fixed income returns were positive in June as investors focused on the growing possibility of easier monetary policies. Comments from US Federal Reserve and European Central Bank officials suggested that monetary easing could be provided should risks to the global expansion increase. The biggest risk is the possible impact of any escalation in global trade tensions and protectionist policies. Global manufacturing output growth has already slowed, as indicated by purchasing manager surveys, and there is concern that this could broaden to other sectors of the major economies. While credit spreads have narrowed since the beginning of the year, a further increase in global recession risks would likely reverse this trend, especially if equity market volatility also increased. Hence, going into the third quarter the determinants of market behaviour will be the economic data – to gauge how trade tensions have already impacted on economic activity, the evolution of discussions between China and the US on trade, and the willingness of the central banks to meet market expectations of easier policy. Our view is that rates will generally be lower and that a recession will be avoided. However, valuations are less attractive in both rates and credit markets and there are considerable uncertainties in the outlook. As a result, fixed income returns may be less appealing than so far in 2019.