Commenting on the wider financial backdrop, Bentley says the key challenge facing fixed income investors in 2017 could be managing volatility in a global economy facing increasingly expansionary policies in the U.S. and a more positive growth environment in Europe, offset by political unpredictability.

"While we expect to see some growth in the U.S. and Europe, there are risks and fears inflation could get out of control if it rises more rapidly than expected. There is also some concern over whether U.S. growth policies will be executed properly.

"These, together with concerns on the Chinese economy and uncertainty over the forthcoming European elections mean managing upside/downside volatility in 2017 will be a key theme," he adds.

MARKET MOVES

While the U.S. Federal Reserve’s (Fed) central forecasts indicate it will raise interest rates up to three times this year, Bentley is sanguine about the impact of any hikes. He believes they have already been largely factored into the market.

“We agree on the central case for Fed interest-rate hikes but realistically we believe that is not what is going to drive fixed income markets this year. Instead, we think bond risk scenarios and concerns about inflation could dominate thinking,” he says.

“One risk scenario is the danger that inflation gets out of control, the Fed does not do enough and bond yields spike more quickly. Equally, another risk is that President Trump's pro-growth policies become watered down and are not as effective as initially expected and the U.S. economy starts to slow down towards the end of the year.”

“We believe in analyzing different areas of fixed income in depth, generating ideas that may give us an extra edge in terms of coverage and adopting a systematic investment process with tight
risk management and procedures. We invest in fixed income in a non-directional way—making money in different markets rather than relying on markets to go our way.

FLEXIBLE ALLOCATION

Looking ahead, Bentley says he sees potential pockets of opportunity in a range of fixed income sectors—including emerging market (EM) debt—with low correlations to U.S. Treasuries and bonds. “In terms of very short maturity EM plays, markets such as Brazil, Russia, Indonesia and Colombia all offer high yields and decent value provided you adopt a cautious approach to currency exposure—hedging currency risk while taking yield,” he adds.

CREDIT POTENTIAL

On the credit spectrum, Bentley predicts a relatively benign default environment for assets such as high yield in the months ahead, adding that he prefers to seek selective opportunities in short maturity high yield instruments. In the government bond market the strategy has a short bias, and while Bentley said he expects yields to rise, he remains cautious on developments within the sovereign bond sector.

Against a backdrop of rising inflationary pressures, the strategy has recently taken advantage of potential benefits in the index-linked bond market.

Commenting on market prospects for the months ahead, Bentley says: “From a market perspective, we believe we are in a mildly positive growth phase which holds pockets of opportunity but also some potentially high risks, especially but not exclusively based on political risk.

“While we do expect inflationary pressures to build, particularly in the U.S., we believe there are also some positive stories to come. The key, whether investing in the U.S., Europe or other markets, is to be selective about the assets you buy. Careful research and thorough risk assessment and management will be important factors in achieving success in the months ahead,” he concludes.