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# Bonds: cautious and underweight

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## Francesco Castelli, manager of Fixed Income at Banor Capital Limited, answers Fondi&Sicav’s questions about global bond funds

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‘Keep clear of government bonds, especially long-term ones’, advises Castelli, Banor Capital

**In many segments of the bond market yields have begun to rise in recent months. Do you think the current levels are an opportunity or do you think it’s still too early to increase certain positions?**

**The rise in interest rates has occurred mainly in the US yield curve, whereas in Europe and Japan the effects have been minimal.** On the periphery of Europe there has even been a drop in yields, driven by spread compression (although the recent political volatility in Italy has made the situation less promising than expected). Looking at the spreads, i.e. at the risk premium of corporate and high-yield markets, although there has been a moderate increase in values, levels have not really changed since the start of the year.

**From a historical perspective, therefore, values are still very low. Overall, our position on the bond markets is extremely cautious.** The rising bond cycle, lasting several decades, has come to an end and we should expect a lengthy period of normalisation during which government bond rates will tend to rise and prices to fall. Monetary policy is already normalising in the US, but in Europe and Japan we haven't yet seen a rise in official interest rates. **If the European Central Bank and the Bank of Japan finally change their stance, then we'll see another wave of bond sales, but this time mainly euro and yen.**

**What types of bonds do you think contain value and which ones should we avoid because their risk/return ratio is poor?**

**Generally speaking, we advise a cautious approach and keeping bonds, all of then, underweight.** At the moment our portfolios are positioned on a very short duration and with a moderate exposure to credit, particularly in the case of issues whose maturity is fairly close. This approach is designed to make the portfolio less sensitive to rate rises, while keeping a very small amount of extra-yield. **In relative terms, we think the US bond market offers the most interesting opportunities:** with 10-year rates over 3%, it's not hard to find corporate bonds around 4-5%, depending on the maturity and the issuer. Bearing in mind the quality of the issuer, these opportunities are good and offer a valid alternative to equity. **Keep absolutely clear of government bonds, especially long-term ones: they will be the most exposed when the central banks wake up.**