

The time has come to adjust to a bond allocation with a long-term perspective and a broader approach



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With the abrupt change of stance by the major central banks over the last few weeks, the amount of debt that carries negative interest rates is once again close to \$10 trillion, the highest level since 2017. As the prospect of renewed US quantitative easing has resurfaced, in connection with the announcement concerning the change in the composition of the assets held in the Federal Reserve's balance sheet in the medium term, one could consider that US monetary policy is going to maintain downward pressures on yields over the coming quarters.

In this context, asset allocators are facing some important decisions. Swiss allocators are even more concerned, due to the fact that our monetary authority is in a mood that should mean there is a long delay before we return to zero interest rates (at best) in Switzerland.

BOOK SOME PROFITS

The performances of bond markets year to date are quite impressive. Fixed income assets are pricing the return of a 'goldilocks' environment. A lack of visibility concerning the macroeconomic developments over the coming

quarters should not be overlooked. In this regard, one has to determine if bond investments offer a satisfactory risk/return profile to justify their holdings.

Obviously, a diversified portfolio cannot ignore fixed income assets as a key component of an allocation in the medium term. As a firm, we have made the tactical choice to underweight bonds in our investment strategy.

Moreover, we are not (yet) convinced that 'goldilocks' is going to materialise. Just as we rejected the hypothesis of a looming recession in the final quarter of 2018, so we remain doubtful about the ability of the cycle to regain significant strength without any inflation issue over the medium term.

TACTICS ARE KEY

Complementing a tactical underweight with products that exhibit very flexible characteristics when it comes to bond investing is interesting – as long as you are sceptical about the idea of a new 'goldilocks' environment prevailing in the coming months. The ability of such funds to act swiftly and to adjust their positioning is not only attractive in terms of dealing with the recent fixed income rally – ie. to book some profits – but also as a means of building a portfolio with a long-term perspective. As a matter of fact, the lack of visibility on the economic cycle warrants a careful approach when it comes to bond investments.

The emerging market space is also something to consider for the long term, even if the short-term potential is reduced. As modern monetary theory is getting more support in some developed countries and as the credibility of central banks is even more at stake after the Fed's recent decisions, one should be careful when it comes to debts from the developed

world; as a matter of fact, these are at risk of a spiraling debt increase that could reduce their relative safe haven status compared to emerging countries.

ALTERNATIVE WINNERS

Last but not least, liquid alternative fixed income strategies are worth considering in the construction of a bond portfolio. In this regard, Prime Partners has built exposures in different products that offer solid capacities to take advantage of relative value in the fixed-income space. Such products seem to be investment vehicles that suit the bond environment we will face. As a matter of fact, we reckon that a bond strategy that puts too much emphasis on credit risk is too aggressive, as the medium- to long-term economic outlook is quite hard to assess.

