

Bond management in a low rates environment

Peter De Coensel

Fund Manager

CIO Fixed Income



1

Undercurrents

2

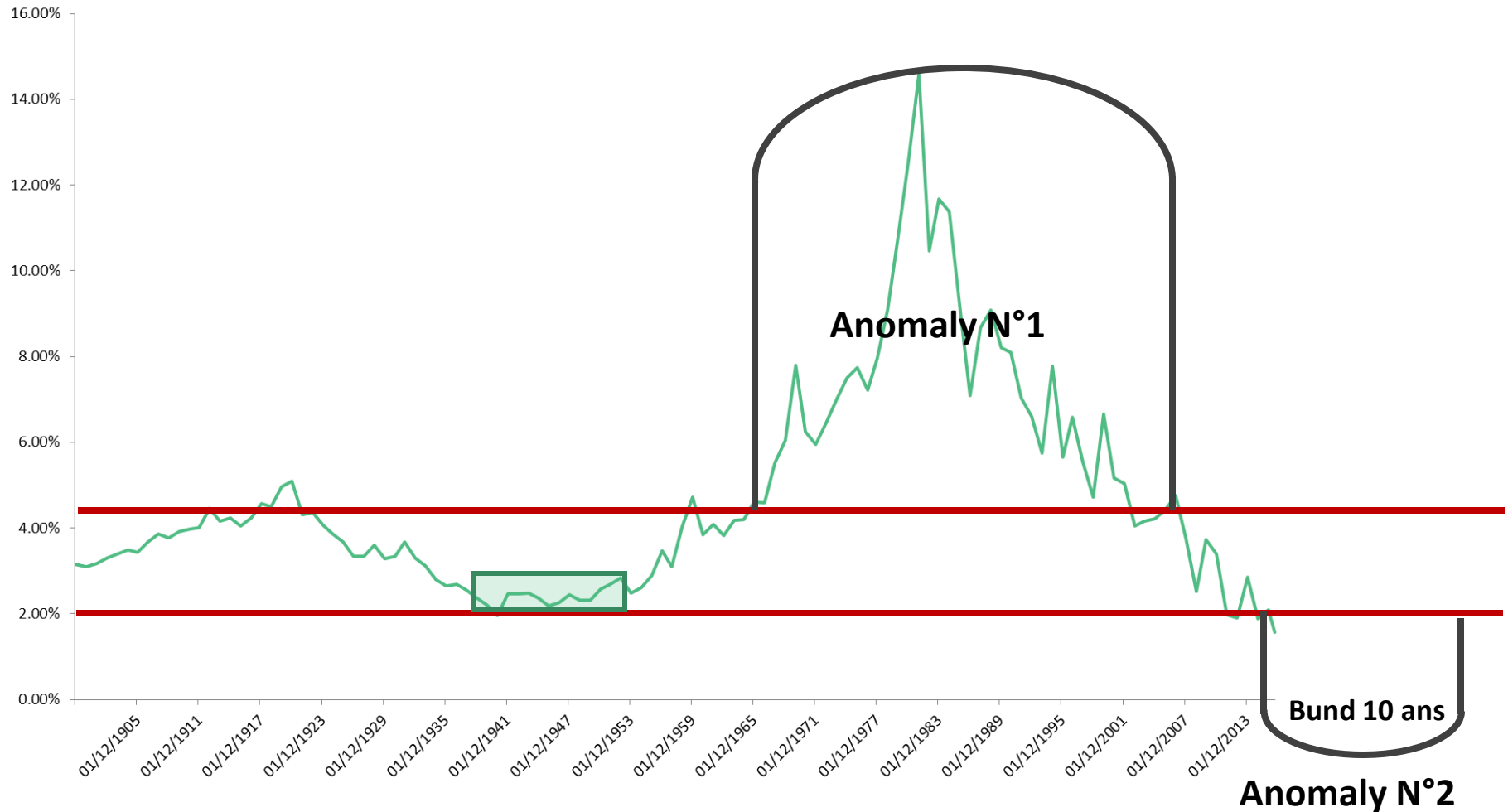
Coverage

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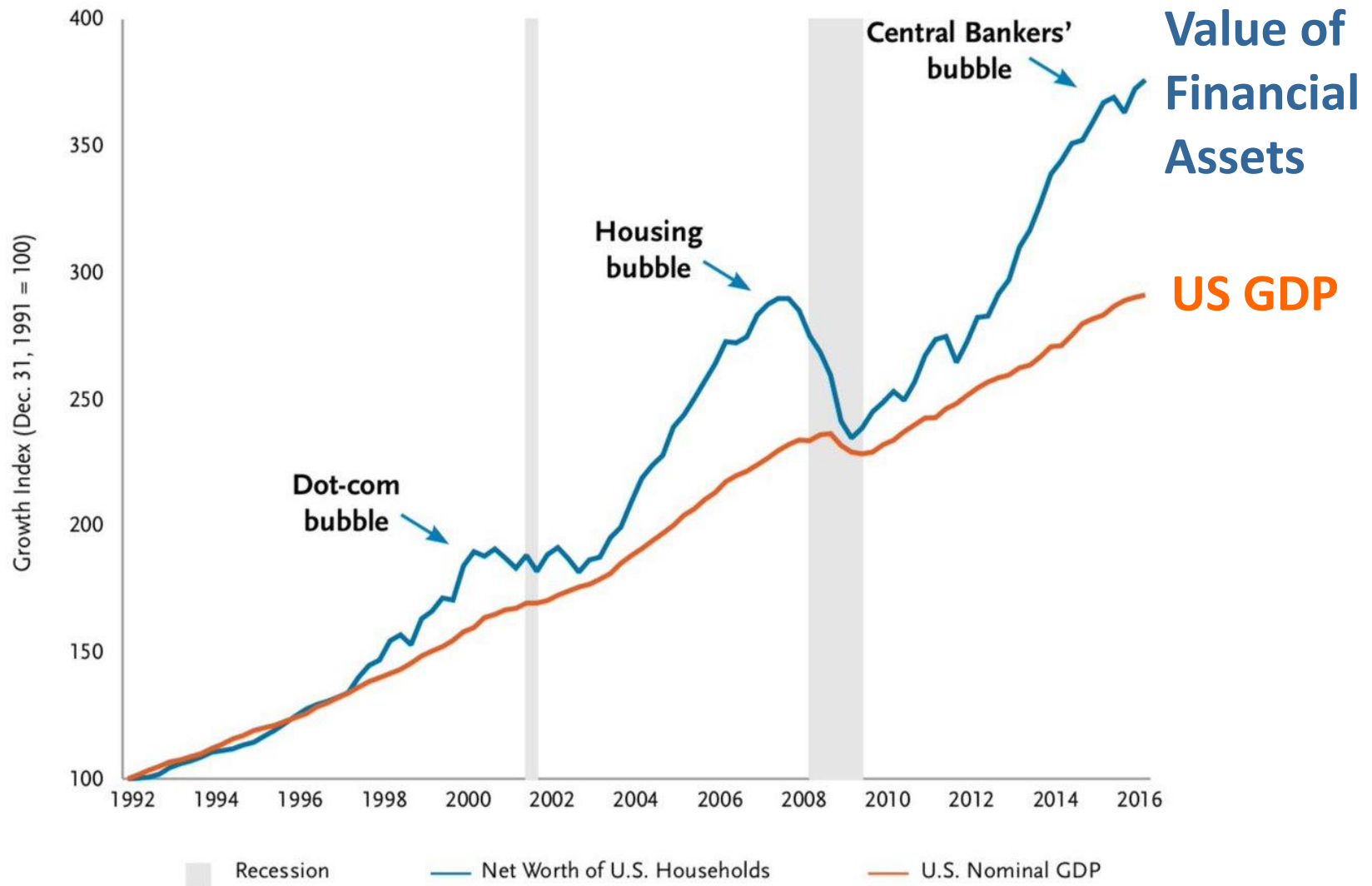
Today



US 10 year Treasury rates from 1900 till today



We are very well aware of the asset inflation due to QE



Source: Bloomberg, TCW



Bond investors are advised to:

Opt for smart diversification across fixed income sectors

Adhere to strict, daily risk controls and manage efficiently in low volatility world

Invest responsibly in order to reduce company or country specific risks

Select a, balanced, critical and experienced Fixed Income Team



Monetary policy is changing. Instead of chasing specific objectives...

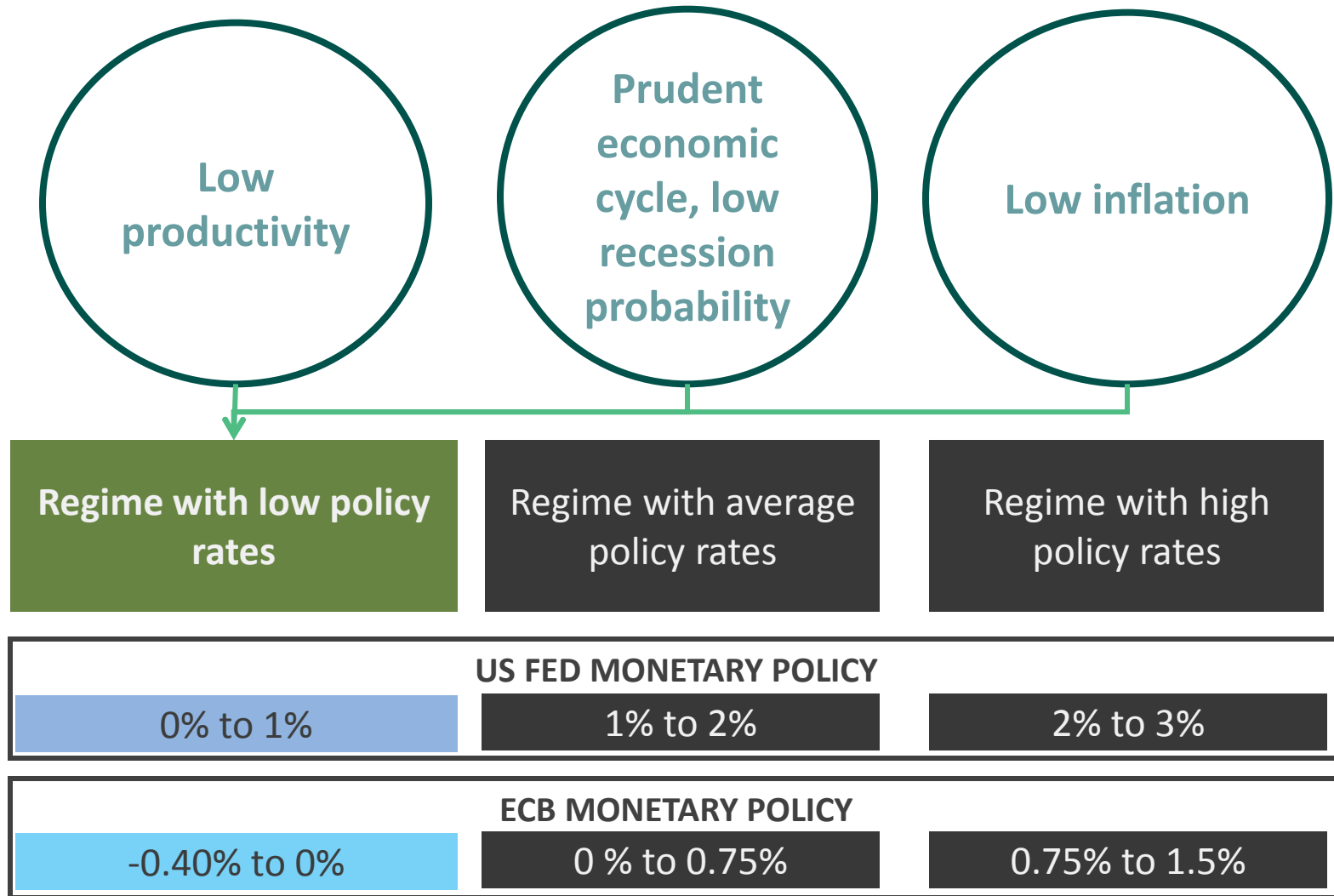
Improve potential
growth

Full employment

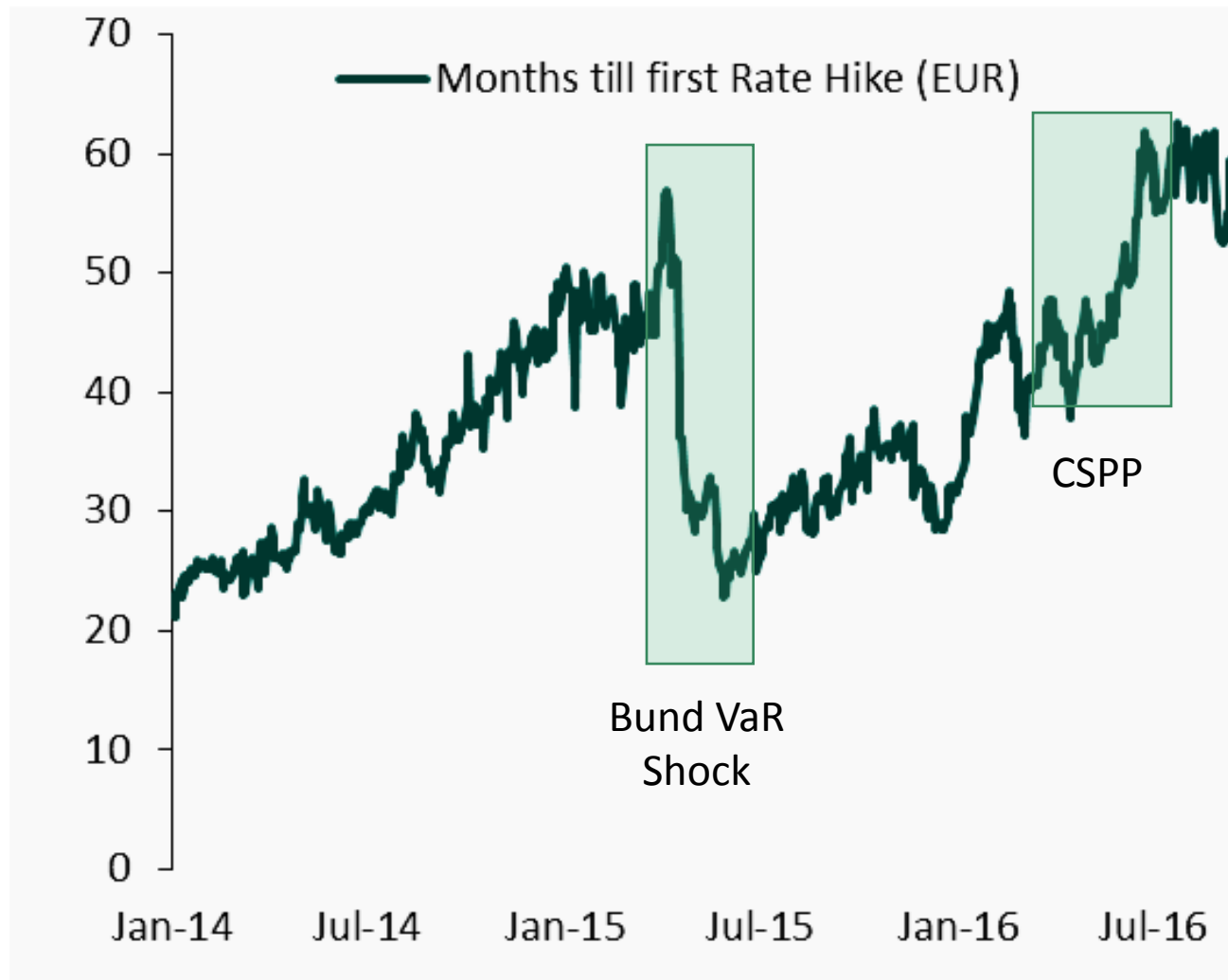
2.00% inflation target



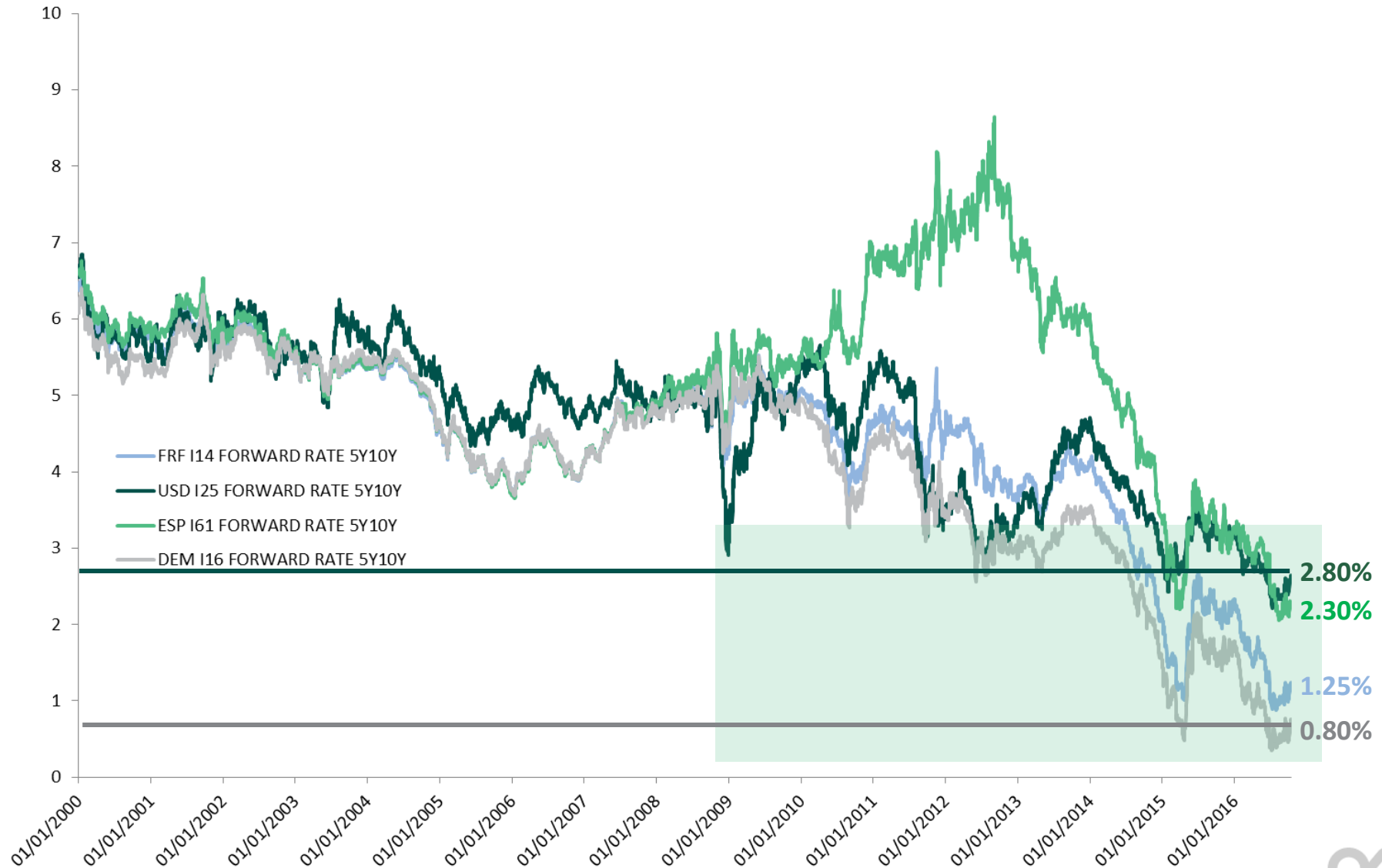
...central banks adopt stable and transparent policies aligned with a certain *regime*



Market pricing tells us that the ECB policy rates remain unchanged for the next 55 months or over 4 years



10 year rates 5 years from today: US, Spain, France and Germany



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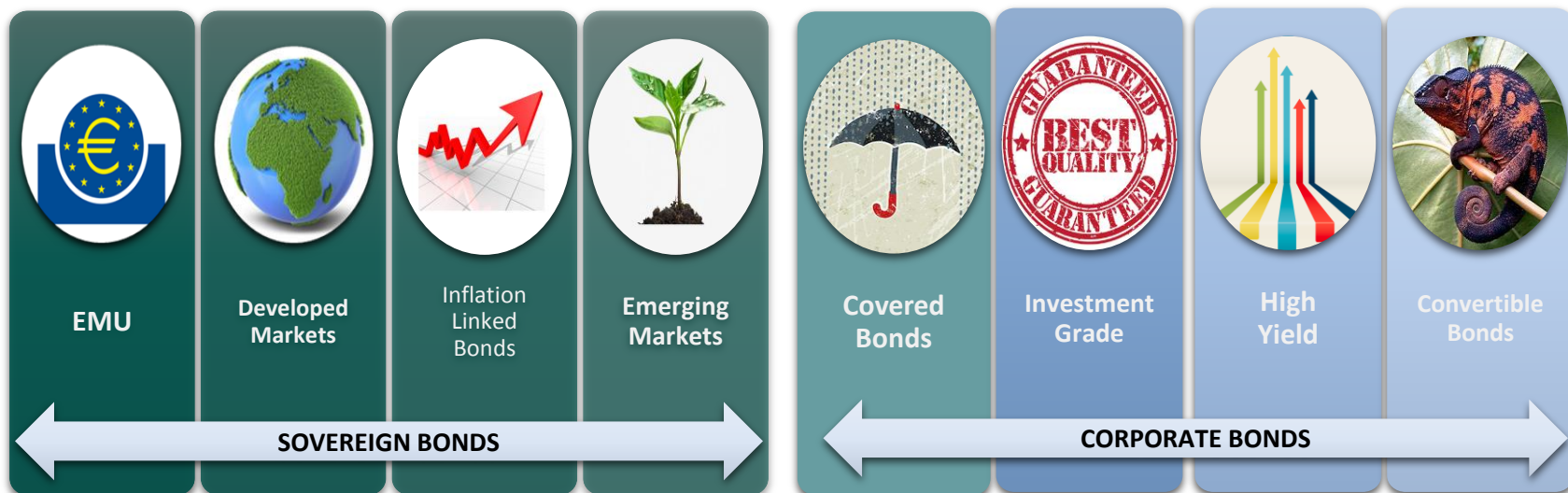
Coverage

3

Today



Global expertise



Team

GOVERNMENT BONDS FUNDS



10

'07

Ronald Van Steenweghen
Lead Manager



01

'16

Lowie Debou
Co-Manager

EURO GOVERNMENT



16

'09

Sam Vereecke
Lead Manager



04

'12

Pierre Renna
Co-Manager

GLOBAL GOVERNMENT & INFLATION



24

'10

Thierry Larose
Lead Manager



21

'07

Carl Vermassen
Co-Manager

EMERGING GOVERNMENT



14

'05

Ophélie Mortier
RI Coordinator

RI COMPETENCE CENTER

CORPORATE BONDS FUNDS



05

'11

Anahi Machado Tironi
Lead Manager



10

'06

Steven Decoster
Co-Manager

INVESTMENT GRADE



25

'09

Peter De Coensel
Lead Manager



04

'12

Pierre Renna
Co-Manager

GLOBAL BONDS UNCONSTRAINED



18

'05

Bernard Lalière
Lead Manager



22

'04

Marc Leemans
Co-Manager

HIGH YIELD

ANALYSTS



22

'13

Michaël Oblin
Head of Credit Research



09

'14

Isabelle Peiffer
Credit Analyst



04

'11

Andrew Deback
CFA, Credit Analyst



08

'16

Barbara Mainieri
Credit Analyst



11

'15

Arthur Homo
Credit Analyst



08

'11

Antoine Ruotte
CFA, Credit Analyst

CREDIT ANALYSTS



11

'15

Frederiek Van Holle
Team Leader



07

'11

Joeri Willems

QUANTITATIVE ANALYSTS

25

'09

Peter De Coensel

CIO Fixed Income,
Fund Manager



Convictions

COUPON

**CAPITAL
PRESERVATION**

**BALANCED AND
DIVERSIFIED
EXPOSURE**

**SELECTION OF BOND
RISK PREMIA**

**TOP DOWN
BOTTOM UP**

**CONTROL OF RISK
FACTORS (RATES,
CREDIT, FX)**

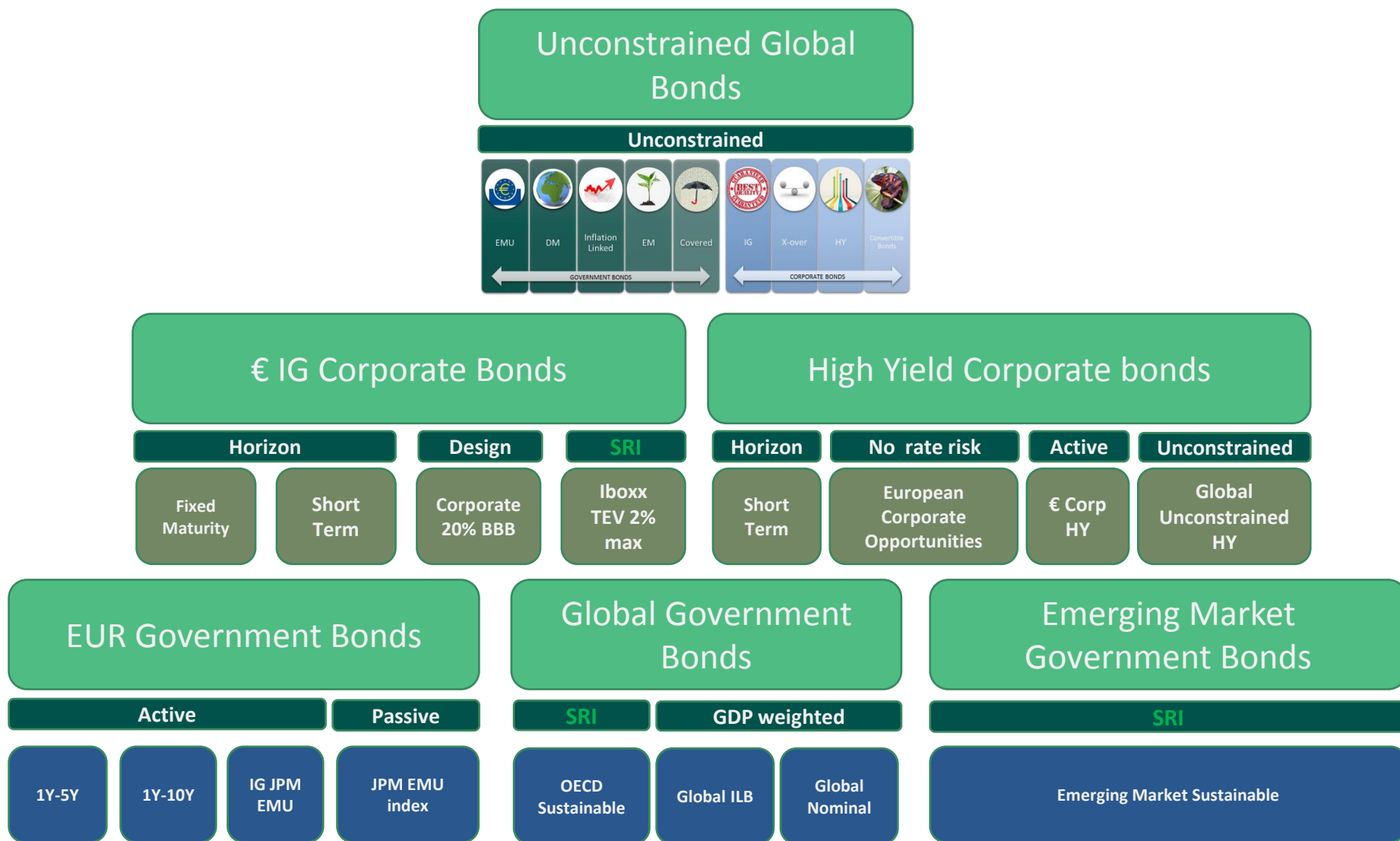
CONSISTENCY

REMAIN INVESTED

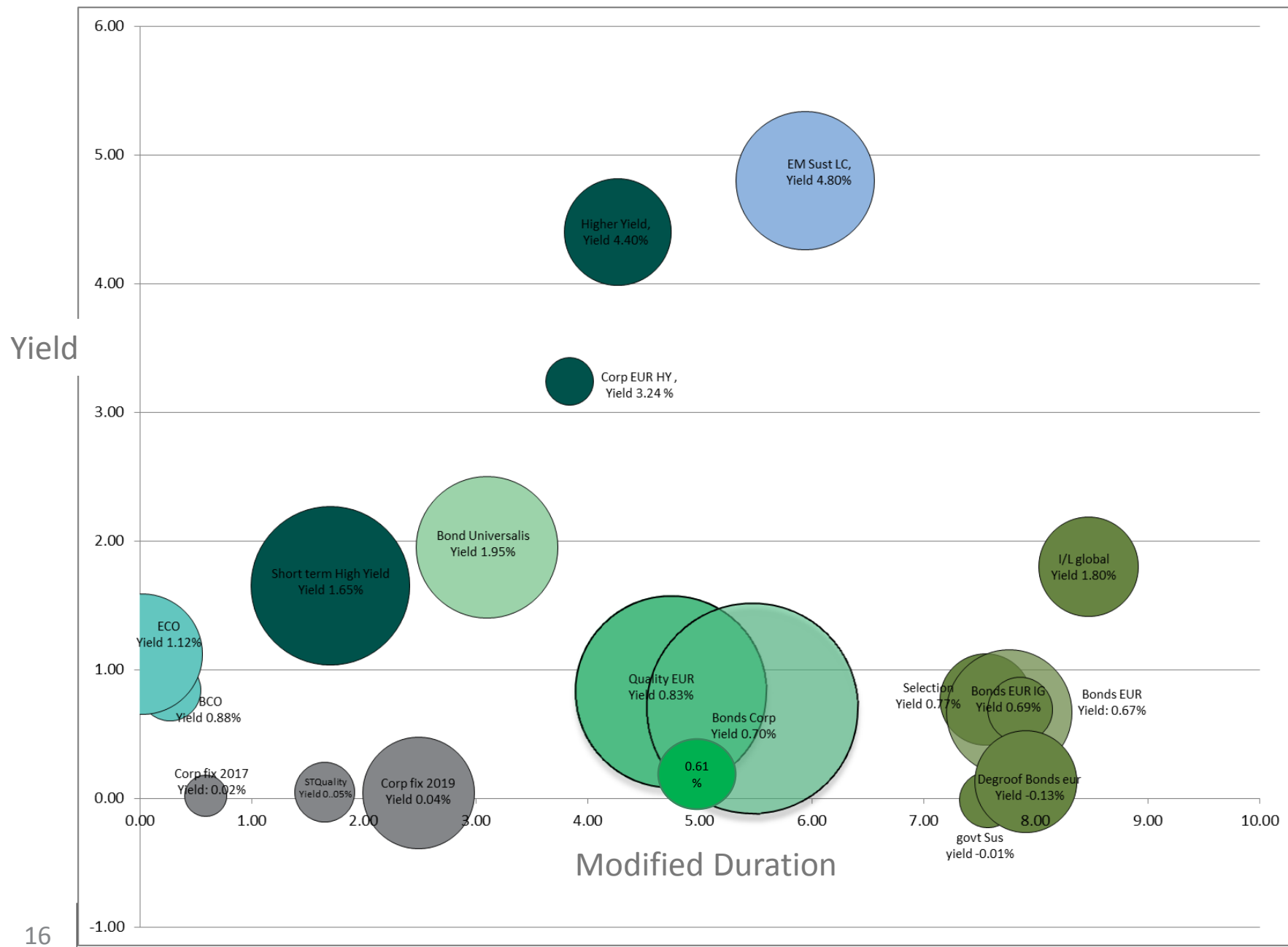
**ROBUST
PERFORMANCE**



Unique and diversified product offering



Yield versus Duration



1

Undercurrents

2

Coverage

3

Today













EUR Rates | We are remain bearish on LT core rates

Horizon	ECB			MM		2Y	5Y	10Y	30Y	Comment	- Duration +
	REFI	DEPO	LEND	EONIA	EUR 3M						
-1M	0.00	-0.40	0.25			-0.64	-0.51	-0.05	0.53		
Spot	0.00	-0.40	0.25	-0.34	-0.30	-0.67	-0.48	0.06	0.70	<ul style="list-style-type: none"> • Lots of central bank policy action. Yield curve control reshapes monetary toolbox. DB worries and taper show fragility of markets 	
3M	fwd rate	-	-	-0.37	-0.37	-0.64	-0.44	0.11	0.77	<ul style="list-style-type: none"> • Valuations remain too stretched given better incoming data / ECB QE program is almost hitting its limits and any changes will have detrimental impact on curve behavior on the ST / Market remains net long / Supply is not an issue / Post-Brexit fall-out limited / LT forwards and inflation B/E remain low 	<div> <div></div> <div></div> <div></div> <div></div> <div></div> </div>
	DP forecast			→		→	↗	↑	↑		
	BB Consensus (Q4 16)	-0.3	-	-	-	-0.55	-	0.05	-		
1Y	fwd rate	-	-	-0.41	-0.41	-0.63	-0.35	0.22	0.82	<ul style="list-style-type: none"> • Inflation should increase over coming months due to base effects / OPEC deal reinforces move • Credit growth is picking up but very slowly / monetary transmission channel more important in the future? • Market complacency on Brexit could be tested given PM May's current rhetoric • No election accidents should remove yield pressure on core rates 	<div> <div></div> <div></div> <div></div> <div></div> <div></div> </div>
	DP forecast					→	→	↗	↗		
	BB Consensus (Q4 17)	0	-	-	-	-0.60	-	0.15	-		
3Y	fwd rate			-0.30	-0.29	-0.21	0.07	0.52	0.94	<ul style="list-style-type: none"> • LT Forwards are pricing in a Japanese deflation scenario while ST are driven by ECB action ... do not expect Japanification scenario to realize • Demographics / output gap / excess savings / regulatory environment / balance sheet repair should keep interest rates however below "normal" levels for foreseeable future & longer 	<div> <div></div> <div></div> <div></div> <div></div> <div></div> </div>
	DP forecast					↗	↗	↑	↑		
	BB Consensus	-	-	-	-	-	-	-	-		



EUR Rates | Country Allocation

Country	10Y Spot	1Y Trend	1Y fwd	Macro	Carry & Rolldown	Spread vs History	Valuation	ECB QE Impact	Supply & Demand	Political Risk	-	+	Comment
Germany	0.06		0.22	--		=	--	+	+	=	<div></div>	<div></div>	Economic growth momentum picking up / Expensive vs. fundamentals / Merkel's popularity up after "entschuldigung" for refugee crisis / momentum fading
Austria	20.9		18.0	-		=					<div></div>	<div></div>	
Belgium	23.3		32.1	=		-			+		<div></div>	<div></div>	Industrial & Consumer confidence indicators are losing steam / Deficit reduction negotiations needed to avoid conflict with Europe
Finland	13.4		17.9	-		-			-		<div></div>	<div></div>	Economy seems to have bottomed out / Spreads remain at close to YTD tight levels
France	29.0		31.3	=		--		+	-	-	<div></div>	<div></div>	Q2 GDP number revised to -0.1% / Hollande's popularity is not pointing to a re-election / Though deficit action needed in the coming months
Ireland	48.1		59.1	+	+	-		-	+	+	<div></div>	<div></div>	Tax clash with Europe / Solid recent performance
Italy	134.0		149.3	=	=	-	+	+	+	=	<div></div>	<div></div>	Italian referendum due 4 December / Forward indicators remain mixed bag
Netherlands	11.7		13.3	-		-		++	-		<div></div>	<div></div>	Brexit impact should be mitigated by internal demand / Consumers are quite upbeat on the future
Portugal	338.1		380.2	-	+	+		+	=	--	<div></div>	<div></div>	DBRS rating review on 21 October / economic growth continues to be revised downwards
Spain	97.1		113.0	+	=	-		=	+	=	<div></div>	<div></div>	PSOE faces internal troubles / economic momentum remains solid



Global Rates | September Central Bank Action

- **US.** Warming up towards of Q4 hike (December).
- **BoE.** No further updates, they probably overdid it in August
- **Japan.** Moved to QQE with yield curve control, giving flexibility in the purchasing programme to target the 10 year yield at 0%. They will keep rates low until they have an inflation overshoot. They remove the time window of 2 years to reach inflation target. BoJ hasn't excluded cutting the 10y target, but don't see this as a current likely scenario.
- **Eurozone:** Left its rate unchanged, no extension announced. Somehow surprisingly kept their silence on any issue related to extension details. Keeping their options open for an extension announcement in December.



Global Rates | Market finally starting to price a Fed Hike

Horizon	FED			MM		2Y	5Y	10Y	30Y	Comment	
	Target Low	Effective	Target High	US OIS	LIBOR 3M						
-1M	0.25	0.42	0.50	0.42	0.84	0.73	1.12	1.53	2.22		
Spot	0.25	0.40	0.50	0.43	0.88	0.83	1.26	1.72	2.45		
3M	fwd rate	-	-	0.56	0.99	0.96	1.36	1.80	2.47	Markets are pricing very slow hiking path. We see a hike around the end of this year. This will need to push up short rates. Short/Medium term rates might come under pressure, but long end provides attractive carry which we want to capture. Linkers provide a good alternative.	
	DP forecast					↗	↗	↗	➡		
	BB Consensus (Q1 16)	0.43	-	0.7	-	0.92	0.93	-	1.73		-
1Y	fwd rate	-	-	0.76	1.15	1.16	1.59	1.96	2.54	We don't see the risk of a recession over the next year, despite some headwinds. Rates are fairly priced towards the long end.	
	DP forecast					↗	↗	↗	➡		
	BB Consensus (Q1 17)	0.92	-	1.2	-	1.39	1.38	-	2.16		-
3Y	fwd rate			0.98	1.41	1.68	2.02	2.32	2.69	Rates normalisation on the longer end of the curve following improvement in global outlook, in which case 10 year rates trend towards 3%, 30 year rates to 3.5%, reflecting a convergence towards moderate growth and (just below) target inflation over the longer term. This medium to long term moderate growth outlook is based on expected demographic effects, combined with low productivity increases and remaining high debt levels.	
	DP forecast					➡	➡	↗	↗		
	BB Consensus	-	-	-	-	-	-	-	-		-
Meeting Date		Nov 16	Dec 16	Feb 17	Mar 17	Jun 17	Jul 17	Sep 17	Nov 17	Dec 17	
Nr of Hikes priced in FFF		-0.04	0.52	0.61	0.83	1.10	0.96	1.27	1.27	1.41	Market still very slow to price hikes
Single Hike Probability		-4%	64%	10%	30%	29%	6%	31%	1%	16%	

Arrows indicate the Degroof Petercam view on United States interest rate behavior over a ST (3M), MT (1Y) and LT (3Y) horizon per different tenors. It is important to highlight that these views are expressed vs. market implied forward rates and not the current spot rates.

↗ Indicates that interest rates on this tenor will trade HIGHER than the implied forward rates over the investment horizon

↗ Indicates that interest rates on this tenor will trade SOMEWHAT HIGHER than the implied forward rates over the investment horizon

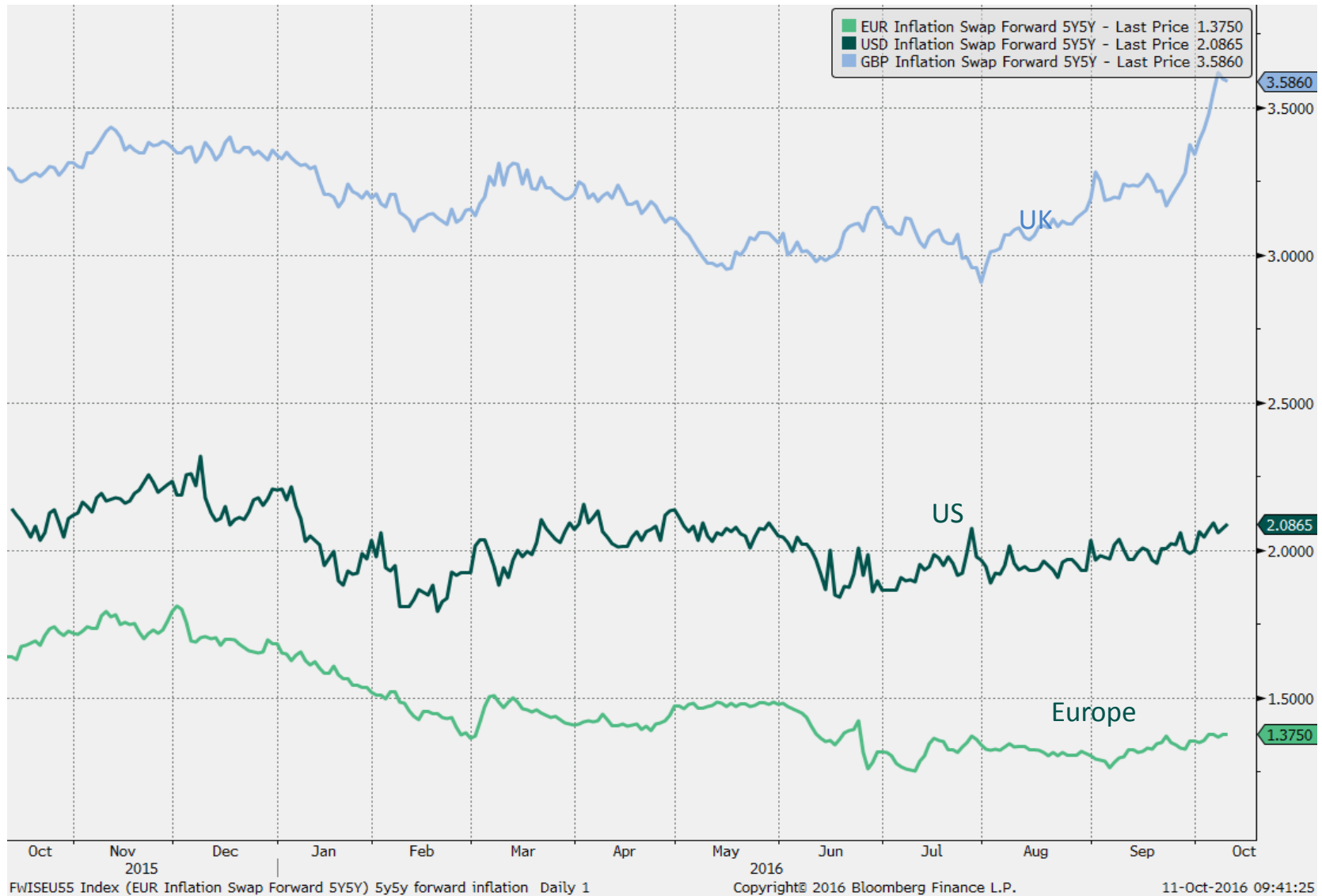
→ Indicates that implied forward rates are IN LINE with the DP view on this tenor over the investment horizon

↘ Indicates that interest rates on this tenor will trade SOMEWHAT LOWER than the implied

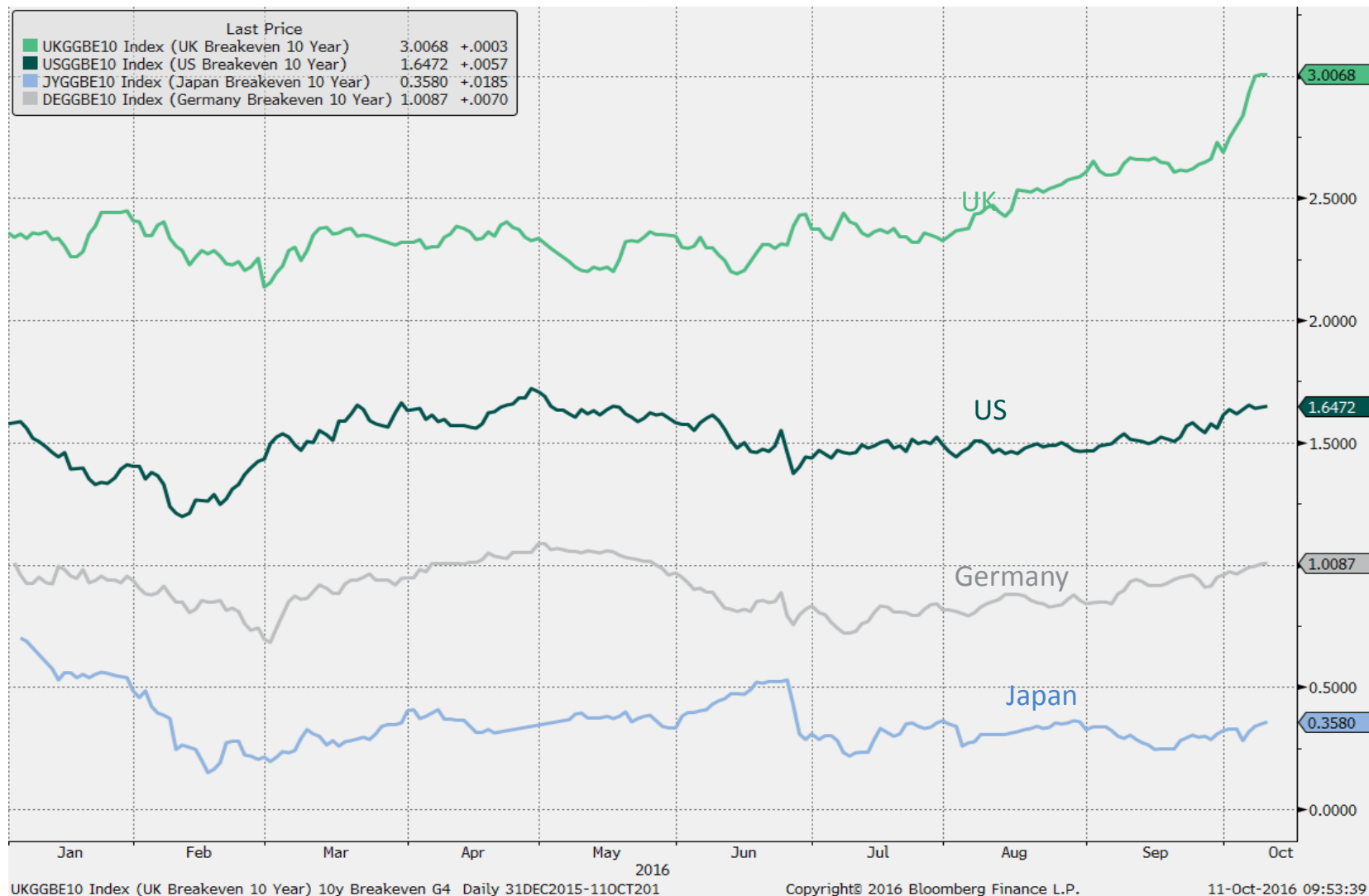
↓ Indicates that interest rates on this tenor will trade LOWER than the implied



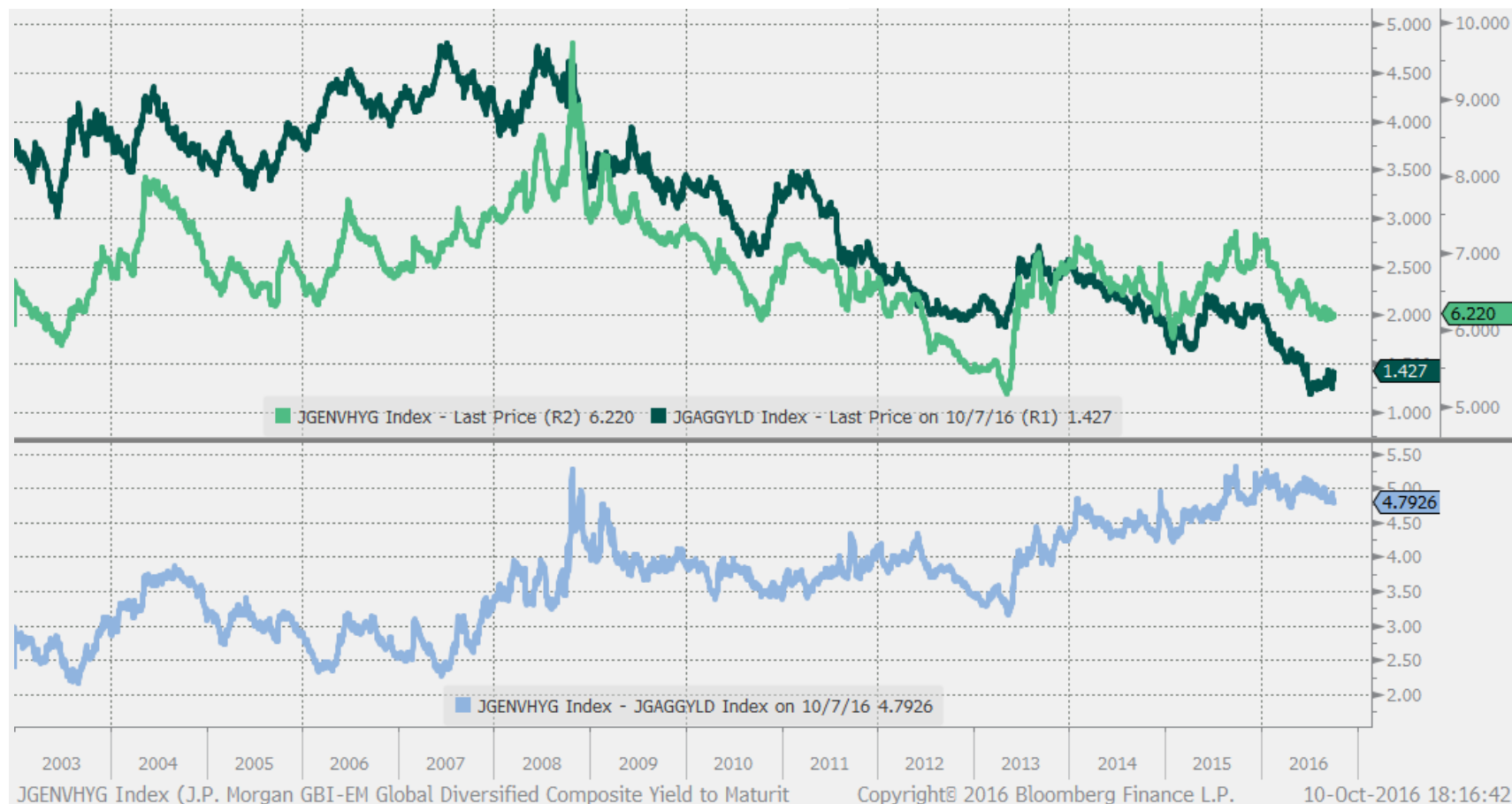
5Y5Y forward inflation expectations



Inflation expectations – 10 year inflation expectations



Emerging Market Bond Valuation: Spread still attractive



Spread between JP Morgan Global Aggregate and the JP Morgan GBI EM

Even after the stellar performance of local EMD, the valuation remains historically attractive



EUR Credit | Summary

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DIRECTION

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SHORT TERM

* **Heavy supply**: secondary curves should widen if investors are selling bonds to fund primary purchases (-)

* **Valuation**: most pockets of credit are at or near YTD tights (-)

* **Political risk** in the periphery (-)

* **Strong technicals**: ECB is managing to buy 1.5bn/week (+)

* EBC **extending the QE** program (+)

* **Supply** is being well absorbed by the market (+)

* **Supply** could disappoint (+):

Relatively little announced acquisition financing;

UK issuers turning to sterling markets

* **Negative deposit rates** encourage to reduce allocations to cash (+)

* **Inflation risk** subdued (+)

Mild tightening



Investment summary for European HY

Neutral on valuation grounds

- Corporate leverage has not increased over the year.
- Low rated issuance is limited.
- Banks continue to be supportive for companies.
- No increase in LBO's or frenzied M&A. Investors remain rational, and « bad » deals are pulled.

Nevertheless, spreads correctly reflect the situation. Equity volatility driven by geo-political events remains the key risk.



Relative Value | Summary

Summary - Fixed Income segments

General View

September 2016 might go into history as the month during which central banks stopped pushing on the string called NIRP (negative interest rate policy). Given a global DM regime that is characterized by low inflation, low productivity and steady business climate conditions we might have steady central banks in their policy rate setting, including the US Fed. One FED hike in December this year and done. That will anchor DM yield curves at current levels for longer. What are markets telling us today where 10y rates will be in 10 years' time? German 10y10y forwards sit at about 1.00%, Japanese 10y10y at 0.90% as well and US 10y10y Treasuries at 3.00%. Given the link with nominal GDP growth we might be fairly well priced here. Germany is expensive as is Japan. US yield curve has value at these levels.

Rates		Valuation		Positioning		Comment	-	RV	+
Country	Tenor	Yield	Vol	Direction	Curve				
Germany	10Y	0.02	54	-	↗	TRADING RANGE INTACT -25bp to +25bp. SCARCITY ISSUES WILL BE ADRESSED BY ECB IN Q4.	■		
USA	10Y	1.72	67	+	↘	EXPECT HIKE IN DEC 2016, CURVE REPRICED AND WE DO NOT HEDGE OUR USD RATE RISK ANYMORE WITH 10Y AT 1.72%			■
Japan	10Y	-0.06	26	-	→	MAINTAIN SHORT 10Y JGB RATES; Bank of Japan YIELD CURVE CONTROL POLICY	■		
UK	10Y	0.97	74	=	↘	NO DIRECTIONAL CONVICTION, EURGBP MIGHT TEST 0.98 BEFORE CONSOLIDATING		■	



Relative Value | Summary


Segment	Valuation			Positioning	Cross-Market	
Gov. Bonds	Duration	Yield	Vol	Direction	Like	Dislike
EMU	7.56	0.26	43	=	Periphery Covereds	FRA & PORT
EMU IL	8.17	-0.62	56	+	ITA & ESP linkers	FRA
DM	8.12	0.65	37	=	USA Periphery	JPN
DM IL	13.03	-0.73	42	+	USA Periphery	JPN
EM	5.03	6.22	62	+	BRA, ZAR	TUR
Corp. Bonds	Duration	Spread	Vol	Direction	Like	Dislike
EUR IG	5.29	112	32	+	BBB	
Financials	4.65	134	38	=	Core	UK
Non Financials	5.68	99	32	+	ECB-Eligible	
EUR HY	3.51	404	157	=	ECB-Eligible	
USD IG	7.03	138	38	=	Technology	
USD HY	3.90	476	197	=		




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