Talking Heads with Boutaina Deixonne

Christopher Iggo: Hello. Welcome to this week's BNP Paribas Asset Management Talking Heads podcast. Every week, Talking Heads will bring you in depth insights and analysis on topics that really matter to investors. In this episode, we'll be discussing [the] euro credit short duration fixed income strategy, one of our euro credit fixed income strategies managed by the bond team here at BNP Paribas Asset Management. I'm Chris Iggo, a member of the Investment Insights team and I'm joined today by Boutaina Deixonne, [the Head of Euro Investment Grade and High-Yield Credit] in the Fixed Income team based in Paris. Welcome Boutaina, and thanks for joining me today.

Boutaina Deixonne: Hi Chris. I'm happy to be here with you.

CI: Good short duration strategies in the bond space have been very popular in recent years, and given the increased volatility of interest rates, they still are attractive. Recently, we've seen a sharp rise in long-term government bond yields. However, short duration strategies are more protected from rising long-term interest rates and tend to perform better in such an environment, so it's a good time to talk about the strategy. Could you explain, to start off, a little bit more about the euro credit short duration bond strategy managed by you and the team at BNP Paribas Asset Management?

BD: First, it's important to define what does it mean, 'short duration'? Short duration is defined as bonds with [a] maturity of less than three years. Our strategies would typically have an average duration between one and five and two years. This means we do not buy long-dated bonds that we hedge with futures.

Commented [SL1]: 1.5?

Instead, we focus solely on bonds with a duration below two years. This approach is actually crucial because our philosophy is really to limit large drawdown[s] for euro IG (investment grade) and high yield duration strategies.

However, our strategy extends beyond risk minimisation and drawdown control. In today's market environment, marked by higher inflation, geopolitical tensions, uncertainties around central bank policies and evolving themes like AI (artificial intelligence) funding, short duration strategies indeed can play [a] critical role, whether [in the] investment grade or high yield segments.

We believe these strategies can help investors navigate periods of intense market volatility like the one we have been experiencing since the start of the war in the Middle East. Ultimately, both IG and high yield duration buckets offer investors a combination of stability, attractive yield and the potential for [a] steady income stream.

CI: Just to be clear for our listeners, duration measures the sensitivity of a bond to changes [in] interest rate[s]. So absolutely, a bond with a two-year maturity, its price will be less sensitive to changes [in] interest rates than, for example, a bond with a 10-year maturity. What are the attractions for investors in this uncertain world? Perhaps you could give some idea of [the] current levels of yield in the market and what you're seeing in terms of credit trends.

BD: Typically, investors who choose this strategy aim to manage their liquidity needs. And as you said, mitigate interest rate risk as a lower duration helps limit downside compared to long duration bonds.

However, risk reduction is not the main or the sole focus in these strategies. We adopt a 'risk aware' approach emphasising high-quality bond[s] and careful selection to optimise risk-return. So, it's not only about risk; it's also about return and performance. The credit short duration strategy offers the potential to generate steady income.

From a historical perspective, yields remain attractive, approximately 3.3% for investment grade bonds and around 5% for high yield bonds, both with [a] duration [of] just below two years. And as are you aware, all in yields have been a key focus in the global credit market over recent years. This trend suggests that investor demand for the euro credit asset class is likely to stay strong in the foreseeable future.

Commented [SL2]: Falling?

CI: We're hearing about lots of issuance of new bonds, particularly from US tech companies. Governments are also issuing a lot of bonds to cover their budget deficits. With that in mind, could you give us a flavour of what liquidity conditions are like in the part of the market that you're focusing on?

BD: Indeed, the euro short duration bucket offers a large degree of liquidity as about one-third of the euro investment grade market has a duration below two years. This is equivalent to about €1 trillion. This large universe allows for effective diversification and ensures consistent liquidity within our strategy, which manage[s] €3.5 billion of assets.

As such, we have more than 150 different tickers and over 250 bonds in the portfolio, delivering a well-diversified solution for our clients. Similarly, the short duration high-yield strategy manage[s] over €1.7 billion in assets. In this segment, liquidity is even more critical as we focus on companies with good cash flow generation, solid liquidity and cash in hand and a robust balance sheet. This approach help[s] us to maintain resilience and stability in a more volatile market environment.

CI: It's a big market and there's lots of bonds coming from many different kinds of issuers. How do you and your team manage the strategy to generate performance over time?

BD: Like all the portfolio[s] we manage within the team, short duration strategies follow a robust and strict process. The first driver of performance of these strategies is sectors and name selection. We have to implement those sector convictions to allocate between subordinated and senior debt and of course select the right issuers with the right maturity and the right bonds.

Specifically for the IGE strategy we have leeway to invest up to 10% in high-yield bonds which allow[s] us to generate extra performance. We are also able to use future and some derivatives to adjust [the] overall duration of the portfolio and tactically we may use some CDS (credit default swap) indices in a nimble manner to be able to position the portfolio and take opportunities quickly in period[s] of volatility.

Commented [SL3]: Investment grade euro?

The philosophy for [the] short duration high-yield strategy does not differ materially from the investment grade one. Here again, the objective is to capture a significant part of the total return of the European high-yield market while minimising the volatility. We have consistent discipline and a higher level of scrutiny when analysing high-yield credit when it comes to financial covenants, liquidity and forecasting models.

CI: Thanks, Boutaina. The outlook remains very uncertain given everything that's going on in the world. But credit remains quite a solid asset class and this particular strategy, I think, remains very attractive for investors. So, thanks for joining me today and thank you for your comments.

BD: Thank you, Chris, for having me.

CI: That's it for this week's episode of Talking Heads. If you would like to learn more about all our investment insights, please reach out to your BNP Paribas Asset Management contact or cheque out Viewpoint, our website for investment insights. You could find that at viewpoint.bnpparibas-am.com.

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You've been listening to the BNP Paribas Asset Management Talking Heads podcast with me, Chris Iggo, and Boutaina Deixonne from the BNP Paribas Asset Management European Fixed Income team.

Please do join us again on Talking Heads next week. Until then, take care.