ASSET MANAGER OF THE WEEK

Francesco Castelli

Banor - Head of Fixed Income

Francesco Castelli is the Head of Fixed Income at Banor Capital and asset manager of the Banor Sicav Euro Bond and Aristea Sicav Enhanced Cash funds. He joined the company in 2015 and, previously, was bond manager in leading groups such as Zurich Investments, Sanpaolo IMI and Kairos Partners. He has over ten years of experience in the analysis of banking and insurance issuers, mainly on European markets, and specialises in investing in subordinated bonds and capital securities. Castelli earned his first degree and a masters in economics from Bocconi University in Milan and qualified as a Chartered Financial Analyst (CFA) in 2003.

"Ethical" bonds are good for portfolios

A look at ESG virtuous companies that outperform the market

Marzia Redaelli

■ **The Fed has taken investors by surprise; Powell said that the cut in interest rates is not the first one of a long series, but it depends on the data. But the market continued to buy bonds, except for those with a very short-term maturity. What is your macro scenario?**

The Fed is doing its job. The trade war risks thwarting growth and Powell does not want to run any risks. In a scenario that is full of uncertainty determined by a political tug of war, the outcome of which is difficult to forecast, it is better to adapt, however, without making long-term commitments.

Is there the risk of a bond market bubble?

Bond markets, in general, are not very attractive. Apart from the United States (where yields are low, but positive), Europe and Japan, there are 13 trillion worth of bonds with negative yields. Most interest rate curves are below zero. A paradoxical situation, which is a result of a phenomenon that many refer to as "financial repression". In a normal world, nobody would lend money at negative interest rates. But today, we live in a world where public players (central banks) have opted for negative interest rates, while private players (pension funds, insurance companies, commercial banks) are unable to make totally rational choices. Many purchases of government bonds are dictated by applicable regulations and not by a pure investment decision.

Are there sectors that are more attractive and less vulnerable to the economic slowdown for bonds issued in the euro zone?

In general, the credit market tends to be under pressure when the economy slows down, bankruptcy risk increases and the credit spread widens. This is the time to prefer less cyclical sectors and higher ratings. Going against the trend, we are under the impression that banks and insurance agencies (the epicentre of the 2008 crisis) can survive a slowdown better than investors believe. After a decade of capital increases, regulatory restrictions and balance sheet restructuring, they will again become a relatively defensive sector, as in 2001 and 2003.

Do you think that the ECB will launch a new expansionist manoeuvre, a QE2? Which securities would it favour?

The ECB has clearly registered signs of weakness in the European economy (not only in Italy, but also in Germany) and it will do whatever is possible. QE, however, has limits. It is like a drug that induces addiction and dependence; you cannot do without it and you are forced to take increasingly high doses. German Bund interest rates today already incorporate a moderate lowering of official interest rates (which could fall from -0.40% to -0.6%) and a resumption of QE. We do not think that there is much potential for a rise. And therefore, it is better to go for peripheral bonds or corporate issues for which it is still possible to obtain a decent spread. During an economic slowdown, it is always worthwhile to remain with solid issuers, avoiding the lower ratings.

Italy is the country that has the greatest weight in the portfolio of your Euro Bond Absolute Return fund. Is the premium worth the risk?

If we exclude government bonds maturing in less than 3 months, used as a liquidity investment, Italy's weight in our strategy is just over 20%. Relevant, but not a priority. The Italian names that we have in our portfolio are solid institutions, capable of surviving unscathed moments of tension linked with politics or an economic slowdown: Saipem, Ferrari, Enel and Telecom Italia, in addition to the main financial issuers such as Unicredit, Intesa and Generali.

FLASH

Fundamental analysis underlying strategies

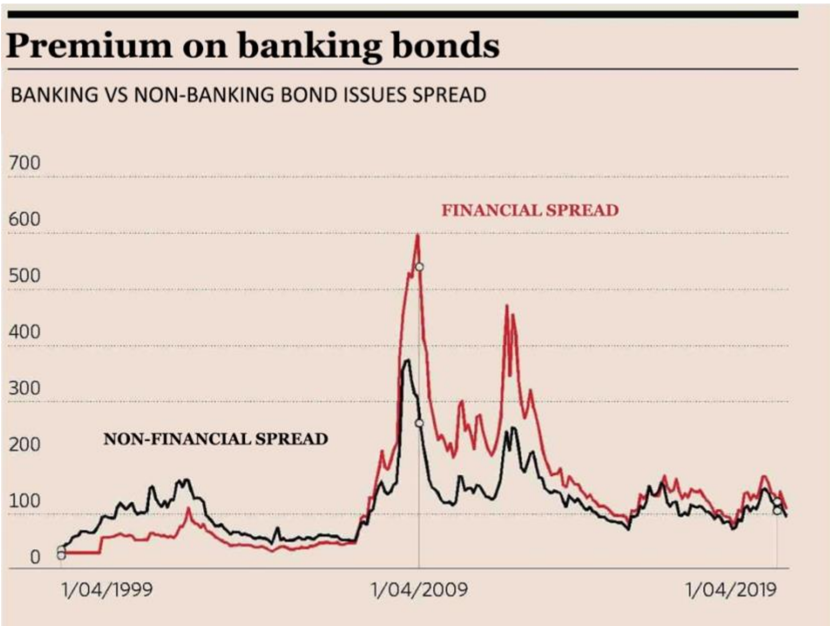
Banor Capital is an independent asset management company founded by finance professionals who have worked as a team for over 18 years. It is specialised in "value" strategies (on securities that promise a constant generation of value) and adopts a fundamental investment selection approach. The choice of financial assets to add to the portfolio is conducted through research and meticulous risk management. The company subscribes to the PRI (Principles for Responsible Investments) and respects ESG (Environmental, Social and Governance) themes to contribute to spreading a culture of sustainability in investment.

What is the effect of the ratings issued by the rating agencies on Italian bond issues?

Rating agencies have an eminently guaranteeing role (especially for prominent government issuers such as Italy). In the sense that ratings are not a forecast, but reflect, in cold accounting terms, a country's solvency. We are tormented by rating agencies because, for decades, our country's finances were close to being rated as inadequate: a small downward turn and Italy risks being relegated to a rating below triple BBB, along with junk bonds. At that point, it would become very difficult for the treasury to place its debt because many investors would stop buying BTPs, or they would even try to sell them and the ECB could not intervene to help us out. A country like ours, which places between 10 and 20 billion in fresh debt per month, cannot afford any rejection.

Which bonds have the most attractive expected yield?

Our style of investment is bottom-up, We carefully study each individual issuer and each single issue. We conduct a multi-level analysis. Our method includes a careful analysis of credit prospects (the probability that our bonds are repaid), but also an investigation into the ESG profile of the issuers (i.e. the sustainability of the company on environmental, social and good governance themes). ESG analysis is not just a fad. In a recent study conducted together with the Politecnico di Milano, we found that ESG factors have an impact even on bonds. We learned, on a scientific basis, that issues of more virtuous companies tend to outperform the market, and for this reason we include them in the portfolio. Investments in Volkswagen (one of the most convincing companies in the field of electrification) and in Intesa Sanpaolo (one of the European banks with a higher ESG rating) are examples of the application of this methodology.



The credit spreads of bank and insurance companies bond issues were hit particularly hard in 2008. At that time, banks were at the centre of the Great Financial Crisis and yield spreads surged to over 600 basis points. In less severe situations (like the 2001/2003 recession), the behaviour of financial issuers was different. They bore the brunt of the economic slowdown but behaved in a relatively defensive manner, with smaller increases in spreads compared to industrial issuers. We believe that senior banking issues can once again become a safe haven for investors. The risk of bankruptcy today is higher for industrial securities than for banks.

PLUS Il Sole 24 ORE
MILANO/ITALIA

ISSUES

ISIN	ISSUER	MATURITY	CALLABLE	YIELD (%)
XS1693822634	Abn	Perpetual	2027	**4.20**
XS1619422865	Bbva	Perpetual	2022	**4.66**
FR0013367612	Edf	Perpetual	2024	**2.04**
XS2000719992	Enel Spa	2080	2025	**2.25**
FR0011896513	Groupama	Perpetual	2024	**2.37**
XS1346815787	Intesa Sanpaolo Spa	Perpetual	2021	**4.39**
XS1640667116	Rbi	Perpetual	2022	**4.35**
XS1219499032	Rwe	2075	2025	**2.05**
XS1795406658	Telefonica	Perpetual	2026	**2.88**
XS1629774230	Volkswagen Intl Fin Nv	Perpetual	2027	**3.09**

In the context of ultra-low or even negative interest rates, subordinate bonds represent one of the few niches where attractive yields can still be found. These are relatively complex bonds (it is better to rely on a professional in this case); maturities are long or perpetual, but such securities are generally repaid early, at the callable dates. The extra-yield earned by investors depends on the level of subordination of the securities and their legal complexity. In any case, issuers are often large, well-known companies, which simplifies the work of the analyst.

Government yields - the curves

Government bond interest rates as a function of the various maturities. *Expressed as a percentage*