Monthly Manager Comments
28.02.2022

Pictet - EUR Corporate 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 proved to be a second consecutive challenging month for investors overall. At global index level, aggregate fixed income returned -1.3% (-2.9% YTD), high yield credit was -2.4% (-4.6%), and government bonds -1.0% (-2.3%). Russia's invasion of Ukraine overshadowed what had already been an eventful month. It began with growing noises that central banks would be forced to embark upon a more aggressive tightening cycle than anticipated, particularly as inflation continued to surprise on the upside. The month ended with a risk-off move prompted by warnings and then the reality of Russia's invasion of Ukraine, which in turn triggered severe sanctions on Russia that have had a severe market impact across asset classes. The negative tone from geopolitics and central banks meant that equities were the worst performers with US and European equities both falling around 3%; European bank shares lost over 9%. For the second month running, major DM credit indices fell, with losses shared among IG and HY, across EUR, GBP and USD. The prospect of higher inflation and hawkish central bank action hurt sovereign bonds although there was some relief towards the end of the month in the risk-off move. Periphery spreads widened and underperformed. Numerous commodities surged with oil moving above $100/bbl for Brent and WTI while European natural gas, wheat and aluminium also increased sharply.

Performance analysis

The portfolio underperformed its reference index in February on the back of its overweight exposure to credit spreads and overall longer duration. The exposure to Financial sectors, Energy and Utilities were the worst performers while Consumers and Autos were positive given the sector underweight. Among financials, the performance from bank Tier 2 was slightly positive, but insurance subordinated proved negative. Our long exposure to US banks was the main negative contribution in MREL/TLAC debt. Contribution from pure senior debt was negative but came mainly from Real Estate exposure. Hybrid debt contribution was negative but concentrated on ENBW and Total as we had a moderate exposure overall. Regarding maturities, the biggest negative contribution came from our overweight on senior corporate debt of 10-year maturity and beyond. At the single name level, the negative ones were BP, JAB holdings, WPC and Vonovia. The positives were driven by the underweights we had on Engie, Unibail and ENI.

Portfolio activity - overweightings & underweightings

We had a positive stance with an overweight on credit spread and a neutral duration before the ECB meetings as we expected a dovish and accommodative communication. In the following days, we reduced in Italian issuers and in BBB corporates that benefited from the central bank buying programmes. However, we took the opportunity to add in high-quality insurers' subordinated debt that had underperformed. As the market turned more negative due to interest rates volatility and geopolitics tension, we initiated a CDS protection structure and also exited non euro-denominated bonds in order to reduce off-benchmark exposure. Regarding rates, we diversified our hedges with French OATs and Italian BTPs. In the last part of the month, we participated to several new issues to carry on new issue premium. With the heightened geopolitical tension and the market sell-off, we added spreads exposure through CDS options to benefit from a recovery scenario in the next 2 months.

Market outlook

At a macro level, the three main risks we are monitoring for 2022 are the geopolitical risks and associated sanctions on Russia, a China slowdown bleeding into global growth and the ongoing fallout of a higher inflationary backdrop. Russia's invasion is clearly at the forefront of investors' minds. While we don't have any Russian or Ukrainian exposure, we are monitoring the impact of the sanctions and what they can bring to the financial system in terms of counterparty risks; these are so far underappreciated by the market. If these risks escalated, they would undoubtedly lead to dovish central banks. However, at present they are trapped in a corner, with inflation remaining elevated but with growth at risk of slowing even before they start hiking. The Fed will still try to hike in March but might try to temper QT. Meanwhile, the ECB might have to find ways to dial down its recent hawkishness with war and sanctions on its doorstep. We still note many underlying credit market fragilities in weaker names, such as questionable fundamentals, elevated corporate leverage and the overall deterioration of credit quality, particularly in terms of IG indices

Portfolio strategy

Parts of IG are beginning to look more attractive in terms of the spread levels, and we will selectively look to add here, particularly if the situation shows signs of improvement. Therefore, we are keeping a positive cash balance to put capital at risk and take advantage of new opportunities when they arise. We will also look into the primary market to source new opportunities with attractive premiums. Following the sharp repricing of government curves in February, we tactically shifted the portfolio duration from underweight to overweight to take advantage of the flight to quality. We might go back to underweight or neutral duration depending on the future rate moves. In addition, we turned our attention toward EUR credit as value is emerging in EUR compared to USD or GBP. EUR has indeed unperformed USD and GBP credit in this market sell-off, creating opportunities for EUR credit. Overall, we maintain a long bias toward more defensive sectors and quality (Senior vs Sub). That being said, we are analysing and gathering investment ideas, especially looking at subordinated debts (both corporate and hybrid) and longer-dated bonds in which we can deploy capital quickly enough to benefit from the rally should the situation improve.

General information

Legal form	Sub-fund of a SICAV
Regulatory status	UCITS
Domicile	Luxembourg
Inception date	04.09.2000
Launch date	04.09.2000
Share class currency	EUR
Compartment currency	EUR
ISIN	LU0128472205
Reference index	Bloomberg Euro-Aggregate Corporate
Min. investment horizon (year(s))	3

Fees

Ongoing charges (OCR)	0.61%
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

Jon Mawby
Mathieu Magnin
Charles-Antoine Bory

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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