22 April 2021 | Fund focus

Omnis Short-Dated Bond Fund

We spoke to the team at AXA Investment Managers who manage the Omnis Short-Dated Bond Fund. They explained how they seek to capture potential income in short-dated securities and why these assets should continue to provide strong investment opportunities as the world recovers from the coronavirus pandemic.

As fund manager, AXA Investment Managers (AXA IM) seeks to deliver returns from short-dated fixed income securities (those with a maturity or expected call date of fewer than five years) while minimising default risk. The securities include government bonds and investment grade credit, as well as high yield and emerging market bonds.

Through active management, AXA IM seeks to preserve capital and ensure optimal portfolio diversification. By constructing a portfolio that offers a well-balanced maturity profile, it ensures an appropriate level of portfolio liquidity and aims to achieve superior risk-adjusted returns by providing an attractive yield while limiting volatility.

AXA IM's philosophy is based on the belief that limiting the risk of losses on an initial investment and reinvesting the income paid by bonds can unleash the power of compound interest.

This approach combines a view of the global economy with thorough analysis of the individual bond issuer to select investments for the portfolio. The AXA fixed income team narrows the field of opportunities to bonds expected to repay the initial investment within five years. The next step is to assess each bond's level of risk and eliminate what they believe are the riskiest issues.

Meet the manager

AXA Investment Managers is a responsible asset manager, actively investing for the long term to help its clients, its people and the world to prosper. Its high conviction approach enables it to uncover what it believes to be the best global investment opportunities across alternative and traditional asset classes, managing approximately €858 billion (December 2020). AXA IM employs over 2,440 employees around the world, and operates out of 27 offices across 20 countries.

The fund seeks to achieve a return including both income and capital above the ICE BofAML 1-5 Year Sterling Non-Gilt Index by 1%, before all fees and expenses, over a five-year rolling period.[1]

The benefits of short-dated bonds

Why is it a good idea to have short dated bonds in a well-diversified portfolio?

- Short-dated bonds have traditionally served as a relatively secure investment, since their short lifespan (typically less than five years) leaves them less exposed to market volatility.
- The short lifespan of short-dated bonds results in frequent cash flows as the bonds mature, making the asset class very liquid.
- A low interest rate environment, such as the one at present, has seen returns and income streams on cash and many government bonds fall sharply. Short-dated bonds can offer income streams over both cash and government bonds.
- Short-dated bonds are less exposed to interest rate risk. Interest rates will rise again at some point in the future, and when this does happen, the asset class should help protect investors' capital (remember that as interest rates rise, the price of bonds tends to fall).
- The asset class offers exciting opportunities for active investment management, given its global reach and the sheer breadth and depth of underlying securities to select from.

Looking to the global economic recovery

With vaccine programmes progressing rapidly and economies starting to reopen around the world, investors are anticipating strong reflation. As a result, the resolve of central banks to keep interest rates unchanged may be tested. In the current environment,

[1] There is no guarantee that this will be achieved over this, or any, timeframe and capital is at risk.

short-dated bonds offer an attractive investment due to their lower sensitivity to increasing interest rates and market volatility.

Credit markets continue to absorb new issuance of bonds without significantly impacting yields. In the US, fiscal stimulus and the potential for pent-up demand should boost growth and help ease leverage concerns. As a result, it is unlikely that we will see more companies defaulting on their bond payments. In Europe, the European Central Bank (ECB) remains a key support for credit markets.

The outlook remains mixed for emerging markets, with recent volatility caused by President Erdogan's decision to replace the central bank governor in Turkey. Higher US yields also tend to have a detrimental effect on markets that rely on external funding, but strong growth and attractive valuations are positive for emerging market debt.

Protecting against market volatility

Since November 2020, the fund manager has gradually reduced exposure to cyclical names. Cyclical companies are those that make or sell discretionary items and services that are in demand when the economy is doing well. The US elections and positive vaccine news towards the end of last year helped boost valuations for companies in this sector.

After the market sell-off in March 2020, AXA IM increased the level of risk in the portfolio. However, since February 2021 the team has started to reduce the level of risk, doubling the exposure to sovereign bonds from 3% at the end of February to 6% at the end of March. The strategy has also rotated from emerging market debt into high yield bonds and reduced allocation to high yield overall.

Emerging market debt is vulnerable to higher Treasury yields and a stronger dollar. In addition, there are risks associated with the coronavirus pandemic, with areas such as Latin America struggling, and controversy over the replacement of Turkey's central bank governor.

Going forward, the fund will continue to reduce exposure to high yield and emerging markets while increasing exposure to government bonds. AXA IM will continue to buy very short-dated government bonds (dated around one year or less) as a proxy for cash in the portfolio.

Get ready for take off

AXA IM continues to reduce its exposure to cyclical sectors. Although companies within the airline, airport and tourism sectors have been performing extremely well since November 2020, the team believes they no longer offer investors attractive returns when considering the underlying risks. For example, easyJet bonds were trading at yields of more than 10% above government bonds in March but have since tightened to around 1%.

The team is exploring cross-currency relative value opportunities to help enhance returns for the same underlying risk. They recently invested in a two-year sterling bond issued by Aeroporti di Roma (Rome Airport), which was trading in line with the six-year euro bond. They believe the sterling bond was a more attractive investment – the only differences were that the sterling issuance was smaller, a little less liquid, but was delivering a higher yield.

Elsewhere, they found that British property development company Hammerson's euro bonds were a lot cheaper than the sterling bonds. The team decided to invest in the two-year euro bond.

The benefit of AXA IM's global approach means the manager can exploit these anomalies to deliver better risk-adjusted returns within the fund.

Investing through a sustainable lens

The Fund invests in green bonds – an area that is rapidly growing in popularity and currently makes up around a third of new bonds coming to the market.. AXA IM follows a stringent selection process, and each potential investment is sent to its green bonds team for assessment before any decisions are made.

The team assesses investment opportunities through:

- a proprietary environmental, social and governance (ESG) scoring methodology;
- ESG analysis embedded into its fundamental credit research; and
- a qualitative analysis framework for sustainable bonds.

As part of its investment process, AXA IM includes:

- ESG key performance indicators (KPIs) integrated into its portfolio decision-making tools;
- strong governance and ESG risk monitoring; and
- transparency through ESG dashboards and reports.

The team believes that integrating ESG factors into its investment decisions leads to more effective solutions that address global challenges and create sustainable value for investors.

Short-dated bonds in diversified portfolios

As we navigate the current low interest rate environment and the reopening of global economies, active management becomes increasingly important. The Omnis Short-Dated Bond Fund benefits from global diversification and is defensive in nature. When part of a diversified portfolio, this fund can act to reduce overall volatility in times of market stress.

To discuss this fund in more detail please get in touch with your financial adviser, and you can find monthly factsheets and investor literature online here.