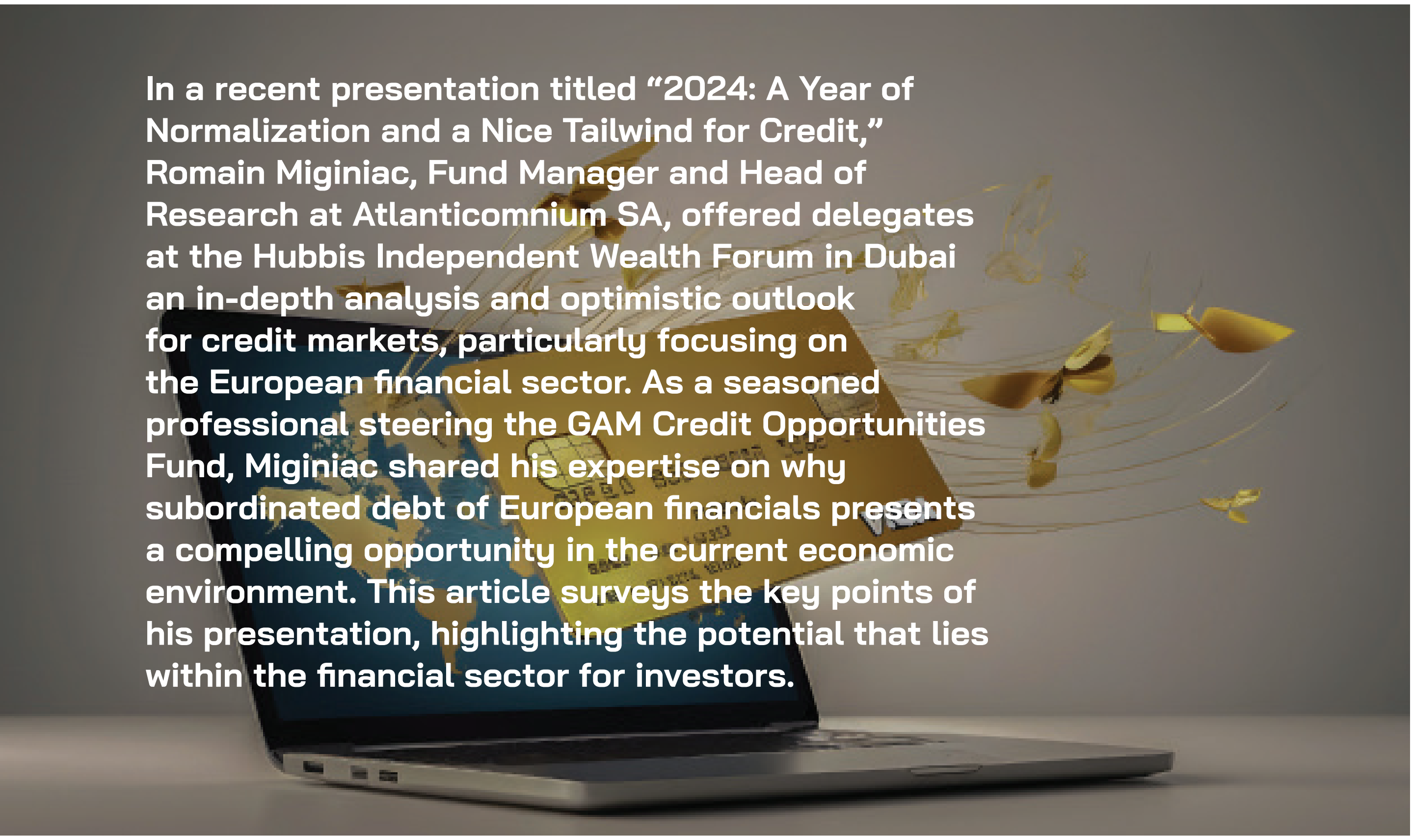
2024: A Year of Normalization and a Nice Tailwind for Credit – Insights from Atlanticomnium's Romain Miginiac



In a recent presentation titled "2024: A Year of Normalization and a Nice Tailwind for Credit," Romain Miginiac, Fund Manager and Head of Research at Atlanticomnium SA, offered delegates at the Hubbis Independent Wealth Forum in Dubai an in-depth analysis and optimistic outlook for credit markets, particularly focusing on the European financial sector. As a seasoned professional steering the GAM Credit Opportunities Fund, Miginiac shared his expertise on why subordinated debt of European financials presents a compelling opportunity in the current economic environment. This article surveys the key points of his presentation, highlighting the potential that lies within the financial sector for investors.

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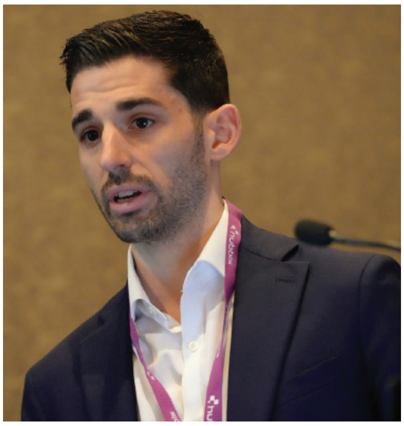

ROMAIN MIGINIAC
Atlanticomnium

The Macroeconomic Backdrop

At the heart of Miginiac's optimism is the current macroeconomic landscape, which he describes as ripe for investment in financials. "We seem to be in this environment where inflation is coming down, central banks will be gradually loosening monetary policy, but yet, the economy remains robust, heading towards a kind of soft landing scenario," he explained.

This scenario, according to Miginiac, creates a conducive environment for fixed income investments, particularly at a time when the last hike from the Federal Reserve marks an attractive entry point. However, he cautions that amidst significant uncertainties, including geopolitical tensions and inflationary pressures, a strong bias towards quality is crucial.

Why Financials?

Miginiac's confidence in the financial sector is strongly underpinned. He points to the regulatory overhaul post-financial crisis that has significantly derisked and strengthened the sector. European banks, for example, have seen a dramatic improvement in their profitability due to higher interest rates, with institutions like HSBC doubling their earnings compared to the past decade. "The amount of money that's available in the form of earnings to protect bondholders in case we go through a recession, in case there's a shock like COVID, is much, much higher than it has been," Miginiac highlighted, illustrating the sector's resilience and safety for investors.

The Appeal of Subordinated Debt

The allure of subordinated debt, particularly AT1 CoCos (Contingent Convertible bonds) issued by European banks, lies in its combination of high yield and relatively low default risk. Miginiac pointed out the mispricing in the market, with yields on such instruments reaching around 8%, and thereby offering a very attractive risk-reward ratio.

The Misunderstood Risks

A significant part of Miginiac's presentation focused on dispelling misconceptions around the risks associated with subordinated debt. He argued that the market overly penalises these instruments for extension risk—the possibility that bonds will not be called at their first call date. Citing historical data, he reassured investors that the majority of AT1 CoCos have been called at their first opportunity, debunking the fear that these bonds would be left outstanding indefinitely.

The Case for Active Management

Miginiac firmly believes that subordinated debt markets, particularly those involving complex instruments like AT1 CoCos, are not well-suited for passive investment strategies. "It's a market where you need to have a conviction on the issuer. If something bad happens, you basically get back zero," he stated, underscoring the importance of selective investment and active management to navigate the nuanced risks and opportunities within this space.

Conclusion: A Promising Outlook for 2024

In conclusion, Miginiac presented a compelling case for investing

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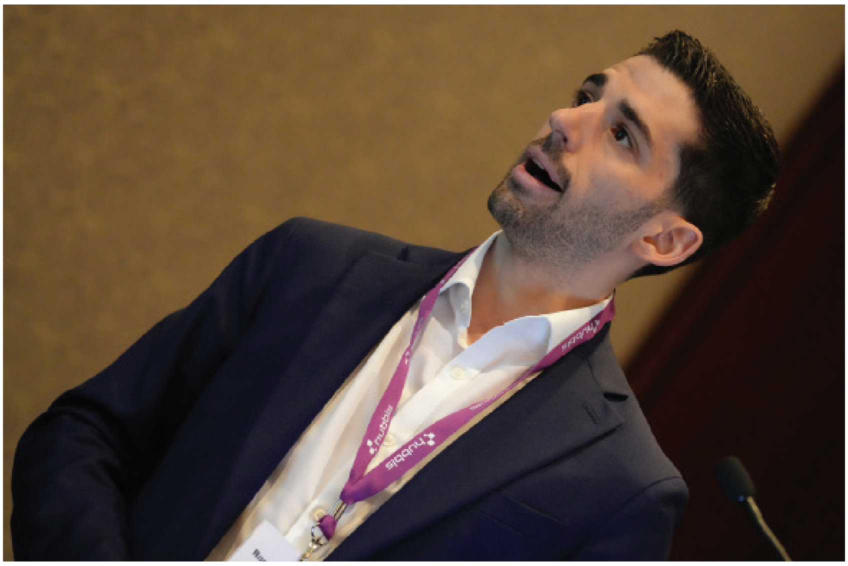

in the subordinated debt of European financials, arguing that the sector stands on solid fundamentals amidst a favourable macroeconomic environment. Despite the prevailing market uncertainties, his analysis suggests that the current conditions offer a unique combination of safety and potential for high returns.

"I think going ahead we're in a market that's mispriced, the 8% yield that we're getting on the market is 100 basis points more in terms of spread than what we're getting on top on high yield," he said, concluding his talk. "We think we're getting paid way too much for the risks that we're taking, the fundamentals are really rock solid and this is one of the best sectors to be invested in and there's still too much extension risk priced in," he stated. "You get very high income from very safe companies, but you still have quite a bit of upside on prices as things normalise and as spreads come down and paper gets called."

As 2024 unfolds, his insights offered guests attending the Forum with a valuable perspective for their investor clients looking to navigate the complexities of the credit market with a strategic and informed approach. ■

For further information and insights, CLICK HERE to view a PDF of their presentation.

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