

FRANCESCO CASTELLI Asset Manager at Banor Capital

“European banks will be an opportunity

The year 2020 will be another lean one for those looking at the bond market. Nonetheless, there will be no lack of opportunities that investors will be able to seize by focusing on inflation and by selecting the countries and companies with more prospects. This is what was affirmed by Francesco Castelli, Head of Fixed Income at Banor Capital.

Following the strong rally on peripheral government bonds is there still any room for growth?

“Peripheral Europe offered excellent opportunities in previous years, but current levels offer limited opportunity for extra return.

In any case, it is important to highlight the fact that BTPs continue to give higher returns than Spanish bonds or even Greek bonds. Among the few opportunities offered by the BTP curve, we would like to underline the good risk-to-return profile of Italian BTPs that are linked to domestic inflation. In particular, those expiring in 2023 and 2024 offer practically the same returns as standard BTPs. In the worst-case scenario, i.e. in the case of zero inflation or even deflation, these securities will have a return that is substantially in line with ordinary BTPs. If, on the other hand, inflation resumes, those holding Italian BTPs will earn extra performance. We do not expect great surprises on the inflationary front, but it is not

difficult to imagine that these bonds could provide a little satisfaction in the medium term”.

Which countries and which maturities is it best to focus on today?

“Given the few opportunities, it is worth looking at diversification outside the Euro area. For those who can afford the currency risk, sterling is maintaining very interesting quotations. There are also good opportunities in emerging markets, both by way of the yield spread offered by strong currency securities, as well as by way of a good return offered by local currencies”.

Which corporate issues do you consider most attractive?

“In this sector, returns move at very low levels, with an average rate of around 0.5%. In order to seize something more, it is necessary to look at niche markets, which still offer good returns, but must be approached with the help of an expert in the sector, given the complexity of issues and issuers. Bank subordinated and perpetual bonds (the so called CoCOs) today offer returns between 4% and 6%, low when viewed in a historical perspective, but very attractive as a yield spread on government bonds. In this sector, we see good opportunities for solid issuers in peripheral Europe (Intesa, Unicredito e Bbva). There are also good opportunities with British household names (Lloyds

and Barclays) that however, are usually issued in US dollars or sterling”.

Do you think that the yield spread could rise again in 2020?

“The yield spread, and this is so not only in Italy, but in the rest of peripheral Europe, is linked to government policy and government stability. Apart from political parties’ political credence, it is important that the governing political parties remember the mountain of debt on which the country rests. One must engage in a dialogue with the financial markets because, while they are the ultimate judge of a government’s annual budget law, they are also an important partner to boost growth”.

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