Pictet - EUR Bonds - I

Risk and reward profile

Don't take unnecessary risks.
Read the Key Investor Information Document.

Lower Risk						Higher Risk
1	2	**3**	4	5	6	7

Typically lower rewards — Typically higher rewards

Market review

February saw markets shift focus from inflation-driven policy rate hikes to Russia's invasion of Ukraine, leading to massive risk-off moves across most asset classes. In the US, the probability of future rate hikes rose and the US Treasury curve bear flattened following higher jobs and inflation data. Eurozone CPI rose to record levels, prompting expectations for 40 bps of ECB tightening in 2022. German Bunds and peripheral Europe suffered as a result. Both the Bank of England and Reserve Bank of New Zealand hiked rates 25 bps while multiple EM central banks maintained their hawkish stance with continued rate hikes. Credit spreads widened and yields climbed amid a repricing of global risk assets and borrowing costs. EM Sovereign credit total return fell 5.11%, with CEE responsible for the majority of losses. In Russia, all asset classes suffered heavily, with sovereign credit lower by 64%, local government bonds losing 71%, with the currency (RUB) falling 21%. Russia's Central Bank hiked rates sharply to 20%. In China, the government adjusted 2022 priorities to focus on growth stability, but Chinese USD property bonds still underperformed. The USD ended the month flat after a weak start but rallied on the invasion. The EUR and GBP slid, as did CEE currencies, as geopolitical tensions dominated while LATAM FX, with their hawkish central banks, performed well.

Performance analysis

The portfolio underperformed its benchmark in February. Rates contributed negatively, primarily from our long US duration positioning, with our long German Bund positions also underperforming. Our long New Zealand Dollar (NZD) and long Norwegian Krone (NOK) duration detracted. Spread positioning was the main driver of underperformance over the month from both developed (DM) and emerging markets (EM). In developed market corporates, financials detracted the most, followed by indices, utilities, communications and real estate. EM spread suffered in general, with hard currency EM allocations to Chinese corporates and EM Europe underperforming the most. In EM local currency bonds, our long rates positions in China, South Korea and Russia were the largest detractors. Contribution from FX was flat, with negative performance from our short NZD offset by positive contribution from our EM FX positioning. Overall, our shorts in CEE (mainly CZK, HUF) performing well but offset by our short BRL, MXN and RMB.

Portfolio activity - overweightings & underweightings

In Rates, we increased our portfolio duration, mainly in the short and intermediate maturities of the German Bund curve, reducing our steepener in the longer end of the curve. In US Treasuries, we also increased duration although to a lesser extent and added to our flattener. We closed our long Antipodeans rates positions, increased our long in Italy and reduced our long China rates positions. We increased our flattener in AUD while adding to our steepener position in SEK. In DM credit, we reduced risk in European credit, both investment grade and high yield. In EM, we sold our small long Russian exposure and our long in PEMEX. In FX, we closed our shorts in NOK, ILS and RUB as well as our long in SEK. We increased our shorts in CZK and BRL, increased our long in EUR and reduced our short in HUF.

Market outlook

What was an already difficult market in fixed income due to stubbornly high inflation and hawkish central banks turned even worse with the Russian invasion of Ukraine. The common denominator is the persistent rise in interest volatility after years of central banks expanding their balance sheets to compress it. In the space of two months, we have witnessed drawdowns in the main fixed income indices not seen in almost 30 years, since the infamous 1994 tightening campaign that led to the Mexican Peso Crisis and eventually to the LTCM and Asian crisis. One of the most striking features of today's fixed income markets has been the spectacular drying up of liquidity conditions, which we believe is due to this re-birth of fixed income volatility and the potential escalation of the war. As a result, correlations sharply jumped, and diversification was very hard to find. We reduced over the last month our exposure to rates and to spread in line with our process. We have reduced our exposure to most illiquid sectors (High Yield and EM corporate bonds). Inflation and a major credit and risk event like the one we are witnessing today make for a very toxic cocktail for financial assets Our concern is that this "oil/confidence shock" makes for an incredibly difficult situation for central banks, raising the risk for a policy mistake. Central Banks may have to choose between bad scenarios.

Portfolio strategy

We believe that for the Fed, the domestic inflationary threat continues to be the priority as confirmed by J. Powell during his testimony to Congress. The US is a big oil producer now, and the conflict seems to be far away for a US government that was pulling out of international military interventions. As such, we believe that the Fed will hike rates this year in line with current market expectations but risks inverting the yield curve as it did after the 1973 and 1979 oil shocks. We have therefore increased our flattening curve positions in the US. The ECB is facing a much more negative energy shock and the conflict in Ukraine is a bit too close for comfort. The priority of the ECB might become making sure that fragmentation does not happen, keeping the integrity of the Eurozone. We believe the QE exit will be postponed in Europe and rate hikes pushed back. We have put in place curve steepening positions and sold the EUR as a result. China might seem to be an "island of tranquillity" at the moment, the economy seems to be stabilizing, and it has strengthened its bargaining position in the global scene. Therefore we have reduced our duration in Chinese local market government debt and cut our shorts in the Chinese reminbi.

General information

Legal form	Sub-fund of a SICAV
Regulatory status	UCITS
Domicile	Luxembourg
Inception date	04.05.2001
Launch date	04.05.2001
Share class currency	EUR
Compartment currency	EUR
ISIN	LU0128492062
Reference index	Bloomberg Euro-Aggregate (EUR)
Min. investment horizon (year(s))	3

Fees

Ongoing charges (OCR)	0.60%
Performance fee (excluded from OCR)	-
Management fee (included in OCR)	0.40%
Max. conversion fee	2.00%
Max. subscription fee	5.00%
Max. redemption fee	1.00%

Management team

Ella Hoxha
Andres Sanchez Balcazar

Source: Pictet Asset Management

Further information can be found in the prospectus.

Pictet Asset Management

For further information, please visit our website assetmanagement.pictet

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