Government bonds: expectations for earnings drop

By **Stefania Basso** - 3 May 2019

Share

Francesco Castelli, Fixed Income Manager for Banor Capital, responds to questions from Fondi&Sicav about the global bonds market

Francesco Castelli, Banor Capital

The Fed's total reversal has given bonds a new boost. After the strong recovery of listings recorded in recent months, do you believe that the sector still has growth margins?

The strong recovery of government bonds reflects the pessimism over global growth that has taken hold over recent months and central banks' consequent change in attitude: the Fed decided to disrupt the cycle of increases, the ECB has already (partially) turned the tap back on with a new programme, TLTRO. Looking ahead, however, **it will become more difficult to make earnings on governments bonds**: either the global economy will go into **recession** (and then **bonds would continue to increase**, leveraging on the downturn of official rates) or, even with **stabilisation in the economic conditions, there is the risk of earning very little from bond investment**. Especially in the US, we may see an extreme scenario where the Fed changes tack and reneges the increases made in the past two years. In **Europe**, on the other hand, **the potential bullish trend seems minor**: the rates curve for German bonds is already negative over the entire short and intermediate term, with positive rates on long maturities alone. And let's not forget that the ECB already has negative rates, with little margin for further monetary expansion.

Debt levels that are often very high, unstable corporate and government ratings and a slowing of company profits are key elements for sustaining debt. Which of these drivers could influence the performance of the bonds market in the coming quarters?

In our opinion, **the current situation is at the end of the cycle**: the **global economy has entered a deceleration stage** (which unfortunately is particularly **acute here in Europe and Italy**). Following an economic expansion that lasted over a decade, in the best case scenario we would experience a **period of weak growth**; but a wise investor must also be a good risk manager and be able to consider the adverse scenario of a recession. In both cases, **the current state of the markets requires a prudent approach: opting for good-quality credit, avoiding companies with low ratings and high financial leverage**. In this economic stage, we tend to see a comeback in default rates, which are focused in the high-yield market and bonds with B or CCC ratings.

TAGS	banor capital	global bonds market	government bonds

Stefania Basso

A graduate of the University of Milan, she has collaborated with Fondi&Sicav since 2006. With extensive experience in the asset management sector as a marketing manager at Franklin Templeton Investments and J.P. Morgan Fleming Am in both Milan and Luxembourg. Brief experience at Lob Media Relations as a press officer for some foreign financial firms. Throughout my career I have worked in close collaboration with people from different parts of the world, who have allowed me to take a dynamic and exciting approach to learning through the comparison of different firms.