RBC Global Asset Management

When volatility is a good thing

July 2024

Simon Chennell
Institutional Portfolio Manager, Investment Grade

BlueBay Fixed Income Team

"Generating alpha requires both volatility to be present in the opportunity set and positive manager skill."

Global volatility is resulting in divergent returns in financial market assets and differentiation in performance. Below we look to explain how this backdrop creates opportunity, and how our Absolute Return Bond fund benefits from this market environment.

Generating alpha requires both volatility to be present in the opportunity set and positive manager skill. And the good news is that with many uncertainties around the likes of the path of central bank policy, economic growth, inflation, and indeed politics and geopolitics, volatility looks set to continue. This environment is particularly attractive for our active investment grade propositions, with plenty of alpha to capture by our very stable, experienced investment team. The team has been running absolute return funds, alongside traditional benchmarked strategies, for over 20 years, using a proven, strong, disciplined investment process.

Comprising 26 specialists who focus on the universe of global rates, sovereign and corporate credit and currencies, the team is part of the broader BlueBay fixed income platform, which comprises 128 investment professionals and manages over USD125 billion in assets[1]. The team is structured to deliver outcomes tailored to meet clients' needs and operates according to a single investment process. We believe that having one team of specialists using this single process gives us a more holistic and nuanced approach to decision making.

Our Investment Grade Absolute Return fund has been designed to generate returns of cash plus 3%, with volatility of 3%, through active management. We use long and short positions to reflect high conviction investment ideas coming from our investment process. Approximately half the targeted return is expected to come from bottom-up sector and issuer selection, with the other half from macro and policy analysis and themes. Return potential is not a function of actual market yields, but rather we seek to capitalise on the movement of yields, credit spreads and currencies. As such, it is volatility, divergence, and issuer and sector dispersion that provide the opportunity for positive risk-adjusted returns.

[1] RBC GAM, as at 31 May 2024.

Over time, clients investing in this strategy have done so to fulfil various needs. For years, the main reason was as an alternative to traditional beta-driven funds i.e. to obtain fixed income exposure but without taking exposure to embedded duration risk (driven by the fear of higher interest rates) and credit risk, which are features of a benchmarked fund.

Clearly, with yields having repriced much higher in 2022 and rates having peaked, this is a less of a concern for investors currently. However, there is still demand on the back of the fear that rates could go higher, or more likely, that with multiple rate cuts already priced in by the market, there is room for disappointment and so higher yields. In this context, a cash plus return when the curve is inverted could provide attractive returns, and indeed, the non-correlation dynamic could lead investors to hold such funds as a diversifier. With rate cuts priced into bond yields, and therefore inverted curves, our fund, which seeks to generate returns by monetising volatility in markets, remains an attractive prospect.

At a broader level, we still see investors using ''liquid alts' funds for diversification benefits, which comes from the low correlation to fixed income market returns and, in some cases, we see investors using the fund as an enhanced vehicle for cash that will not be needed in the short term.

"With rate cuts priced into bond yields, and therefore inverted curves, our fund, which seeks to generate returns by monetising volatility in markets, remains an attractive prospect."

As we go into the second half of the year, we continue to see scope for volatility, and this could benefit a fund that looks to monetise volatility through manager skill in investment decision making, and so is able to generate attractive returns in all market conditions.

This document was prepared by RBC Global Asset Management (UK) Limited (RBC GAM UK), authorised and regulated by the UK Financial Conduct Authority (FCA), registered with the US Securities and Exchange Commission (SEC) and a member of the National Futures Association (NFA) as authorised by the US Commodity Futures Trading Commission (CFTC).

In the United States, this document may also be provided by RBC Global Asset Management (U.S.) Inc. ("RBC GAM-US"), a SEC registered investment adviser. The entities noted above are collectively referred to as "RBC BlueBay" within this document. The registrations and memberships noted should not be interpreted as an endorsement or approval of RBC BlueBay by the respective licensing or registering authorities.

With respect to the investment performance presented, **past performance is not indicative of future performance**. Actual account performance may or will vary from the performance shown because of differences in market conditions; client-imposed investment restrictions; the time of client investments and withdrawals; tax considerations; economies of scale; portfolio turnover; the number, type, availability, and diversity of securities that can be purchased at a given time; differences in the underlying currency of the assets in the account, and other factors. Client assets managed using these strategies in separate accounts or different vehicles may be subject to restrictions, fees or expenses that are materially different than those found in the non-US funds.

This document is confidential and, without RBC BlueBay's consent, may not be (i) copied, photocopied or duplicated in any form by any means or (ii) distributed to any person that is not an employee, officer, director or authorized agent of the recipient.

Information herein is believed to be reliable but RBC BlueBay does not warrant its completeness or accuracy. This document contains information collected from independent third-party sources. For purposes of providing these materials to you, neither RBC BlueBay nor any of its affiliates, subsidiaries, directors, officers, or employees, has independently verified the accuracy or completeness of the third-party information contained herein.

The information contained herein does not constitute investment, tax, accounting or legal advice. Recipients are strongly advised to make an independent review with their own advisors and reach their own conclusions regarding the investment merits and risks, legal, credit, tax and accounting aspects of all transactions. Any risk management processes discussed refer to efforts to monitor and manage risk but should not be confused with and do not imply no or low risk. No chart, graph, or other figure provided should be used to determine which strategies to implement or which securities to buy or sell.

For Institutional Use Only - Not For Public Distribution.

RBC Global Asset Management (U.S.) Inc.
800.553.2143 | **rbcgam.com**