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The analysis

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"A bearish market is an opportunity"

According to Francesco Castelli of Banor Capital, investors need to be selective. The focus: subordinate products and the emerging markets.

'The situation is, we're grappling with a bearish market on both the share and bond fronts". That's how Francesco Castelli, Head of Fixed Income at Banor Capital, clarifies the framework in which the financial markets are currently operating. In London, where he's based, the climate among investors is one of concern. But it's at times like this that opportunities can emerge that mark the difference between one fund manager and another and point to pportunities for a growth in value over time. "Our approach is focused on maintaining an overall low-risk approach: there are always bargains available, but the time isn't yet ripe to give in to the temptations of promised yields".

The epicentre of the tensions is set to remain in Italy for the long term, given that the Government has opted for a tug-of-war with the other countries of the European Union, a situation that isn't going to be resolved any time soon. "We'll be seeing the main repercussions in the credit sector", Castelli adds. If we look to a slightly longer time horizon, however, the scenario changes. "We're convinced that it doesn't take much to change the mood in the markets. The recent adjustments were significant and the political tensions will wane", underscores the expert. The change of direction could come in mid-2019 or slightly earlier, after the European elections of 26 May, when new equilibria will be established in the Union. "A more accommodative monetary policy could restore the appeal of fixed income products in terms both of returns and of renewed stability in banks' accounts". As a consequence, banks' issuances should be followed closely. But back to the present. As Castelli explains: "We see opportunities in financial sector subordinates [Ed's note: a special category of bonds that are reimbursed – in the event of the issuer experiencing financial problems – after ordinary creditors have been reimbursed] with yields of 6-8% per year. An interesting prospect, but definitely not for everyone. "The small amounts concerned and the complexity of these instruments mean that they're suitable for professional clients", warns the expert. The scenario is clearer on the other side of the Atlantic. There, the Fed's interest rate rises (the next is expected mid-month, when the central bank meets again) have taken the yields of 10-year Treasuries into the 3% area, a good level of returns.

Banor also views issuances by the emerging countries with interest. “Most of these currencies experienced heavy devaluations when the Fed began to tighten rates. However, in many cases their fundamentals remain stable, so we see opportunities to buy at reasonable prices”.

As regards the dollar/euro rate, in Castelli’s view the scenario looks set to change with respect to this year, which saw green-backs chosen by investors as the ultimate safe asset. “When the political tensions in the euro area calm down, the single currency will grow in strength”, underscores the expert. “Not least because, while it’s true that the United States are growing more right now, this is partly the result of their heavy recourse to the deficit. Over time, that deficit will need to be refinanced and the dollar will feel the consequences.”. All the more so if, in the post-Draghi era, the European Central Bank begins a process of rates normalisation, thus reducing the differential with the United States. “This is an inevitable trend”, concludes Castelli. “However, it might not start right away, if the signals pointing to a slowdown in GDP and inflation are confirmed in the coming months”. After all, we can’t imagine rates beginning to rise while fears of the euro area falling back into recession are intensifying, given that the zero-rates situation itself doesn’t offer any more room for manoeuvre for the ECB if the situation takes a turn for the worse.

Francesco Castelli
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