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MORNING ESPRESSO

Interview with Karsten Bierre, Head of Fixed Income Allocation within Nordea's Multi Assets Team

Flexible Fixed Income Plus and Conservative Fixed Income Strategies

Please note the conference call occurred on the 10th of February 2021. All market commentary and information refer to the period before then.

Key takeaways

- Attractive Fixed Income yields are very difficult to find these days and there is little likelihood of this changing in the foreseeable future.
- Strategically and tactically we are cautiously positioned towards traditional government and corporate bonds.
- Rather than just increasing the credit exposure, we prefer to leverage on existing alpha-sources and flexibility to keep returns up.
- With the addition of the Conservative Fixed Income Strategy and the Flexible Fixed Income Plus Strategy we now have a solution for every fixed income investor's need.

Your proprietary Assumption Paper stands at the cornerstone of your investment models: can you remind us of you return expectations across the Fixed Income space?

We expect returns from fixed income to remain very low – in negative territory for the higher quality segment – over the coming decade. After a decade of monetary stimulus through both rate cuts and QE, there is little expectation from the markets of these changing over the coming years. At the same time, credit spreads have tightened to close to pre-Covid levels, even though Covid and the associated economic challenges are still out there. Some investors are looking at inflation proxies to boost returns, but in Europe we see the risk of low inflation to be greater than the risk of high inflation. Thus it is not easy for investors to find fixed income returns without moving far along the risk spectrum.

What are your current portfolio views?

Strategically, we are very cautious about both duration and credit risk. Tactically, the same is true. Within our tactical duration model, we consider valuation, fundamental momentum, and the trade-off between these. We are low in duration risk. We assess credit tactically too. At the moment we see positive risk momentum, but the spreads simply aren't wide enough to offer insulation against credit events so we remain cautious here too.

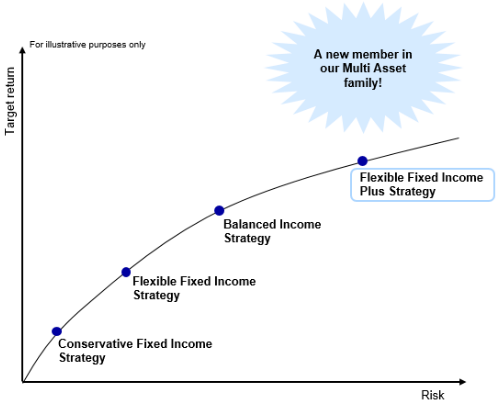
In that case, where can you turn?

Our approach is based on the risk balancing principles, where we balance defensive drivers with risk-on drivers. In the fixed income space, defensive drivers would be high quality government bonds, such as German Bunds, and risk drivers would be in spread products like high yield. But given the negative yields of Bunds, we have to ask how much portfolio protection they can actually offer: we need to remain flexible in order to deliver returns without increasing portfolio risk. We need to take a flexible approach to Strategic allocations, and to manage risk carefully in our Tactical allocations. One area we are able to find returns is through active currency management. This isn't new, it's always been a part of our strategy, and we can still find returns here.

Can you tell us about the new Flexible Fixed Income Plus strategy that you've launched?

In our range of fixed income strategies we follow the same investment risk balancing approach and philosophy – combining defensive and aggressive return drivers with reliable negative correlation. We then tailor each strategy to target different levels of risk and return.

In today's negative cash environment, some of our clients seek a highly liquid solution able to serve as an alternative to cash. This is our Conservative Fixed Income strategy, which targets a cash plus 100 basis points return.[1] We also have a slightly higher risk version, our Flexible Fixed Income strategy. It has the same focus on limiting downside and a high degree of liquidity, but with a target of cash plus 200 basis points.[1] Our Balanced Income strategy adds some equity exposure on top of the more traditional fixed income instruments in the Flexible Fixed Income strategy. This enhanced risk profile enables us to target cash plus 300 basis points.[1] The newest member of our stable in the Flexible Fixed Income Plus strategy, which doubles up the positions in the Flexible Fixed Income strategy – easy to do, since many of our positions use derivatives anyway – to target returns of cash plus 300-400 basis points.[1]



	1/2x FFIS	−	+	1 TO 1.5X FFIS + Eq	2x FFIS
	CFIS	FFIS		BIS	FFIPS
Expected Volatility	1.5-2%	2-5%		3-6%	4-10%
Target Return	Cash + 0.7–1%	Cash + 2%		Cash + 3%	Cash + 3-4%
Portfolio Context	Negative yield on cash	Alternative to safe Govies		Alternative to Credit	Alternative to Credit
Investment Universe	Fixed Income, Currencies	Fixed Income, Currencies		Fixed Income, Currencies, Equities (0-25%)	Fixed Income, Currencies

~~There can be no warranty that an investment objective, targeted returns and results of an investment structure is achieved. The value of your investment can go up and down, and you could lose some or all of your invested money.~~

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