aegon asset management

BondTalk

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AEGON INSIGHTS

Strategic Thinking: Looking back at the Strat Summer of 2024

Bond markets decided against a traditional "quiet summer" and instead gave us two bouts of volatility to book-end the period – the snap French elections in June/July and the "flash crash" in August. I thought it might be useful to provide some details on how the Aegon Strategic Bond funds reacted to these events.

Snap French Elections – June/July

Backdrop

- President Macron announced surprise lower house (Prime Minister) elections in attempt to quash the rising support for the Far Right led by Le Pen's Party.
- This sparked a sharp risk off move pushing credit spreads wider – especially French names – and Government bond yields lower.
- By the time of the actual vote in July, the support for the far Right had diminished and a crisis was averted/delayed.

Strategic Bond Fund - Actions

- Reduced further the already modest level of French credit risk in the fund
- Increased headline duration further to 8.5yrs to add more protection
- Opened a 10yr Germany vs 10yr France position to profit from underperformance of French Government bonds
- After spreads gapped wider: increased level of credit risk through reduction of credit default swap (CDS) protection – viewed these levels we viewed as unsustainable.
- Added cheap bonds that had "overshot" in the sell off
- Level of credit risk was reduced again in early July as the vote took place

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Outcome

- The fund was able to avoid the worst of the impact of the market weakness due to the lower overall level of credit risk and higher duration risk ahead of the event
- The fund was then able to then add value from its active management of this risk and exploiting bottom-up opportunities – in both Government and Corporate bond markets

The "flash crash" – August 2024

Backdrop

- Steadily weaker economic data – Consumer Price Inflation (CPI), International Securities Market (ISM) etc - was building expectations that the US Fed would start its easing cycle in September. Fed Chair Powell highlighted downside risks in the labour market as an area of concern
- US Non-Farm Payrolls surprised meaningfully to the downside, stoking fears of a weaker economic outlook than the soft-landing expected
- Equity markets and Government bond yields fell sharply; CDS spreads gapped wider, cash credit fell much less
- Market priced in 150bps of cuts by year end and a chance of an emergency cut – these extreme expectations unwound as the month progressed
- Bond yields backed up again and risky assets recovered as it became clear they had overshot (in the short term)

Strategic Bond Fund - Actions

- After the collapse in Government bond yields, we cut the duration risk from 8.25yrs to 7yrs therefore locking in gains and to protect against back up in yields.
- After the widening in spreads: increased credit risk through reduction of CDS protection
- We then increased duration to 8yrs again after a back-up in yields and our increased rate cut conviction
- The level of credit risk was then dialled down once more as spreads returned to more expensive levels again

Outcome

- The fund was well set up to absorb the volatility and through its flexibility, was also add additional value from its duration positioning and the tactical management of credit risk

The lesson of the Summer: When volatility spikes, Flexibility is key

What these examples outline is the benefit of an **active and flexible approach to fixed income investing** – this allows the fund to **quickly adapt to new information** to protection the fund if necessary, and then take **advantage of any anomalies** caused by volatility to add risk via cheaper assets.

By having **six different sources of alpha**, the Aegon Strategic Bond fund has a number of levers it can pull on – **both top down and bottom-up** – to exploit these opportunities effectively when they arise.

Simply having flexibility in your fixed income strategy is not enough; **the real test is whether you actually use it!**

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