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NEWTON'S REAL RETURN TEAM: WHY US RATE RISES COULD BE AN ANTI-CLIMAX

By Stephen Irving, BNY Mellon Investment Management

The fund's global investment manager Suzanne Hutchins says the Fed is unlikely to raise interest rates by more than a nominal amount - if at all - in the short term.

The US Federal Reserve may raise rates once or possibly twice later this year but a substantial 'normalisation' of interest rates is not on the cards, according to Suzanne Hutchins, global investment manager and a member of the Newton's Real Return team. Hutchins adds that 'normalisation' – were it to occur – would be likely to involve interest rates going up to 3% or 4% based on previous cycles.

The prevailing view seems to be that US interest rates will go up by much more than the team anticipates. However, as the expectations of market participants shift from the probability of a considerable rise in interest rates to a much less steep one or even to no hike, this is likely to coincide with a period of weakness in the US dollar.

The bounce, for instance, in the price of oil or in some emerging-market economies, will not, in the team's view, last and is more a reflection of the weak dollar than the improving prospects in those areas, says Hutchins.

The team's view on US Treasuries has been relatively positive and in structural terms remains so. This view encapsulates the notion that Treasuries represent reasonable value relative to other core government bond markets and the team has confidence in the ability of the US economy to pay back its debts. However, the team has recently seen a 'back-up' in yields and, importantly, a change in correlations between equity markets and debt markets.

The Real Return team fears that investors may already have drawn their own conclusions about the first US interest-rate rise and that this has contributed to a continuing sell-off in the Treasury market. Tactically, the strategy has reduced its exposure to the US Treasury market but with an expectation of re-establishing that position should a further back-up in yields be observed.

"We continue to have hedging in the strategy, predominantly in the form of an S&P short future position, and we still have exposure to gold. Therefore, taking into account the government bond exposure that we still have in areas such as Australia, as well as the cash position, the hedging and, arguably, the exposure to gold, there is a case for asserting that the Real Return strategy is as defensively positioned today as it was back in 2008," Hutchins concludes.

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