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FoFs star: why we are underweight fixed income

By **Terri-Ann Williams** / 01 Feb, 2018 at 11:00

Fund of funds managers would be minded to underweight fixed income but shouldn't pile into new areas - such as risk premia - as a result.

That is according to Banque de Luxembourg Investments' Fabrice Kremer, who is a Citywire A-rated fund of funds manager.

‘We are not even sure that the historical negative correlation between equities and rates will prevail in the near future in case of a correction in the stock market,’ he told *Citywire Selector*.

Kremer, who manages the BL Fund Selection 0-50 fund, said the team were previously keen on M&A strategies but added this sector is now currently less attractive for euro investors.

'The largest part of this strategy is deployed in the US and currently, the cumulated headwind of management fees and currency hedge is eating away more than 3% of gross returns.

'Since we consider that the plain vanilla spread in an M&A transaction should be lower than 500 bps, the residual potential of the strategy seems currently very limited if you do not want to bear the risk attached to the US dollar.'

Another sector of the absolute return space Kremer is also avoiding is risk premia. ‘While risk premia are well identified by many academic studies, we are surprised by the differences in terms of performance when looking at the peer group.

‘Because this heterogeneity seems to hide many differences in terms of approach and implementation and because the asset class is very young we consider that it is difficult to judge if performance rankings reflect superior skills or are just random. Therefore, we stick to our philosophy: just to do what we understand.’

Big changes

Kremer said one of the biggest changes he has witnessed since 2013 when he started managing the fund has been within the rates environment.

‘It was very useful to allocate a large part of the portfolio to fixed income assets such as sovereign, credit and even high yield, in a patrimonial fund like BL Fund Selection 0-50 with a performance target of 3% annualised.

‘But now that yields, especially in euros, are so low, it is not possible any more to feed our performance with this asset class without adding too much credit risk or duration risk.

‘Therefore, we needed to find something else to diversify the portfolio and to keep the potential performance at the same level than before. This is when we decided to add exposure to the Alternative Ucits space, which has experienced a big increase in supply,’ he added.

Over the three years to the end of December 2017, Kremer returned 6.25% in euro terms. This compares with a 2.31% rise by the average manager in the sector over the same time period.