Rates Off the Peak on Dovish Central Bank Remarks

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- Central Banks not giving in to the market reaction on rates hikes, Fed and BOE dovish on the meeting and keeping their transitory inflation view
- Robust US jobs data show another month of progress in unemployment rate and average hourly earnings while labor participation continues to be sluggish
- Shaky HY real estate markets and rising COVID cases in China dampen domestic activity despite a pickup in export - something to closely monitor
- Cash-bond spreads moved sideways over the week while CDS indices outperformed

Table 1: Weekly performance overview

		Change			
	05-Nov-21	1 Week	2 Weeks	1 Month	YTD
EUR IG Corp spread (bp)	89	2	3	4	-3
BBB	101	2	2	3	-7
IG-ex BBB	36	0	3	3	6
EUR HY Corp spread (bp)	320	11	1	0	-38
BB	238	10	4	-1	-18
Capital Structure spread (bp)					
Bank AT1	317	1	9	-16	-85
Bank Tier 2	122	1	3	7	-11
Corporate Hybrids	199	15	8	-4	-23
Sub Insurance	163	7	8	5	-12
ETF Total return					
EUR IG ETF (IEAC LN)		0.9%	0.9%	0.1%	-0.4%
EUR HY ETF (IHYG LN)		0.7%	0.7%	0.3%	2.7%
USD IG ETF (IEAC LN)		1.2%	2.1%	1.2%	-0.5%
USD HY ETF (IHYG LN)		1.0%	1.1%	0.8%	3.7%
***Cape Fixed Income Fund (EUR B Inst.)**		0.0%	0.0%	-0.1%	1.3%
***Cape Fixed Income Fund (USD B Inst.)**		0.0%	0.0%	-0.1%	2.0%

* as of Nov 04th 2021

		Change			
	05-Nov-21	1 Week	2 Weeks	1 Month	YTD
iTraxx Europe OTR (5 year, bp)*					
Main	48	-2	-2	-4	-8
Xover	244	-17	-16	-22	-30
Snr Fin	55	-3	-2	-4	-11
Sub Fin	107	-6	-4	-7	-18
CDX OTR (5 year, bp)*					
CDX IG	49	-3	-3	-4	-6
CDX HY	288	-17	-14	-17	-5
Govt. bond yield (bp)					
10 year US yield	145	-10	-18	-7	54
10 year Bund yield	-28	-18	-18	-10	29
10 year Gilt yield	85	-19	-30	-23	65
10 year BTP yield	88	-29	-12	-2	33
BTP - Bund spread	116	-12	5	8	5

*since index roll

Source: Bloomberg, Bloomberg Barclays, Markit as of October 29th, 2021

This week had two major Central Bank meetings, the Fed and the BOE; both were on the dovish and patient spectrum in terms of inflation outlook and rate hikes. The Fed has announced a reduction of its asset purchasing program, which was well publicized by the committee members and largely anticipated by the market. On the policy rate front, Powell emphasized that tapering doesn't mean rate hikes and that the labor market condition has not yet passed the test for a lift-off. The BOE surprised the market by leaving policy rates on hold as the expectations to hike were widely built in the curve with a MPC vote of 7-2. A twist to the previous week's trajectory, rates across the board reversed their recent upward path. As the economic recovery continues and uncertainties on labor and pricing pressures persist, both upside and downside risks on rates remain elevated with an increasingly binary outcome. Duration products will therefore remain under scrutiny, and we recommend fading the very recent rally in rates.

October US NFP data was another robust print, with almost 20% more private payrolls being added vs. consensus (531k vs. 450k est.) in addition to a sizable upward revision to the previous two data points (+234k). Unemployment rate dropped another 0.2pp, now at 4.6%. The less shiny spot of the survey remains in labor participation, which has been sluggish and refused to pick up even as unemployment benefits fade. The job market remains tight and wage pressures are visible with YoY average hourly earnings growth now at 4.9% (MoM at 0.4%).

China's HY real estate market remains under pressure with more developers failing to deliver payments due, which could pose a threat to the medium-term growth prospects given the sheer size of the sector. A rise in new COVID cases is also dampening the zero-case policy and leading to restrictions in domestic activity. China's GDP this month has dropped to its YTD low despite the growth in its export number.

On risky asset performance this week, equities picked up on the rates rally, robust job data as well as upbeat earnings over the week, valuations have reached another peak. However, credit spread movements in cash bonds were more differentiated and on average underperformed equities as volatility in rates caps the investors' conviction. It's worth mentioning that the reopen trades have gained another wave of strength. Some of our holdings within the reopen sectors have posted remarkable earnings, shielding these names from the generic beta movements in the credit market, something that we continue to pursue in the portfolio. In line with these thoughts, we recommend maintaining a selective approach in equity/credit portfolios with an overall beta close to home.

Additionally, the CDS index market where rates duration is not a problem took the cue from the equity and rates market as the indices outperformed cash bonds and tightened 2bps in Main (the EUR IG CDS index) and 17bps in Xover respectively (the EUR HY CDS index), benefitting the CDS-linked positions that we positioned for within the Cape Fixed Income Fund.

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