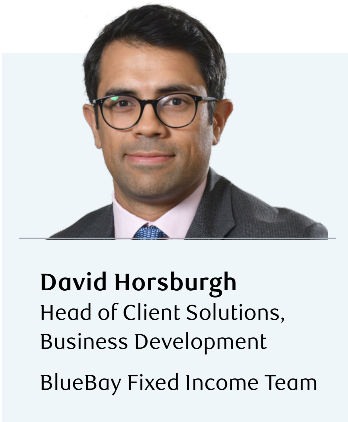
RBC Global Asset Management

Return of the Mac(ro)

December 2023



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Return of the Mac(ro)

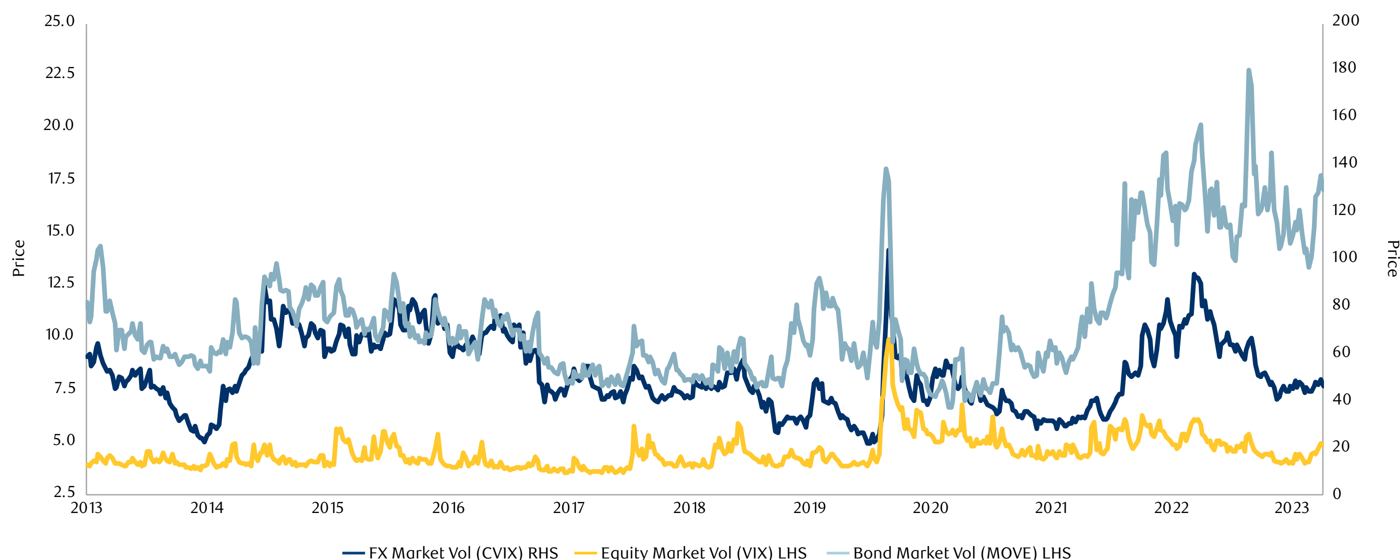
Unconstrained risk taking in macro fixed income is having a moment in the sun. Volatility is elevated, and this has greatly improved the opportunity set, providing investors with an ability to monetise trades and utilise fundamental research. In this article, we look at the recent drivers behind this environment, while highlighting the opportunity going forward. We also discuss some of the tools that investors can use to maximise returns in this space.

Macro volatility

It is clear that macro factors are dominating the narrative across many asset classes. While central banks use the policy tools at their disposal to regain control over inflation, the long-term secular theme of globalisation is coming under pressure, and the interplay between different currencies, rates, and economic policies has become more pronounced. The cycles of risk-on/risk-off and yield fluctuations have become compressed and more violent. It's a target-rich world for macro risk takers but one where a different mindset to previous cycles is required. Whilst a mix of tactical and strategic opportunities exist, in this environment it is important to wait for price action to dislocate, allowing valuations to become stretched before taking active risk. It's a time when reacting to market moves can yield positive results.

Looking at fixed income flows, positioning in cash and short-term instruments has been elevated – and flows into risk assets trailing. This risk-off positioning can be explained, partly, by the way in which the relative calm of the summer months was upended in September and October – with much more fixed income and FX volatility. The speed at which the narratives changed was surprising, with a relatively muted post-Federal Open Market Committee dot plot indicating 'higher for longer', and some stronger economic data causing a large sell-off in 10-year yields and equity markets. Even the dollar, rallying at the same time, flew in the face of a longer-term belief that it was overvalued and overdue a correction. Cut to a month later and yields are rallying once again at the long end, on the back of different economic data – a view that financial conditions have tightened (because yields are higher) and more compelling inflation data and dovish central bank messaging exists.

Chart 1: Volatility ticking higher in recent months



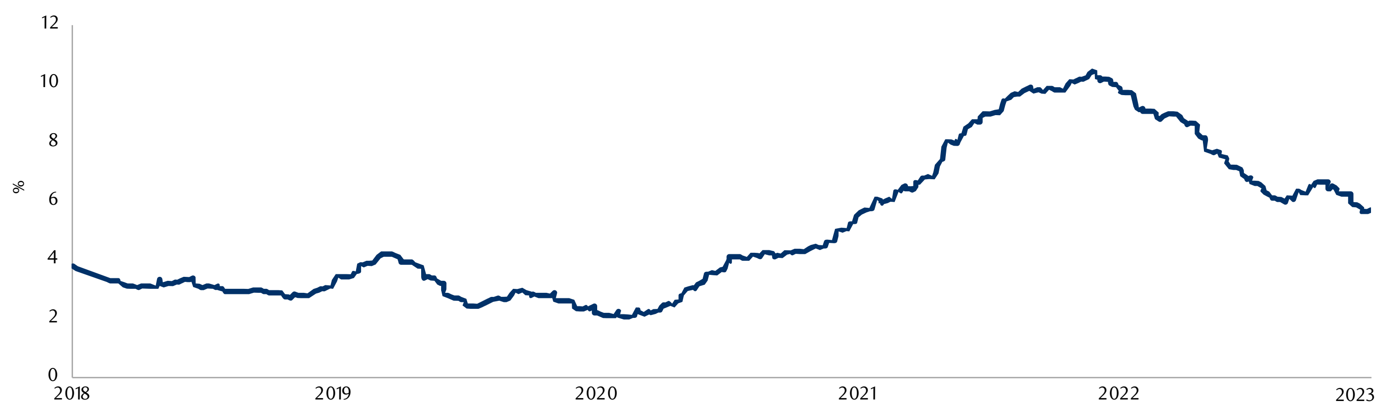
Source: Bloomberg, 31/10/23.

As rates reach their peak, the direction of travel for yields is invariably lower, but the path to arrive there will be winding. This is underpinned by the fact that while inflation has fallen, the final push to bring it within target will likely be difficult and drawn out. Central banks will be in pause mode for the time being, while they wait to see if the effect of their policy actions begin to reflect in economic data. There is always the spectre of further hikes in the future, if required, and markets will continue to turn on a dime as new headlines emerge.

Higher for longer

At the heart of the recent fixed income volatility is a move higher in yields, and a return of term premium in sovereign curves. Since the middle of the summer, global bond yields have shifted higher. According to Bloomberg, in the US 2s10s inversion had shrunk to its lowest point in over a year, with intraday trading in October bringing it back to within 9bps of reinverting, before reversing gains over the following month. Looking at Europe and Japan, the same phenomenon can be seen with higher yields in Europe, driven by rising rates, and in Japan, through the slow – but systematic – relaxation of yield curve control.

Chart 2: Global inflation has been falling, but the final push will be drawn out



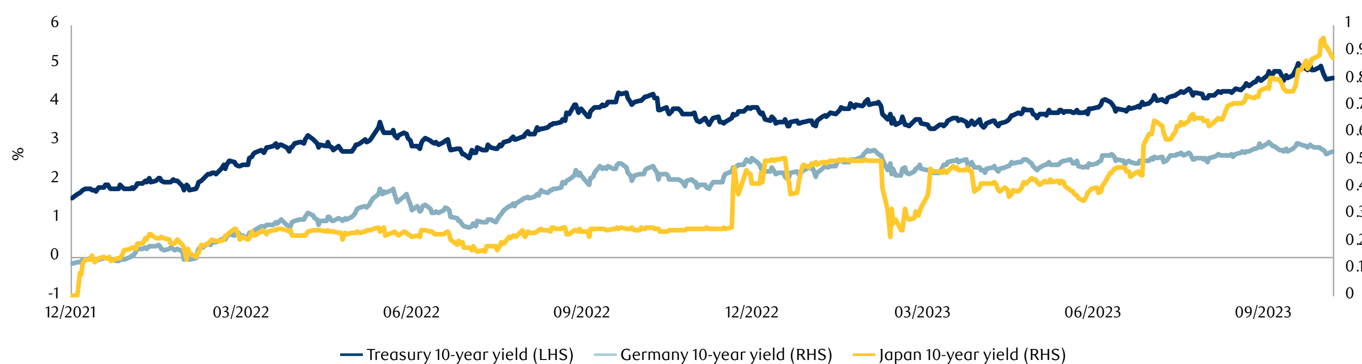
Source: Bloomberg 10/11/23.

More recently these yields have rallied, but central banks will continue to be data led, allowing for further volatility and swings in pricing as we approach 2024. Rate cut expectations are priced for perfection and there is room for disappointment here.

Although a challenge for strategic asset allocation, the macro picture has created a strong environment for macro strategies, and more dynamic active funds.

Volatility is elevated, led by FX and sovereign bonds, and a changing geopolitical landscape. Add to this a still uneven approach to fiscal and monetary policy in the face of a hard-fought election in the US, and we can easily see this macro volatility enduring into 2024. Investors with an unconstrained mandate and strong bottom-up research and analysis stand to benefit from this regime. The underlying cash returns are attractive, but the price dispersion and volatility are fertile ground for alpha generation.

Chart 3: Core bond yields march higher



Source: Bloomberg, 31/10/23

BlueBay Global Sovereign Opportunities Strategy

Launched in December 2015, the BlueBay Global Sovereign Opportunities Strategy comprises a daily liquidity UCITs Macro hedge fund. The strategy invests primarily in government bonds, interest rates and currencies of developed (DM) and emerging markets (EM). For more information about the fund that matches this strategy, please visit our website here.

The global sovereign universe offers a rich and evolving opportunity set as the line between EM and DM becomes increasingly blurred. Consequently, this strategy leverages off the combined resources of the entire BlueBay investment team, harnessing high conviction ideas from both DM and EM specialists. To offer daily liquidity to our clients, the strategy will always invest at least 50% of net assets in investment grade-rated securities and has a bias towards DM positioning.

The strategy offers investors direct access to high conviction macro views across the firm and looks to minimise correlation to major asset classes, while providing detailed transparency and a risk structure appropriate to a daily liquidity vehicle.

BlueBay Global Sovereign Opportunities Fund Risks:

- Past performance is not a reliable guide to future performance.
- At times, the market for investment grade bonds may dry up, which could make it difficult to sell these bonds, or the fund may only be able to sell them at a discount.
- There may be cases where an organisation with which we trade assets or derivatives (usually a financial institution such as a bank) may be unable to fulfil its obligations, which could cause losses to the fund.
- Investing in emerging market bonds offers you the chance to gain higher returns through growing your capital and generating income. Nevertheless, there is a greater risk that the organisation which issued the bond will fail, which would result in a loss of income to the fund along with its initial investment.
- BlueBay's ESG analysis can rely on input from external providers. Such data may be inaccurate or incomplete or unavailable and BlueBay could assess the ESG risks of securities held incorrectly.
- BlueBay could suffer from a failure of its processes, systems and controls – or from such a failure at an organisation on which we rely.

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Our experts offer their perspectives on the latest developments in global credit and the state of the markets.

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