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(English translation of original text)

How to avoid the European credit slump?

European corporate bond investors have become increasingly cornered by three recent developments in bond markets, all concurring with ECB quantitative easing. These are historically low rates and bond yields, reinvestment headaches, and distorted European country risks. Where can the investor look for relief?

Historically, interest rates have been decreasing indeed for about three decades now in core Europe, save a few intermittent periods. The same has been largely true for the US. As a result, in Europe, the average corporate bond yield as measured by e.g. the Barclays Euro Corporate Index is below 1%, a historical low. Supported by ECB quantitative easing, these bonds will have a very low yield and carry for the near future, while also the long term opportunity for decent returns from further falling rates is limited in the current "close to zero or negative" interest rates environment. If one is allocating new money with an investment horizon of more than say two years initiating such an investment now is not the best idea around.

Reinvestment headaches arise in a more subtle way. If one bought corporate bonds some years ago at substantially higher yields, one would have recorded nice returns to date. Institutional investors driven by liabilities can even have good reasons to hold on to the same bonds still. What if one is ready to take profits and sell these bonds e.g. to the ECB now - the elephant-in-the-room scheduled to buy the bond market systematically in the next two years? The same key question arises: what to invest in next for the long term?

Lastly, the ECB program has the unfortunate side effect that all European country risks are diluted and soothed away, while the root causes of the peripheral sovereign debt problems are not being addressed in full. Hence, more financial institutions fall-out might be expected during or after QE, with ECB tapering promising to be a tumultuous period for bond markets, if growth fails to pick up. So, where should an European bond investor be heading to avoid all these issues?

Moving up the risk curve and going after risk premia from stocks or commodities is not a real option for investors with limited risk budgets. Tapping into returns from high yield bonds or leveraged loans might look attractive, but if history is a guide, downside risks should not be neglected when rates go up e.g. after EBC tapering, or even earlier if the equity markets correct after the run-up of last years.

Another interesting secular trend in equity investing might help out. Equity investors have increasingly moved away from a bias to invest in the home country or region and went global; the same cannot be said (yet) for fixed income investors. Still there are good reasons to do so. The strong undercurrent of globalization of the economy through products and commercial trading is not expected to revert any time soon. In addition, smart bond issuers have already recognized the opportunity of using global capital markets, kudos to corporate treasuries like Apple's or Coca-Cola Co.'s issuing EUR bonds at record low coupon rates, or to Nestle with its bonds having negative yields (i.e. a company "getting paid" to use investors' money).

So is the answer for the European corporate bond investor to go global? Prudence is needed, as there are several challenges when investing in global corporate debt. Many new beta exposures need to be managed carefully. Currency risk for debt issued in a foreign currency, e.g. USD, needs to be considered. Nowadays however, exchange rates exposures can be relatively accurately hedged.

Interest rate risks from other sovereign yield curves need to be managed, and sector credit exposures need to be considered. Interestingly enough, exposure to the higher yields of the US yield curve represent an opportunity at the moment. Lastly, the default risks of the issuers need to be analysed systematically.

Here again, careful selection of global bonds represents an opportunity, as many globally successful companies have been hoarding cash the last few years, and are therefore in an excellent position to service their debt and meet their financial obligations.

In summary, a conservative investment approach to global credit can address European investor needs. An active investment process that systematically looks for global companies whose bonds are expected to outperform their peers can add value, while systematically controlling or even minimizing risks from new beta bets or too concentrated portfolios.