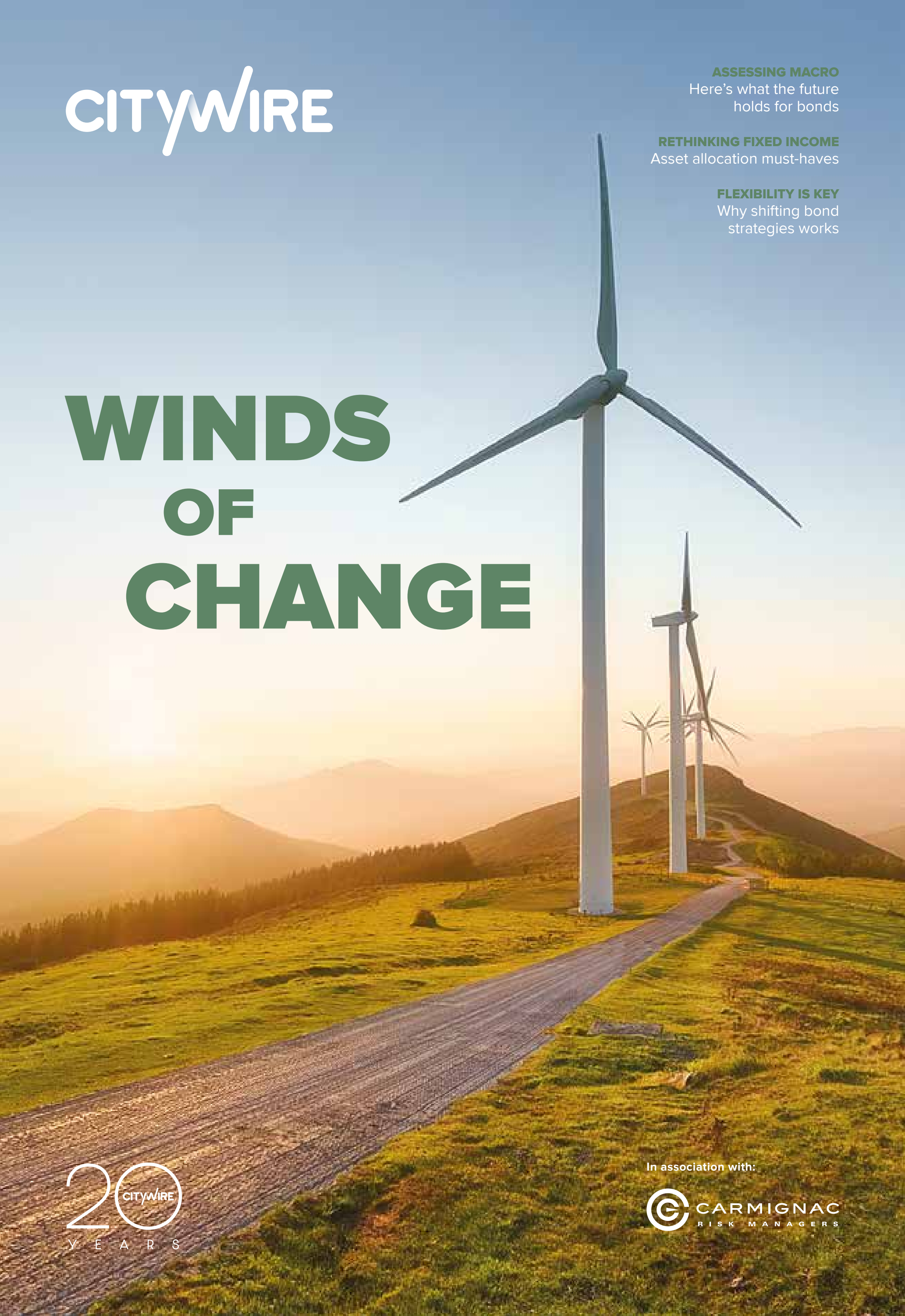
Citywire

ASSESSING MACRO
Here's what the future holds for bonds

RETHINKING FIXED INCOME
Asset allocation must-haves

FLEXIBILITY IS KEY
Why shifting bond strategies works

WINDS OF CHANGE



Citywire 20 YEARS

In association with:
CARMIGNAC RISK MANAGERS

A NEW WORLD ORDER

'There will be social unrest', predicts one fund selector, if central banks keep lowering interest rates, putting the finances of many savers at risk. In response, he says, banks should change their policies to avoid the common criticism that they are not independent. This sombre idea and more was at the centre of a recent Citywire roundtable event, in association with Carmignac, where key fund selectors shared their biggest calls on fixed income in an ever-changing macro environment.

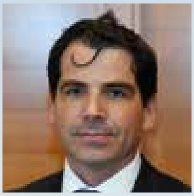
The debate also touched on the many changes happening in the global economy, including the slowdown in growth, and how the strong communication skills of newly-appointed ECB chief Christine Lagarde might pan out for investors. Overall, the panellists agreed that a bigger change in fixed income might be looming. For example, in a system where pension funds continue to focus on bonds, new policy rules might shift the attention back to equities.

So where does all this lead to? Fund selectors have different options for their bond allocations, where the asset class is clearly becoming more difficult to position in portfolios. One panellist sees three options, suggesting investors 'go very short-term bonds, you go with more illiquid strategies or you change the asset class'.

A more optimistic conclusion is that investors need to invest in bonds whatever the outlook, and other suggestions point to the use of unconstrained strategies as a forward-looking option that would play on flexibility.

Finally, panellists expressed their views on what this flexibility really stands for and how it fits into their thinking. 'We hope to get it right', declared one panellist, echoing other fund selectors' comments on just how challenging the world of bonds has turned out to be.

Panellists



FABIAN KALBERMATTER

BANK JULIUS BAER

Fabian Kalbermatter is the portfolio manager of the Julius Baer Multi Manager Fixed Income Unconstrained fund at Bank Julius Baer, where he combines specialised credit managers with flexible and absolute return-oriented fixed income managers. Prior to joining the firm in 2016, he was responsible for the construction and management of the fixed income fund building blocks of the UBS discretionary business. Before that, he was a fund analyst with a focus on fixed income products for the UBS discretionary and advisory business. He graduated from University of Bern with a master's degree in economics and finance.

OMAR GADSBY

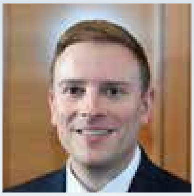
CREDIT SUISSE

Omar Gadsby is director and head of fixed income and multi-asset class fund selection in Crédit Suisse's private banking and wealth management division in Switzerland. Before joining the firm in 2005, he was a senior fixed income fund analyst at Standard & Poor's in London. He started his investment career in 1995 as a foreign exchange trader on the fixed income team at Merrill Lynch Asset Management in the US. He holds a degree in finance and economics and a master's in business administration. He is also a Chartered Financial Analyst.

MARTIN BÜRKI

MARTINVESTMENTS

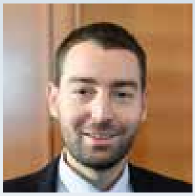
Martin Bürki is the founder of MartInvestments and specialises in the selection of mutual funds and the composition of fund portfolios. He has more than 16 years' experience in fund research, fund portfolio construction and building up an open fund architecture. His firm services private clients and provides consulting services to banks and independent asset managers in Switzerland. Before founding his own company, Bürki was responsible for building up the European fund research team for UBS.



ALEXANDER LAUBER

ALPINUM INVESTMENT MANAGEMENT

Alexander Lauber heads the business management unit at Alpinum Investment Management. Previously, he worked at Morgan Stanley (Switzerland), where he focused on operational tasks, especially for hedge fund exposure. Before joining Morgan Stanley, he worked at fundinfo, a leading international platform for information and mandatory publications of investment funds. He was responsible for the classification of investment funds. He began his career in 2006 at Raiffeisenbank where he worked in the front office advising retail clients. He holds a master's degree in finance and banking.



ELIEZER BEN ZIMRA

CARMIGNAC

Eliezer Ben Zimra is a fixed income fund manager at Carmignac. Eliezer joined Carmignac in 2019. He started his career in 2008 at OneSeven Capital Management, as a fixed income derivatives trader. In 2010, he joined Capstone Investment Advisors as assistant fixed income portfolio manager, further to which he joined the fixed income research and strategy division of Amundi. In 2011, he was appointed total return fixed income fund manager at Edmond de Rothschild Asset Management. He holds a Master in statistics, economics and Finance from ENSAE and a Master of sciences in Applied Mathematics from Harvard University.

WHAT TO MAKE OF THE FUTURE MACRO LANDSCAPE?

Citywire: There's a lot going on within the macro landscape right now, making markets quite hard to navigate. How are investors approaching this?

Omar Gadsby: Monetary policy was somewhat of a surprise this year for us. We started the year not anticipating easier monetary policy. However, that clearly unfolded. That's obviously supported risk assets.

But at the same time, there is a limit. For instance, we saw the Swedish central bank governor highlighting that negative interest rate policy has not stimulated growth to the extent anticipated.

With that concern around negative interest rate policy particularly, I expected this could start to resonate with other central bank heads across the EU. We heard after the recent 10 basis points cut by the ECB [European Central Bank], the Austrian central bank governor also raised significant questions around further easing monetary policy.

After a very strong run this year, we're quite short duration in Europe. We do not anticipate a big increase in interest rates, and certainly many countries will head back to zero. But rates are already anchored so low.

Eliezer Ben Zimra: There has been a clear slowdown. We've seen a deceleration in manufacturing activity since the beginning of the year in China, the US and Europe, related to trade tensions. But also, for example, in the German auto sector. And in recent months, we've seen a spill-over from manufacturing to the service sector, particularly in Europe. In addition, we do not expect the economic data to improve much.

That is why the ECB has decided to ease its monetary policy by lowering its key interest rate and restoring quantitative easing. While in the US, we experienced three consecutive rate cuts and the end of the balance sheet reduction.

We continue to believe that the data-dependent Fed [US Federal Reserve] still has room for monetary easing, which explains Carmignac Unconstrained Euro Fixed Income's long positions on the long-end of the US yield curve. We also believe that emerging market central banks will lower their key interest rate due to real rates being too high in some countries, such as Mexico, Russia and Turkey. While inflation levels are plummeting, inflation targets are far from being achieved, suggesting that these central banks have enough room to lower their rates, especially with a Fed that continues its cutting cycle, a set of elements that explains our overall buying position and a current increase in the portfolio duration.

Alexander, how do you see the macro picture?

Alexander Lauber: We mostly agree with this view. For us, we tend to be short-term invested. I mean, there are different things that are hard for us to position. It's not just the interest rate environment, there are also many political tensions, the trade war, Brexit and all these different things. It's all happening together, which makes things difficult.

Because they feed uncertainty.

Alexander Lauber: Definitely. They feed on uncertainty, and maybe from a portfolio, tactically, there are some opportunities to benefit from rates.

Is the appointment of Christine Lagarde to the ECB a further drift towards the politicisation of central banks?

Fabian Kalbermatter: I think that's an interesting point. The independence of the central banks is so important and it will sustain going forward, as well.

You could argue that, if you look at Lagarde's background, coming from the IMF, she's brought in a lot of restructuring for that purpose. It's something that the eurozone needs at this stage. A lot of her speeches are already directed towards fiscal policy. It's now in the hands of the governments to push the economy further, and there, we agree as well.

I think, in Europe, we see that monetary policy has really reached its limits, and the next step will be the fiscal side.

Omar Gadsby: It's become clear that Christine Lagarde is potentially one of the clearest and strongest communicators in the finance world, and should there be a region around the world that needs clear communication and guidance, she would be the right person for that job.

So, I think if there's one strong argument for her taking this role, it's her success at very clear communication, which is required for the European region right now.

I just wondered whether people felt we were going back to a more political angle?

Martin Bürki: I think we first distinguish between the US and Europe. The US is a totally different economic cycle. We also expect that central banks will cut rates, but what we see in the US right now is that the real rates are already starting to rise.

That's very interesting. If you look at our political system and social system, it is built on

positive interest rates. If you have negative interest rates over a long term, this will strongly put the intergeneration contract – the idea that current generations will support futures ones – in question.

For example, young people today at the age of 18 to 22 entering the workforce know full well that it's likely they won't have enough money in their pensions when they retire. This will totally change the political outcomes and social systems that we've seen before.

Based on that, I think that we can have low interest rates for an additional two years, perhaps, and then it has to change. There will be social unrest.

You're saying the policy change will come as a reaction to the social unrest.

Martin Bürki: Exactly. The first thing politicians may do is change the rules for how pension funds have to invest money. So more in equity, less in bonds. This can have a positive effect on the equity market. And if the interest rates are still negative, then the independence of central banks will be put into question.

So we are headed into a new paradigm?

Eliezer Ben Zimra: Actually, that's exactly what [outgoing ECB president] Mario Draghi has been saying. There are some surveys showing how many times he said 'fiscal policy', and the number of times has been rising exponentially. Monetary policy has reached some limits. So, now, there has to be a transition from the monetary policy to the fiscal policy and that's why the nomination of Lagarde, but also de Guindos as vice president of the ECB, has happened. I think they are really important.

Alexander Lauber: But we're not there yet. Many of the finance ministers across the EU also refuse to start fiscal stimulus, as in Germany, for example. So, the question is: who is able to put the pressure on to change things here?

Martin Bürki: The reason why the system currently works is because a lot of investors are forced to buy bonds, like the pension funds. But it will change. The pressure will rise stronger and stronger and then the rules will be changed.

That's a very sombre thought.

CARMIGNAC
RISK MANAGERS

GLOBAL BOND MARKETS: WHEN COMPLEXITY EQUALS OPPORTUNITIES

Bond markets have been massively distorted for the past ten years. Almost everywhere in the world, financial repression by central banks has led to particularly low rates. For bond investors, it has meant a bull market of historic proportions. Holding bonds over that period was undoubtedly relevant, but it would have been even better with an active risk management. This is what we have implemented within all our Carmignac fixed income strategies, while exploiting their unconstrained nature by being flexible.

Nowadays, it is apparent that bond markets are entering a new era. The global economy is now seriously weakening, but at the same time central banks are limited in their capacity to go back to old recipes. Inflation expectations are still weak, but long-term rates are visibly reaching support levels. This is clearly not good news for passive investment in bonds: simply going long duration won't do the trick anymore. However, being flexible, able to move from positive to negative modified duration across global bond markets will make a difference.

A DIFFERENTIATED APPROACH TO FIXED INCOME MAKETS

In such an environment, finding value in bond investments is becoming more and more challenging. Our solution: to be "unconstrained", thanks to an active and global investment approach, relying on great flexibility in managing exposures through a non-benchmarked philosophy. This opportunistic philosophy provides our unconstrained fixed income Funds the ability to navigate extremely diverse market environments.

For whom? Investors looking for bond performance drivers at a time when yields are extremely low and subject to volatility spikes. Our unconstrained strategies may be suitable for investors seeking opportunities outside Europe, which is undergoing historical financial repression, since it aims to benefit from both rising and declining rates and to seize bottom-up opportunities through our disciplined risk management framework.

AN INVESTMENT PHILOSOPHY BASED ON THREE PILLARS

1

FLEXIBLE ALLOCATION

Pertinent tool kit to manage exposures through wide modified duration brackets & use of credit derivatives

2

GLOBAL INVESTMENT UNIVERSE

Developed and emerging markets
Sovereign and corporate bonds

3

NON-BENCHMARKED APPROACH

No bias to any curves, regions or economic sectors

1. A FLEXIBLE ALLOCATION

Our Unconstrained Fixed Income Funds navigate different market conditions thanks to a pertinent tool kit. For example, wide modified duration brackets that can go from negative to positive territory are used with the objective of generating positive performance even in a rising rate environment and containing the downside when facing market risks.

2. A GLOBAL INVESTMENT UNIVERSE

These Funds deploy a global fixed income strategy which exploits a broad and diversified investment universe to identify opportunities across the globe. Our Fund Managers seek to implement interest rate, credit and, for those authorized to do so, currency strategies (Carmignac Portfolio Unconstrained Global Bond) in both developed and emerging markets.

3. A NON-BENCHMARK APPROACH

Our non-benchmarked investment approach enables us to build high-conviction portfolios that are based on our top-down views. Having latitude in terms of regions, sectors and asset classes gives us the opportunity to unearth performance drivers in both bull and bear markets.

OUR UNCONSTRAINED FIXED INCOME FUND RANGE

	Investment universe	Main limits[1]	Recommended min. investment horizon	Risk scale[2]
Carmignac Portfolio Unconstrained Global Bond Luxembourg SICAV sub-fund	International bonds	Modified duration: -4 to +10 Average minimum rating ≥ BBB- Structure credit allocation <10%	2 years	4
Carmignac Portfolio Unconstrained Euro Fixed Income[3] Luxembourg SICAV sub-fund	International bonds Euro hedged	Modified duration: -3 to +8 HY corporate bonds + emerging markets bonds < 50% Structured credit allocation < 10%	3 years	3
Carmignac Portfolio Unconstrained Credit Luxembourg SICAV sub-fund	Global credit markets	High Yield allocation: <50% Emerging markets allocation < 25% Structured Credit allocation < 20%	2 years	3

(1) Other investment limits may apply. For more information, please refer to the KIID (Key Investor Information Document) or the prospectus of the Funds. The Funds' KIIDs and prospectus are available at www.carmignac.com. (2) For the share class A EUR Acc. SRRI from the KIID (Key Investor Information Document): scale from 1 (lowest risk) to 7 (highest risk); category-1 risk does not mean a risk-free investment. This indicator may change over time. (3) New name of Carmignac Portfolio Capital Plus, following changes made to the prospectus of the fund. The Fund's objective, strategy and investment universe have been reviewed, as well as other characteristics. These changes came into effect on September 30, 2019.

Main risks of Carmignac Portfolio Unconstrained Credit: CREDIT: Credit risk is the risk that the issuer may default. INTEREST RATE: Interest rate risk results in a decline in the net asset value in the event of changes in interest rates. RISK OF CAPITAL LOSS: The portfolio does not guarantee or protect the capital invested. Capital loss occurs when a unit is sold at a lower price than that paid at the time of purchase. CURRENCY: Currency risk is linked to exposure to a currency other than the Fund's valuation currency, either through direct investment or the use of forward financial instruments. Main risks of Carmignac Portfolio Unconstrained Global Bond: CREDIT: Credit risk is the risk that the issuer may default. INTEREST RATE: Interest rate risk results in a decline in the net asset value in the event of changes in interest rates. CURRENCY: Currency risk is linked to exposure to a currency other than the Fund's valuation currency, either through direct investment or the use of forward financial instruments. DISCRETIONARY MANAGEMENT: Anticipations of financial market changes made by the Management Company have a direct effect on the Fund's performance, which depends on the stocks selected. Main risks of Carmignac Portfolio Unconstrained Euro Fixed Income: INTEREST RATE: Interest rate risk results in a decline in the net asset value in the event of changes in interest rates. CREDIT: Credit risk is the risk that the issuer may default. CURRENCY: Currency risk is linked to exposure to a currency other than the Fund's valuation currency, either through direct investment or the use of forward financial instruments. EQUITY: The Fund may be affected by stock price variations, the scale of which is dependent on external factors, stock trading volumes or market capitalization.

RISKS AND OPPORTUNITIES: RETHINKING FIXED INCOME ALLOCATION

Citywire: Fixed income is clearly changing. We were starting to see the beginning of this two years ago. Given this, how are you approaching your fixed income allocations?

Omar Gadsby: The big point, as you say, is the asset allocation. The traditional fixed income asset allocation, given the current environment, has to change – and it will. I think that's the overwhelming consensus.

Historically, we're typically 70% invested in developed markets, 20% invested in emerging markets, and 10% invested in cash and cash equivalents in a fixed income asset allocation. Clearly, the 70% invested in developed markets is excessive right now.

So, it's very important for us to identify better solutions in emerging markets where the negative interest rate problem does not exist, where you capture higher real yields. That's important. And actually, we've enjoyed good success around more defensive strategies in emerging markets. Short duration emerging market debt has worked extremely well for us.

We are exploring more defensive emerging market local currency solutions too.

Within developed markets, we have decided to explore more private fixed income opportunities. Our typical client historically has been invested 90% in public debt and approximately 10% in private debt, and the private exposure has been a leveraged loan exposure.

Now, we are exploring opportunities in other private solutions, which helps to diversify the fixed income mix.

Martin Bürki: In general, if you look at the environment you actually have three options. You go very short-term bonds, you go with more illiquid strategies or you change the asset class.

What's interesting is if you look back at the last 30 years, bonds are less risky than equities. But if you look forward, at least over the long term, I think it's maybe different – stocks may be lower risk than bonds. And if you take that into consideration, then maybe an allocation in dividend stocks is safer than in bonds.

That's certainly been the case this year, where people have used stocks for income and bonds for capital gains.

Eliezer Ben Zimra: I might agree with you if you have the choice. But a lot of our clients need to invest in bond markets.

That's why the solutions that we can propose are unconstrained solutions, meaning that we think benchmark-oriented funds or ETFs will have some trouble ahead of us. In the fixed income space, we have to move more strongly to flexible and global approaches, where the asset allocation and the management of the interest rate risk can be managed more actively. I think that will be crucial in years to come.

That leads us to a technical question. How should investors be managing the interest rate risk of their portfolios?

Omar Gadsby: That's clearly an issue. I would argue for us, the policies that we have focused on over the last 12 to 18 months has been to introduce more floating rate securities into a portfolio.

Floating rate assets can reduce your weighted average duration. That's very important. They also give you convexity.

Often you would like to capture a high coupon bond that is less sensitive to government interest rates and where we have captured convexity, it's in bad debt, subordinated bad debt.

So, we have approached this challenge via going down the capital structure in good companies.

We believe the banks are safe. We believe banks have been recapitalised – they've increased over 500 billion of capital over the last seven years, particularly in Europe. Risk-weighted assets have come down.

We're actually happy to go down the capital structure in bad debt. In these areas, you capture less sensitivity to interest rates. Actually, often they're positively correlated to interest rates. So, more floating rate assets. And subordinated financial bonds have also helped the interest rate concern somewhat.

Fabian Kalbermatter: We have a similar view on duration. It's time to be cautious on duration in developed markets, Europe and the US. So that means we prefer credit over duration at the end of this stage.

If you look within credit, we like the crossover segments still. So that means higher-quality investment grade. So, the double-B, triple-B space. We think the spreads are still quite fair in that region, and additionally, what we like is emerging market corporates.

That's something which we've played for quite some time, and we are still constructive.

The reasoning is that central banks are accommodative at this stage so that's positive for emerging markets, which are also being helped by the Federal Reserve. But spreads are at close to a five-year average there. We like that space as well.

Alexander Lauber: I think that's also the opinion of my colleagues. There're still opportunities to invest in in specific asset classes. It gives you a decent return and you're not taking too much risk. But you have to be unconstrained in choosing your asset.

For example, when we talk about duration risk, we prefer also short-term high yield corporate bonds in the US. We see opportunity to get decent returns there. There's high visibility to know what's happening with the company or not happening. There's a strong pull to par effect and we keep the duration risk low.

Another asset class we prefer is our loans. These are floating instruments, so we benefit in case the interest rate rises. We still see an attractive risk premium we can earn.

Finally, I also have to say there's also an option to better position your portfolio with active management. For example, in the short term, you still can use some instruments like credit default swaps on some indices. You can partially benefit from changes in the interest rate environment.

Do we agree with the need to be actively invested then?

Martin Bürki: Most investors make the mistake that they think they can buy an ETF, that they will get similar returns and its low risk. But what they don't see is that in the last five years, the duration of the benchmarks doubled or tripled.

They've done well this year, perhaps. But they're actually in a much higher risk than they have been before and they're not aware of that.

What we do is look for more flexibility in order to take opportunities worldwide. There are also assets like floating rate or also US municipal infrastructure bonds, which you can't invest individually yourself, and holding an ETF may not be appropriate either.

So overall, where are the risks?

Fabian Kalbermatter: We're more cautious on duration and developed markets. We still prefer credit over duration. It's something we've liked for quite some time and that's still the case. And another part where we are a little bit cautious at this stage is European high yield. If you look at the European high yield index, quite a lot of cyclicals are in there, and if you look at the economic backdrop in Europe, you see some risk spread widening in European high yield. Given this, we're cautious in European high yield and we prefer the US names, where we see a better economic backdrop at this stage. That's from our side.

Alexander Lauber: Given our defensive mandate, we similarly can't have too much duration risk. We're keeping duration low. What we prefer instead is short-term high yield corporate bonds in the US. We also like loans, which are adjustable to interest rates, and, of course, what we try to avoid is everything that is negative yielding.

Martin Bürki: You could say, if you look a bit back over the last 20 years, investing in fixed income was pretty easy, but investing in equities was pretty challenging. I think this is totally changing now.

To invest in fixed income is getting really challenging and investing in equity is getting much easier. Given this, you need a broad strategy that can really take opportunities worldwide in high yield, in floating rates, in all these kinds of strategies.

We combine several absolute return strategies in a portfolio, but you have to be really careful that you're not simply adding products with all the same style. In some cases, it's good to have products with negative duration. Another one, by contrast, is more on the floating rate side, and another one is focused on Asia or the US. All these kinds of strategies you have to combine in a very clever way.

Omar Gadsby: I agree. I'd only add that we've been reducing credit risk, but focusing more on capital structure as a big theme. We go down the capital structure in an investment grade bank or utility and capture our yield from a subordinated security in a high-quality company versus capturing outright credit risk in European high yield.

Identifying good opportunities in emerging markets is another theme. We've been in frontier markets; for example, Egyptian T-bills are yielding 14% over one year, but the currency has actually strengthened and interest rates have come down over 250 basis points over the last six months.

I think the message here is that you have to go outside of your comfort zone -- but sensibly, and that's been the point. Emerging markets, capital structure, explore more alternative income. And be flexible. Those are really the key takeaways.

BE NIMBLE: WHY FLEXIBILITY IS BECOMING KEY IN FIXED INCOME

Citywire: How important is it to be flexible with your fixed income allocation nowadays? And what's the best way to implement flexibility in an overall portfolio?

Fabian Kalbermatter: We like flexible managers, and we think it really makes sense at this stage. You really need to look at what kinds of risk-drivers are behind any given fund, and you need to combine different fund managers and really diversify the styles and regions where they are.

Absolute return funds can do this, of course. But an important point with unconstrained or absolute return managers is that even the most sophisticated managers get it wrong from time-to-time. That's why you need to stick not to one manager, but really combine them.

Alexander Lauber: As we have a multi-manager approach, for us, it's key to be flexible. We want to know their risks and exposures. So we know the risk and we remain flexible, shifting between these different niche strategies.

Eliezer, you're running an unconstrained strategy – what is the best way for people to implement flexible and unconstrained approaches?

Eliezer Ben Zimra: I think we have to define what 'flexibility' is in the fixed income space. Our definition relies on three pillars.

The first one is the active management of asset allocation. So, saying that we can invest in all the different segments of the fixed income markets with no constraint on it. So, for example, right now in the fund that I manage there is 35% weighting to cash and money market papers in the portfolio. Why? We realise that fixed income markets are expensive and that there will be better entry points. So that's also flexibility. There is no forced position and we are not invested all through the year at 100%. That means you can take advantage of market corrections to increase the positions in the high yield sector or on sovereigns, etc. That's one part of flexibility.

The second part is the management of duration. For us, we can go from minus three to plus eight in duration. And we can play different parts of the curve, such as flatteners and steepeners, to add even more value. So, the first two pillars are more top-down pillars and the third is bottom-up security selection. We rely completely on the experts for our choice of issuer and issuances. We acknowledge that one manager cannot be an expert on all the different asset classes, and so, luckily, we can rely on experts in emerging market debt, credit, high yield, etc.

Omar, what does flexibility mean to you? How does it fit into your thinking?

Omar Gadsby: I have one word which describes my flexible approach and it's 'hope'. We hope that they get it right. It's the most difficult asset class as a fund selector.

Over my two decades of selecting managers, I've observed that these unconstrained funds, they go through regimes. They have three or four years of good performance and then something happens and then they go away. It's very hard to observe an unconstrained strategy that's on a 10-year-plus track record that's consistently good.

Martin Bürki: If you look a bit at these unconstrained manager peer groups, you realise 80% are more like global macro managers with a hedge-fund-lite strategy.

If you want to combine a solid portfolio, you have to add some totally different strategies to that because, as Omar said, there are some managers who outperform for three or four years and then suddenly get it totally wrong.

We like H2O, for example. They're crazy guys, but we have fit it in the portfolio since they offer something different as well as solid returns. But it's not easy to communicate these strategies to clients.

Speaking of flexibility, what's the biggest call that a fixed income investor has to make right now?

Omar Gadsby: I would say the biggest call would be your attention to your government bond exposure, and duration especially. If you look at where the imbalances are, it is in developed market government debt. US government yields can go down, so I agree with the slightly longer duration view in the US. But in Europe, I think you have to be cautious. So that's an important area.

On the corporate side, default rates are still materially lower than the 20-year average, so corporate credit risk isn't as big a risk. I think sovereigns pose the bigger risk.

Martin Bürki: As I said before, investing in bonds for the last 20 years has been easy, but it's now getting extremely challenging. That means investors will want to employ active managers that have the capability of much more hedging. The days of holding a single name bond until maturity.

Eliezer Ben Zimra: Maybe we didn't talk a lot about it, but liquidity is still poor in fixed income markets and can be far poorer still if we enter a real crisis. So that's why we are really cautious on the credit risk. When we do add some credit risk to the portfolio, we are really vigilant on the name and the structure of the issuer.

Fabian Kalbermatter: I think the biggest thing investors need to realise is that not everything that worked in the last five or 10 years will work going forward.

We are in the midst of a regime shift. If you think about the next three to five years, we discussed a lot of risks that are out – negative interest rates and so on. People need to get out of their comfort zone and look at alternatives. I think that's the key.

We touched on liquidity risk just before too. Is that something you're concerned about?

Omar Gadsby: Yes. If you look at European high yield, the average bid offer spread can be 75 to 100 basis points. I can execute European high yield via the iTraxx Crossover with a bid offer spread of 10 basis points.

What does this mean going forward? Embracing derivatives to express a fixed income opinion has become quite material for me in selecting the right funds for my clients. Funds that implement an active or derivative overlay and are not forced to actively trade bonds – that suddenly becomes a unique selling proposition. I think it will be important going forward.

Martin Bürki: I would like to make a general statement. Five years ago, I was invited to lunch presentations of European high yield and some investors said to me they would never invest in that because it's too liquid. Those concerns don't seem to be there right now, or people are willing to take the risk because of the reach for yield.

Eliezer Ben Zimra: With daily valuations, it can get quite complicated, and I agree with Omar.

We use all the different instruments in the fixed income space. There are bonds, but we also use CDs – both via an index and individual names. And we also use options to express different views on fixed income markets, such as negative views on German bunds and the yield curve there.

In addition, what is really striking right now is that volatility is at extremely low levels right now in the fixed income markets. That makes it quite interesting to buy volatility for some protection – especially since it's so cheap. We can buy long-dated options, for example, to express negative views on government bonds, but very cheaply because of volatility.

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