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AXA INVESTMENT MANAGERS

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# THE IMPORTANCE OF GOING GLOBAL

- Despite declining risk premiums across the board, yield opportunities are still available in the global credit market
- As global growth and inflation gradually rise, investors face the threat of higher interest rates
- A short duration approach could mitigate interest rate risk and volatility

## Low yield environment

Interest rates remain close to historical lows despite the global economy growing at a steady pace with the search for yield becoming more and more difficult. While the US Federal Reserve is in a tightening cycle, it remains gradual and the central banks of many other developed countries maintain accommodative monetary policies. The European Central Bank (ECB) has not yet provided details on its plan for exiting its quantitative easing program, but leaked language on tapering suggests modestly higher interest rates over the next two years as the economic situation continues to improve. Meanwhile the Bank of England is likely to be cautious on raising interest rates – it needs to balance inflation concerns and growth prospects against an uncertain background of Brexit negotiations and a minority Conservative government. However, should growth and inflation surprise on the upside, there is a risk that major central banks fall behind the curve and need to withdraw liquidity and hike interest rates more aggressively, which could lead to a sharp rise in global bond yields.

> "Investors have three ways to enhance yields: go down in the credit spectrum, look globally for opportunities or extend maturities."

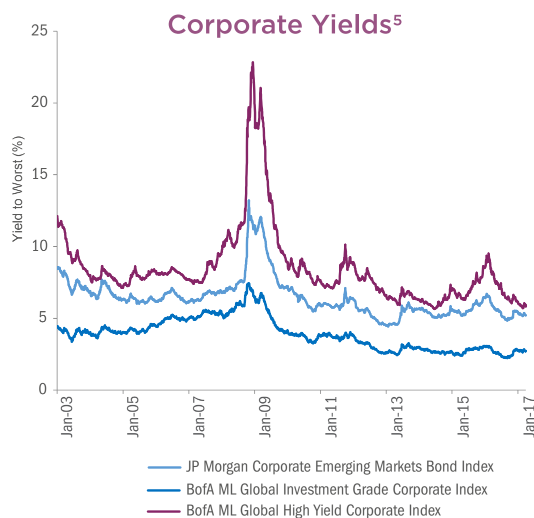
## The importance of going global: harnessing yield opportunities and diversification

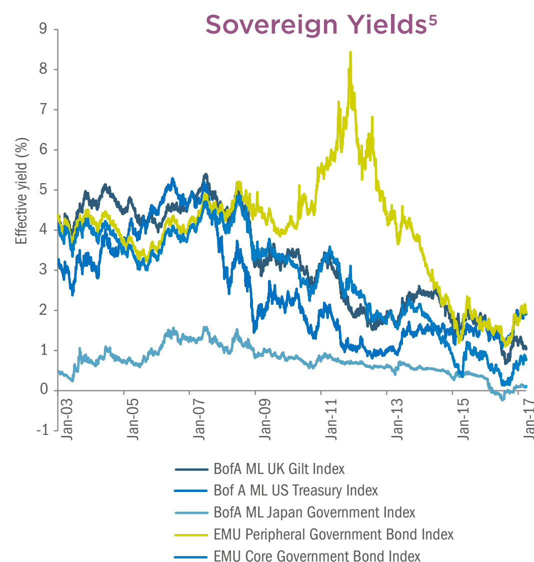
In our view investors have predominantly three ways to enhance yields: they can go down in credit quality, look globally for opportunities or extend maturities. Since the latter is not as attractive due to flat yield curves and the threat of rising yields, investors are increasingly embracing global markets in their hunt for higher returns. Despite declining risk premiums across the board, due to central banks' bond buying schemes, yield opportunities are still available in the global credit market. Depending on an investor's risk appetite, the yield pickup can still be quite rewarding.

By investing across the global fixed income market, investors can also benefit from enhanced diversification and therefore reduce portfolio risk. Investors can have access to a wider range of sectors and geographies compared to single markets. For example, the energy market in the US is much larger and more diversified than in Europe or the UK, and therefore offers comparably greater investment opportunities. To the same extent, the UK's securitised debt market and Europe's subordinated debt market are attractive areas that a global investor can benefit from.

Below is a summary of what can be achieved by investing in four of the major global bond markets: global sovereign, investment grade credit, high yield and emerging markets.

| | Global G7 Sovereign Debt[1] | Global Investment Grade Credit[2] | Global High Yield[3] | Emerging Markets[4] |
|---|---|---|---|---|
| **Market value (USD)** | 23trn | 9.8trn | 2.1trn | 0.4trn |
| **Yield to worst (%)** | 0.9 | 2.5 | 5.1 | 4.55 |
| **Modified duration to worst** | 7.8 | 6.4 | 3.5 | 4.55 |
| **Average linear rating** | AA2 | A3 | B1 | BBB |
| **Number of issuers** | 7 | 1,956 | 1,459 | 559 |




Source: AXA IM, Bloomberg 31 May 2017. Left side: BofA ML UK Gilt Index (GOLO), BofA ML US Treasury Index (GOQO), BofA ML Japan Government Index (GOYO), BofA ML Austrian Finnish French German and Dutch Government Index (NONE) and BofA ML Greece, Ireland, Italy, Portugal and Spain Government Index (EGLR). On right side: BofA ML Global Corporate Index (GOBC), BofA ML Global High Yield Index (HWOO) and JP Morgan Corporate Emerging Market Bond Index (CEMBI)

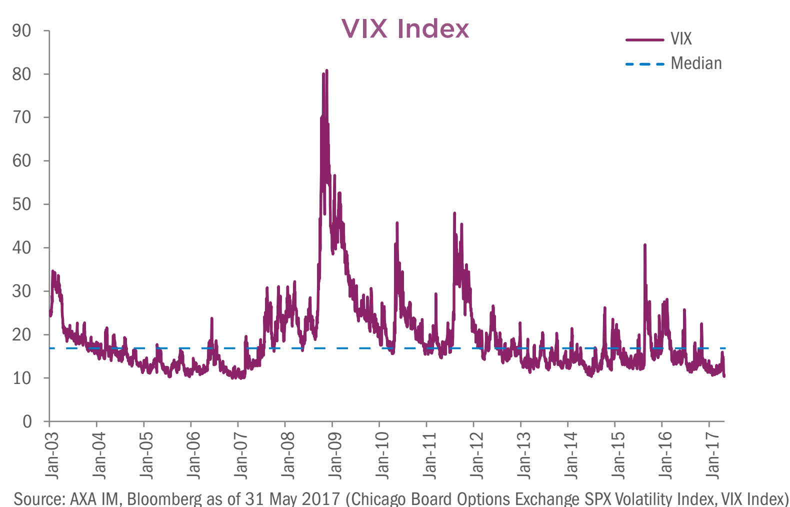
Another advantage of a global approach can be found in cross currency relative value trading. A key theme in today's bond market is the high level of issuance of 'reverse Yankee bonds' - these are bonds that are issued by US corporates in the Euro-denominated bond market. The ECB's bond buying programme and accommodative monetary policy have in some cases made it cheaper for US companies to issue bonds in Euros. As a result, global investors now have an even greater opportunity to pick one issuer's bonds in the cheapest currency and benefit from mispricing opportunities.

[1] Source: AXA IM, Bloomberg as of 30 April 2017 (BofA ML G7 Government Index, W0G7)
[2] Source: AXA IM, Bloomberg as of 30 April 2017 (BofA ML Global Investment Grade Corporate Index, G0BC)
[3] Source: AXA IM, Bloomberg as of 30 April 2017 (BofA ML Global High Yield Index, HW00)
[4] Source: AXA IM as of 30 April 2017 (JP Morgan Corporate Emerging Markets Bond Index, JBDYCOMP)

## Volatility is low, but will it last forever?

Global market volatility is currently at a historically low level, but this trend can be misleading. As the global economy grows at a steady pace, bond investors face the threat of higher interest rates. Coupled with this is an environment subject to potential market risks, including a more hawkish approach from major central banks and a possible further slowdown in China, political risks associated with the Trump Presidency in the US, Brexit and the minority Conservative government in the UK and the upcoming Italian elections in the EU, and geopolitical risks stemming from uncertainty over North Korea and the ongoing crisis in the Middle East.

All of these events could lead to higher market volatility, in which case taking a short duration approach could prove advantageous for investors.




Source: AXA IM, Bloomberg as of 31 May 2017 (Chicago Board Options Exchange SPX Volatility Index, VIX Index)

## To sum up

The investment environment today and in the near term have brought up a number of challenges, but also opportunities. With the yield hunt still ongoing, the global credit market can provide some relief through unique regional opportunities and diversification. Coupling this with a global short duration approach could potentially help investors find yield while managing interest rate risk and volatility.

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