GENERALI INVESTMENTS SICAV (GIS)
EURO CORPORATE SHORT-TERM BOND

Interview with the Fund Manager
November 2020

Fabrizio Viola
- Fund Manager, CFA
- Industry Experience: 18 years

The strategy

- Active approach to investments in high quality, Euro denominated, IG corporate bonds with max. 3 years maturity
- Benefits from the expertise of our renowned credit team
- Limited exposure to credit market volatility and interest rate risk
- Value added through securities selection and intra-sectors bets supported by proprietary bottom-up research

YTD the strategy is outperforming the Barclays Capital Euro Corporate 1-3 Year Index, its benchmark, by +2.66%* – what have been the main drivers of performance?

We started 2020 having a positioning that was a direct consequence of our major conviction at that time - the so-called pre-Covid Era: we were invested into “quality” high beta credits with short duration (1-3 years), predominantly T2 financials, BBB and selected corporate hybrids in stable cash-flow business (utilities particularly). We complemented the allocation with some specific single name hedges on weak names using credit derivatives (CDS). To reduce part of the market credit risk we also decided to add some tactical hedges using the liquid ITRX X-over index, always via CDS.

Immediately after February, the Covid-19 storm arrived and was so quick and hard that credit market became illiquid almost instantaneously. The sub-fund suffered a drop that was a consequence of the sudden widening of the spreads and the inversion of the credit curve which affected all issuers. In this very difficult period, we kept calm, started to manage actively CDS on indexes and single names capturing material gains into the volatility spike. Credit derivatives have been used tactically to surf specific market conditions – among others, tactical hedged at the overall portfolio level, single name active positioning both long and short, basis trades and options to capture miss-matches of volatility – and it proved to be very effective as they remained liquid, while cash bonds were totally illiquid. We did not suffer huge redemptions and consequently, we haven’t sold positions indiscriminately.

This, together with our robust investment process based on qualitative and quantitative screening methodologies, allowed us to maintain the credit profile intact and our major active conviction ideas open. Incoming cash – deriving from bond redemptions – were also re-invested into some prominent new investment ideas: in particular on the primary market, that reopened in early summer months with many corporations that decided to pay interesting new issue premia on their bonds to accumulate sufficient cash buffers.

> *“This proves quite well our ability to navigate rough waters while at the same time maintaining alpha-generating ideas.”*

To conclude, a robust positioning and selection process, an adequate diversification by the issuer, together with a successful and timely hedging activity using derivatives have been the main drivers of this year success. This proves quite well our ability to navigate rough waters while at the same time maintaining alpha-generating ideas.

Performance

As at 20 Nov. 2020	MTD	YTD	1Y pa	3Y pa	5Y pa
Euro BX Acc.	0.49%	3.33%	3.32%	1.21%	1.10%
Benchmark	*0.30%*	*0.66%*	*0.74%*	*0.53%*	*0.75%*

*Source: Source: Generali Investments Partners S.p.A. Società di gestione del risparmio, data as 20.11.2020. **Past performance provides no guarantee for the future. No express or implied liability or guarantee is assumed that the future performance will correspond to the performance described above**. The value of and income from fund units or sub-fund units ("Units") may rise or fall. No guarantee can be assumed that the investment objectives of the subfund will be achieved. The performance of and income from the Units have to be reduced by costs and taxes. The client shall carefully read the KIID, which must be delivered before subscribing the investment, and the prospectus which are available on our website (www.generali-investments.com), on Generali Investments Luxembourg S.A. (Management Company of Generali Investments SICAV) website (www.generali-investments.lu), and by distributors. The subfund change its name from GIS Euro Corporate Short Term Bonds to GIS Euro Corporate Short Term Bond on 19th February 2016.

Only for professional investors subject to the Directive 2014/65/UE that act on their owns and/or on behalf of third parties on discretionary basis.

Could you provide us with some examples of what performed how you expected and what did not?

Subordinated financials of major global banks – in particular T2 bonds – recovered very rapidly all the draw-down suffered in March and all primary deals into this category rallied significantly after the pricing, providing more fuel to the rally engine.

Subordinated insurance bonds continued to be the laggards, irrespective of their even greater robustness and lower regulatory risk. They probably suffer too much their “exclusivity” and investors preferred bank sub-bonds for their greater liquidity and the presence of hedging possibilities using liquid CDS.

We can also mention something that surprised us the most, which was in the portfolio although in minimal part: the rally of legacy T1 bonds – old T1 issued by Banks before the introduction of the Basel rules. A niche market that was pricing a deep discount to par (low coupon, considered perpetual in nature) that rallied after that EBA strongly advised banks to redeem them to avoid having instruments with doubtful equity conversion features – so in practical terms, not useful in case of bank resolution to absorb losses. Now they are all approaching parity after 10-20 percentage point of upside.

In your view, what are the opportunities and threats in the Investment Grade space?

Investment grade (IG) corporate bonds are still an asset class of choice, with inflow facilitated by the lack of other valuable alternatives within the fixed income space and the continued demand for non-financials from Central Banks.

Supply and demand dynamics indicates that, in next months, net supply could even turn to negative as all IG rated companies have already pre-funded their funding needs and are now sitting on huge liquidity buffers - created to circumvent the possible negative effect of the Coved crisis. So, technical elements continue to be favourable and fundamentals are on an improving trend - especially if the vaccines demonstrates to be effective in generating the herd immunity.

However, the other side of the coin is that this situation could immunize every volatility and flatten all curves by issuer and segment. In this situation it is difficult to implement alpha-generating ideas and distinguish the good from the bad stuff, limiting any relative value consideration. This is what I consider the major threat for portfolio managers and investors in 2021.

On top of the stability provided by Central banks, where do see the main driver of performance next year? How do you expect to position the portfolio?

In the short end of the curve, there are a lot of interesting opportunities especially on callable subordinated bonds issued by fundamentally sound banks and insurance companies. Banks are living a strong consolidation phase – a process that started in Spain and is now arriving in Italy and Portugal too. The vast majority of M&A is intra-state, but we also assisted to some cross-border takeover.

Banks are evolving and they will exit stronger from this Covid crisis – also thanks to a benign regulatory framework that helped them to maintain adequate capital levels. That is why we remain positive on the banking segment, keeping our bull stance on selected subordinated paper. Within non-financials, the rotation over segments that can benefit from the incoming vaccine campaign – like airlines, consumer durables, travel and luxury – could generate some interesting opportunities, but it’s still too early to take position. In any case, a stable part of the portfolio would continue to be allocated to quality BBB issuers, more precisely companies with high cash-flow generation capacity and with easy access to the financial market for funding needs.

Key features

AuM	187.27 Mil € (26/11/2020)
ISIN	LU0438548280 (I EUR BX Acc.)
Inception date	July 15th, 2009
Benchmark	Barclays Capital Euro Corporate 1-3 Year Index
Fund Currency	EUR
Domicile	Luxembourg
Management fees	0.35%
Performance fees	Not applied
Management Company	Generali Investments Luxembourg S.A.
Investment Manager	Generali Investments Partners S.p.A. Società di gestione del risparmio

Risk and reward category*

1	2	3	4	5	6	7

Lower risk — Higher risk

Potentially lower rewards — Potentially higher rewards

Source: Source: Generali Investments Partners S.p.A. Società di gestione del risparmio, data as 26.11.2020. *The risk and reward category shown is not guaranteed to remain unchanged and the categorisation of the sub fund may shift over time. For more information about risk, please see the KIID and Prospectus.