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Dickie's View October 2020

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Richard "Dickie" Hodges, Manager of the Nomura Global Dynamic Bond Fund, provides his view of the fixed income market environment:

- September saw a further increase in HY exposure, which now sits just below 20%;
- Our expectations for bank consolidation appear to be gathering wider support, with large mergers planned in both Spain and Italy. Our large exposure to Financials, across the capital structure, is well-placed to benefit;
- We expect to see inflation feed into the global economy as fiscal stimulus continues and the recovery begins. When it does, Central Banks have indicated that they are ready to let it run. It is not likely to surface yet, however.

Very early in September, we took profits on our long-dated Ghana and Egypt hard currency positions, believing that there would be better re-entry points. We did not have to wait long.

The Fund's exposure to the High Yield sector was increased slightly and, as indicated in previous reporting, we displayed a preference for sectors likely to benefit from an eventual economic upturn, with allocations (amongst others) to the Autos sector through ZF and Faurecia and Aerospace through Embraer.

The other clearly visible change to allocation was within Financials, where the net allocation increased due to the downsizing of the CDS-based hedge. We reduced the hedge after spreads widened across the sector.

By mid-month we were buying back into the some of the risks we had earlier exited. Notably Egypt, where we added back to the long-dated USD exposure.

## Strategy & Positioning – Looking Forward

Our medium- to long-term view of markets remains positive – we believe that current and future waves of both fiscal and monetary policy will drive risk markets higher, even though economic recovery will take longer.

Over the next few months, a number of key uncertainties will be removed from markets. Each is likely to cause some volatility and then, should the results be viewed favourably, each should then lead to another leg higher for risk.

The US election is one such uncertainty. Although the Democratic candidate appears to have a healthy lead in the polls, we know that the end result does not always reflect the polls. The markets tend to like a Republican winner, but even if Joe Biden wins, the market will probably expect further stimulus regardless and, if he appoints a more centrist team, this will also likely be taken as a positive.

Brexit is another. We do not have significant exposures to Brexit-sensitive assets. In our view, the result of the Brexit talks remains highly opaque. However, UK asset prices increasingly reflect Brexit risks and thus appear cheap, so we may seek to allocate in the future.

However, surely the greatest risk surrounds Covid. We believe that future lockdowns are likely to be more limited in scope or geography than during the first wave. The risk of a delay in the approval and distribution of a vaccine is more serious, in our view. We suspect that a vaccine that Western medical authorities are comfortable with will be released and distributed, but a delay to that would weigh on markets. Progress on a vaccine is likely to see capital markets move higher.

As we have repeatedly stated, we expect to see inflation feed into the global economy as fiscal stimulus continues and the recovery begins. When it does, Central Banks have indicated that they are ready to let it run. It is not likely to surface yet, however. Even when it does, the associated steeper yield curves that we expect will make government debt affordability problematic. It is reasonable to expect some form of yield curve control. Again, not yet.

Many of our key positions have remained in place for some time and have been described repeatedly in these commentaries. In addition to the themes mentioned previously, our expectations for bank consolidation appear to be gathering wider support, with large mergers planned in both Spain and Italy. Our large exposure to Financials, across the capital structure, is well-placed to benefit.

**Richard "Dickie" Hodges**

Dickie Hodges began his career in 1986 at Chase Manhattan Bank in Fixed Income operations, before joining Natwest Investment where he was responsible for management of a number of specialist investment funds employing derivatives and cash instruments to implement quantitative strategies.

He spent 18 years at Gartmore where he was Head of Pan European Portfolio Construction with responsibility for both their SICAV European Corporate Bond Fund and their SICAV European Bond Fund.

Prior to joining Nomura Asset Management in November 2014, Dickie held the role of Head of High Alpha Fixed Income at Legal & General Investment Management, managing its "Dynamic Bond Trust" – an unconstrained fixed income fund which he managed from its inception in 2007 until April 2014.

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