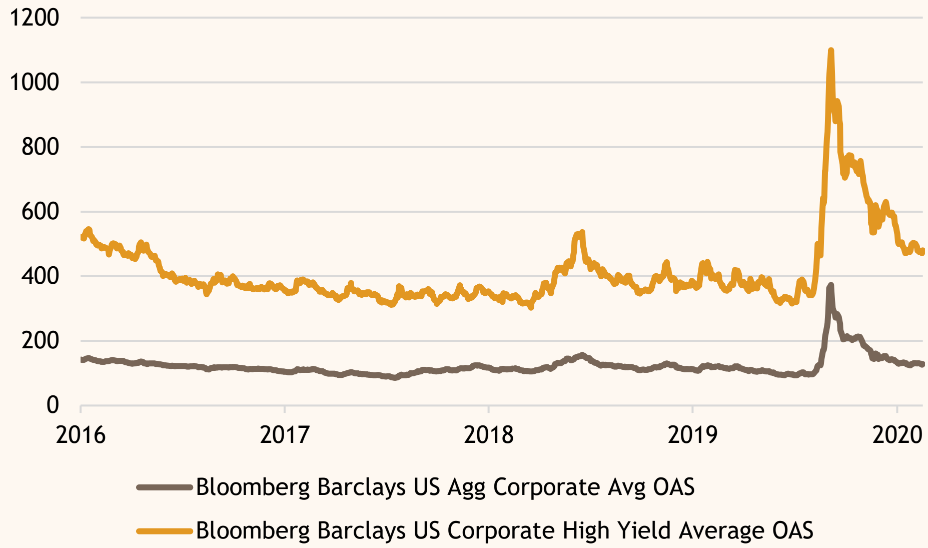
Key Economic Figures/Events of the Week

- It seems that nothing can stand in the way of the current bond rally supported by the overall risk-on mood. This week, credit spreads have narrowed further. The Bloomberg Barclays index for US high-yield corporate credit shows spreads narrowing to 480 from the 1105 March-high (the value stood at 330 on 31/12/2019). The US investment-grade bond credit spreads (according to Bloomberg Barclays US Corporate Investment grade Average OAS) have fallen to 128 from 373 (worst value in March) but are still away from the 94 value as of 31/12/2019.

Credit spreads narrowed significantly from the March highs



Source: Bloomberg

- The high US unemployment of 10.2% raises the question of whether the relentless bond rally is actually justified. The reasoning behind the rally is two-fold. One the one hand, with the Fed stepping into the bonds market with its renewed purchases of ETFs and individual bonds, credit spreads are no longer determined solely by the markets but are being also a policy choice. On the other hand, we believe that the market is currently pricing in the best-case scenario in terms of economic recovery. There are signs that the economic recovery is flattening out. Once this becomes more visible in the economic data, a market correction will ensue more likely than not. Of course, guessing the timing of the correction is like looking for a needle in a haystack. Our base-case scenario is that the economic recovery will take longer than currently priced in by the markets. Therefore, we favour credit quality and low duration in our portfolios. Nevertheless, we do not believe that correction will be of a similar magnitude of the one we have seen in March.
- Economic data is positive, but there are signs that the recovery is loosing momentum. Some parts of Asia, like China, show a brighter picture - new data shows a significant improvement in the services sector. Other countries, like India, are experiencing severe economic contraction due to strict lockdown measures, which nevertheless have failed in getting the infection spread under control. Once credit spreads started their recovery from March lows, the spread movement has converged across regions and industries. However, there is a considerable divergence in recovery prospects at this point, which it is not prudently reflected in current spreads. Therefore, careful selection of credit issuers is paramount in the current situation.

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Weekly Investment Insights

- The forestry products manufacturers Fibria (BBB-) and its parent company Suzano (BBB-/BB+) have announced a repurchase of three bonds outstanding. The pulp & paper industry has been under pressure due to low prices, but with the lockdown measures being eased worldwide, we expect the demand to pick up in the following months. Fibria was acquired by Suzano in 2019, and the merger has brough cost synergies, while the company improved leverage metrics after the merger. We intend to keep Fibria and Suzano in our portfolios as we are positive about the credit profile of the issuers and believe that current yields are fair. In addition, we expect that the new bonds to be issued will be stripped of premia.

Strategy

Primary market activity stayed high in August, despite the holiday season. We believe it will remain elevated in the following two months, as companies will rush to tap the markets before the US presidential elections. This week, we have sold some further issues that reached our price targets. We also participated in the new 10-year primary offer of the Government of Dubai and the 5-year Russian Norilsk Nickel (Baa2/BBB-), which were placed at 2.763% and 2.55% yield-to-maturity respectively. We have not received any allocations due to our yield limit. We like these names but we are not ready to buy them at any price.

We hope you will find this information useful and we will be glad to answer your questions

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