FIMARGE
your independent wealth managers

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# LET'S NOT BE DISTRACTED

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In the last month the markets have shown their ability to make more than one investor doubt. Equities have fallen sharply three times, the euro has appreciated somewhat after having done it greatly during part of the month and sovereign and corporate bonds have suffered significant losses. In fact, the decline of fixed income during the month was more important than the correction in equities. Although bonds enjoy less media notoriety than the stock market, it is nonetheless an important part of most investors' portfolios.

Risk adverse investors consider fixed income as a low-risk asset that will yield a certain return to maturity. In principle this statement is true if we do not consider the risk of reinvesting the coupons and, above all, if we actually hold the bond to maturity. Unfortunately, in times of rising interest rates such as the last month bond prices are negatively impacted. The reasoning is as follows: to sell our bond we must offer the same return as a bond with similar characteristics, therefore we must offer a lower price to make it attractive. What I mean is that higher interest rates penalize bond prices because they incur the opportunity cost of not being able to obtain a higher current yield. Therefore, the sooner the bond reaches maturity the lower its opportunity cost and the sooner it can be replaced with a higher return bond. Longer maturity bonds are subject to a greater price drop because they have to endure a lower interest rate for longer.

We believe that the rising interest rates that have penalized our portfolios in the last month should not last much longer. Why? Because the economic recovery is not strong enough to increase inflation and any unexpected event can make it wobble. In recent months we have been positioning our clients' portfolios in short maturity bonds or, in some cases, in longer maturity bonds because we believed that the improvement in their issuers' balance sheets should translate into lower financial costs and therefore into higher prices. As you can see, the relationship remains reversed.

As an example of this credit analysis we conduct, consider the 2020 Heinz bond in dollars offering a coupon of 4.25%. After improving its balance sheet through its consolidation with Kraft, the company has decided to execute its repurchase option and replace the bond with another one sporting the same maturity but a 2.8% coupon. This operation has brought in a profit to our clients in a month of June in which most bonds have lost value.

If in the next few weeks the market moves in our favour, we will slowly increase our positions in equity at lower prices and in fixed income at higher interest rates in order to build portfolios with higher performance expectations.