

## ADVISOR

# BONDS, PRUDENCE AND SELECTION

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These are the topics under discussion at the 10th *Salone del Risparmio* with a conference on the theme of sustainability and how value investing can be integrated with management to create value. One of the speakers at **BANOR Capital's** conference is **Francesco Castelli**, a bond manager who will illustrate the opportunities present on today's bond market.

### **What has changed for the bond market after Draghi's recent announcement of new TLTROs?**

From our point of view, the ECB's decision to start a new series of Targeted Longer-Term Refinancing Operations (TLTROs) is an important programme to provide liquidity for the banks and will enable them to re-finance and renew financing that is already under way. It is not, however, an additional move to avoid new "disasters", but we don't think it will be enough to stimulate the economy.

The ECB has given a very clear indication, that is, it is pessimistic about the eurozone economy. But we consider that it doesn't have any effective tools, just now, to change the fortunes of the economy, given that interest rates are already negative and quantitative easing (QE) has come to an end. The TLTROs will certainly provide support for government bonds, as we have already seen in the first market reactions after the announcement on 7 March, with core securities going up. The situation for banks is different and we agree with the market judgement that questions whether these operations can revitalise the banking market.

### **What do you think about the credit market?**

We're taking a prudent position. We favour quality and shorter durations, we see opportunities in the high-yield sector, but we prefer to speak about specific opportunities with issuers that we know very well. This is a panorama with few bond opportunities. In terms of absolute yields, the bond market really has very little to offer, going from 10-year German government bonds with zero yield, to a corporate bond market – high-quality issuers – that offers less than 1% on average.

We advise our clients to opt for few government bonds with short durations because, in our opinion, there is a real risk in the medium term of suffering losses on bond investments in their capital account. When clients can afford to diversify a little, they can look at medium duration (5-year) US government and corporate bonds.

More generally, we see opportunities developing in currencies other than the euro, and so we have to accept a certain degree of exchange rate volatility. Lastly, we are moderately optimistic about BTPs because changes in the political situation seem to confirm that the government is paying more attention to economic questions.

### **Will default rates rise?**

L'economia in Europa sta rallentando, in questa fase del ciclo quello che ci aspettiamo è un incremento dei tassi di default, quindi un incremento del numero di fallimenti, e questo storicamente va ad incidere sui ritorni del settore. Altro rischio da non sottovalutare sono i rischi geopolitici (Brexit, ad esempio, oppure le elezioni europee) così come anche le tensioni legate alla guerra dei dazi, che porta in generale a una flessione del ciclo economico globale che è già ben visibile in Europa.

Europe's economy is slowing. In this phase of the cycle we expect an increase in default rates, therefore an increase in the number of failures; traditionally, this affects returns in the sector. Geopolitical risks should not be underestimated either (Brexit, for example, or the European elections). Nor should tensions linked to the tariffs war; such disputes usually lead to a dip in the global economic cycle, which is already clearly visible in Europe.

**TLTROs WILL CERTAINLY SUPPORT GOVERNMENT BONDS, WHICH HAVE IN FACT RISEN AGAIN FOLLOWING THE ANNOUNCEMENT, ALTHOUGH...**