



## ASSET MANAGEMENT

### BATS, GILTS, SABRES AND TESLA - BOND MARKETS THIS WEEK

**Jonathan Platt, Head of Fixed Income**

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Royal London Asset Management's fixed income team share three key trends they see shaping bond markets this week:

#### **1. Geopolitics is MGRA (Making Gilts Rally Again)**

While UK government bond yields had been grinding slowly lower on Monday and Tuesday, the threat of conflict between the US and North Korea accelerated this process on Wednesday and saw a rush to 'safe haven' assets across a number of markets. However, gilts have received an extra boost of outperformance this week off the back of last week's Bank of England inflation report, which means they've rallied strongly compared to US treasuries and German bunds, particularly bellwether 10 year maturity bonds.

#### **2. BATs are back in town**

The biggest corporate bond deal of the week (and second biggest this year) arrived this week courtesy of British American Tobacco (BAT), who have been issuing in dollars, sterling and euros by the billions to help fund their takeover of the rest of Reynolds. Away from the headline deals however, this summer continues to reflect a consistent trend that we've been seeing over the past few months across investment grade markets, that of financial and asset backed bonds outperforming their corporate peers, while supranationals bring up the rear. Credit markets are holding up fairly well this week, despite a few Pacific related jitters.

#### **3. Tesla turns on the high yield tap**

With very large equity market capitalisations and innovative business models that are forcing the rest of their industries to adapt, there are similarities between Netflix and Tesla. However, both also have a tendency to burn through mountains of cash, something which investors will be assessing keenly when the latter's latest bond prices on Friday. The pipeline for new sterling and euro denominated deals is cooling off over the summer period; while in secondary markets global high yield bonds have held up fairly well through a busy interim earnings season.

A sudden wobble, and the subsequent flight to safety is beginning to become a recurring feature of summer markets. However, sabre rattling in the Pacific will have little impact on the longer-term challenges still facing fixed income investors.

This week's rally in government bonds is at odds with a run of strong employment numbers and firmer payroll data in the US, both of which increase the likelihood of an unwinding of the Federal Reserve's balance sheet in September.

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Across the Atlantic, the European Central Bank is likely to begin discussing its own balance sheet reductions in the near future, a move which has implications for bond yields across the credit spectrum. The words of central bankers still hold more sway with markets than tit for tat tweets and threats, for now.

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