Artemis

Alex Ralph – Fixed income: Balancing risk and return

- Trump sees acting tough on China as more advantageous heading into the 2020 election
- Apple has reallocated somewhere between 30 to 50% of its Chinese production. We think this will be replicated by US companies across the board
- The US China trade spat is just one example of transitioning global politics away from globalisation on the back of populist rhetoric
- The EU has been particularly badly hit due to the export led nature of the economy, especially in Germany
- Europe has found a floor on manufacturing, but there are still challenges ahead. France's debt, for example, has sky-rocketed to 322% of GDP. Excess debt will be an issue for a long time to come
- Will the Fed be pre-emptive and cut in July? Fed fund cuts aren't backed-up by the economy, which is still growing at a reasonable rate. Would it encourage Trump's trade war? Or risky behaviour?
- Markets are already pricing in two or three interest rate cuts that they believe will prevent the recession and keep the economy back on track
- We believe the bubble is being created in growth companies, BB-rated and high yield bonds. Our base case is that Fed does cut in July because it doesn't want a panic
- Markets rallied hard last week on Draghi's 'in the absence of improvement, there will be additional stimulus' line. This is a U-turn from just a month earlier and shows the problems in the EU economy. However, we are not sure cutting already low interest rates will make a difference. Fiscal stimulus is likely
- A reversal of globalisation will push up inflation and is not supportive for growth. Future demographics are not as favourable. Could see wage inflation
- There is a need for nimbleness and duration management in fixed income
- Superficial resolution of trade crisis may cause a spike in government bond yields; any rally in equity markets may be short-lived
- Credit - profitability is starting to shift and debt is at all-time highs. Re-pricing is a threat
- We have been moving from high yield to government bonds in anticipation of widening spreads. We have the most over-leveraged balance sheets in history in the US
- There are opportunities in the banking sector
- Liquidity becomes more important the longer we move through the cycle