Global Asset Management

BlueBay Asset Management

Portfolio Manager Perspectives
BlueBay Investment Grade Debt Update

November 16, 2018

Coming up short

Concerns regarding slowing global growth were exacerbated by a sharp fall in oil prices, while in the UK, a wave of government resignations overshadow a Brexit deal.

Oil slump

Additional supply coming onto the market from Libya and Iran (following increased exemptions from sanctions) has undoubtedly been responsible for part of this move, but a declining delta on energy consumption with respect to Chinese growth is also a factor causing the IEA and others to moderate their projections on the demand side for oil.

With Chinese growth becoming more consumer-oriented and with the administration pursuing measures to moderate energy intensity, it is consequently understandable that this has fed into demand concerns at a time when Chinese growth itself appears to be slowing. However, we feel that it may be wrong to exaggerate these fears and with Beijing easing policy to support economic activity, we remain relatively constructive on the global outlook for 2019, with the US economy expected to continue to outperform.

In this context, we are not expecting oil prices to fall substantially further and feel that prices should remain in a USD$55-$65 range in the months ahead, even if we will be the first to confess that trying to predict spot oil prices can be a bit of a lottery at the best of times.

Fed pauses?

US core inflation showed some further moderation in October, declining to 2.1% having peaked at 2.4% in July. Although recent data appear to have confirmed an up-trend in wage data, broader price pressures remain benign and the Federal Reserve (Fed) should remain content to see this. If global growth does disappoint in 2019, it can be seen how this could lead the Fed to pause in line with what is already discounted in market pricing, yet we are inclined to look for a more robust outcome in the next few months.

German growth contracted -0.2% in Q3 but much of this was the result of a shut down in the auto sector related to changes with respect to diesel production. Production should bounce back in Q4 and Chinese measures to stimulate domestic demand should also support sentiment in the next few weeks.

With fiscal policy set to continue to power growth in the US in the next three quarters, we still believe that the Fed will remain on its path of rate hikes through 2019 and into 2020, and thus retain a short rates positions which is expressed via Eurodollar futures. We have held this position with a moderate size, partly wary that a flight to quality trade with equity markets moving lower could see rates rally and present a better entry point.

Brexit in name only

Elsewhere, headlines in Europe have been dominated by the news flow around Brexit negotiations. On Wednesday, Theresa May announced a draft agreement, which had been concluded with EU negotiators, yet any optimism was very short lived with Cabinet resignations following in the hours that followed.

In assessing the deal, it would appear to put the UK in a situation which delivers a Brexit in name only, maintaining access to the single market but remaining subject to EU rules and regulations at the cost of losing its ability to influence the agenda. In this context, both Remainers and Brexiteers are up in arms over a deal that offers the worst of both worlds and it is questionable at this stage if May will even fight on as prime minister long enough to put the deal to a Parliamentary vote.

We continue to maintain a bearish view on the pound, having increased our convictions levels in the past several days. In the short term, we suspect there may be a material rise in hard Brexit fears, which would see the pound under pressure. Ultimately, this may end in another general election or even a 'People's Vote', though first, we feel the Brexiteers will want to have their say and push their agenda – even potentially looking for one of their own to take over as prime minister.

With this backdrop, we expect MPs in the Labour Party to retain a degree of discipline as they spectate on the implosion of the Tory Party. Therefore, although the longer-term trade could be to look for higher Gilt yields in the medium term, it is the FX that may see the bulk of the move in the next few days and we see an opportunity for the pound to test its post Brexit lows against both the Euro and the dollar should events unfold as we currently expect.

Buy the dip

Corporate credit spreads widened over the past week following moves in equity markets. Negative news flow at a company level has seen several large issuers under pressure lately, with this week being the turn of Telecom Italia following the resignation of their CEO. In past times, the 'buy the dip' mentality has tended to stabilise spreads relatively quickly but as has been seen in deteriorating credit stories such as GE lately, underlying market sentiment now seem more punishing of the losers. Elsewhere, spreads in the periphery and emerging markets have also moved wider following moves in other risk assets in the past several days, with declining oil prices weighing on commodity exporters.

People's Vote

Looking to the week ahead, it does feel that we are very much in the Brexit moment where events in the UK offer substantial opportunity. As things stand we can't see May passing her Brexit Bill and the rise of the Brexiteers under the auspices of the European Research Group (ERG) seems the next likely chapter in this saga.

Ultimately, this chapter may be a brief one and with Theresa May even publicly acknowledging the 'No Brexit' is now a possible end-game should there be another People's Vote, it will be fascinating to see how events unfold in the next several days. Mind you, having seen the news that Tom Cruise is about to be replaced in the next Jack Reacher movies on the basis that he is vertically challenged…it seems like Theresa May isn't the only one who seems doomed in Coming Up Short, through little fault of her own…

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