



Does it still make sense to invest in subordinated financial bonds?



Philippe Lomné

Fixed Income Portfolio Manager
 Specialisation: IG Credit IG &
 Crossover

Subordinated financial bonds are a unique asset class and a historic performance driver for our Fixed Income expertise, with particularly attractive characteristics in the current environment.



Jérôme Loire

Credit analyst

Solid fundamentals for highly regulated players

Looking at valuation levels and fundamentals, we are convinced that financial subordinates bonds are a prime market segment. At equivalent ratings, these securities offer an excess return compared with those from other sectors and, over the past two years, we have seen a clear outperformance. We believe that the window of opportunity is particularly attractive, especially given the levels of volatility. We are looking to capture this volatility because we are confident about the fundamentals of issuers.

Particularly in Europe, these are healthy. Banks are implementing share buyback programmes, profitability is high, solvency levels are good and the players are in a position to withstand a recessionary shock. What's more, unlike before the last major financial crisis, European banks no longer have cross-shareholdings, which limits the risk of impairment in the event of a player going bankrupt. Similarly, to counter liquidity and counterparty risk, the world's main central banks have unlimited swap¹ agreements to cope with a drying-up of the markets, particularly the euro-dollar market.

High solvency and renewed profitability in Europe

Every two years, the ECB conducts stress tests to assess banks' preparedness and resilience in the event of a financial or economic shock. In July 2023, following the collapse of Credit Suisse, the ECB raised its already high stress assumptions: a doubling of the unemployment rate, two successive years of recession, a fall in commercial and residential property prices, interest rates and credit spreads² shock, etc. Following these tests, no capital increase was deemed necessary under the most pessimistic scenario. Whether in terms of solvency, profitability or liquidity, the fundamentals of the European banking system have never been so solid. Moreover, the latter is offering visibility on its operating and net profitability, beating consensus estimates quarter after quarter. Peripheral countries are even making a "comeback", particularly banks in Southern Europe. The clean-up of their bad debts has also encouraged a resumption of consolidation in the sector.

Risk factors currently under control in the United States

In the United States, Donald Trump's return to power raised fears of deregulation of the financial sector, but the appointment of Michelle Bowman, considered to be moderate, as Vice-Chairman of the Fed in charge of banking supervision, tempered this risk. Much to the dismay of the current US President, the US Federal Reserve is also taking a very cautious approach to monetary policy, leaving the Fixed Income markets exposed to a rate risk. Jérôme Powell recently indicated that inflation could be more persistent and that a rate hike could not be ruled out. Expectations of a more accommodative monetary policy have even receded in recent weeks.

Although the Silicon Valley Bank case is still fresh in people's minds, the risk of bankruptcy linked to a rise in interest rates is coming under increased monitoring. The Fed has drawn conclusions from this event and has put in place measures to counter it. The Bank Term Funding Program now allows it to buy back at par securities that have been written down due to interest rate risk. We also believe that the risk of deposit flight is limited and confined essentially to the 'small' regional banks.

An investment universe to express your convictions

In addition to banks, the universe of subordinated financial bonds is broad and diversified. Among its sub-sectors, we are paying particular attention to listed and mutual insurers. Their profitability is attractive, even if it is lower than that of the banking sector, and their solvency is very good. There are many investment opportunities, particularly through refinancing.

The market for contingent convertible bonds (CoCos)³ is also growing, and we are no longer a niche market. This segment is large enough to express convictions. There is strong investor demand, the market is dynamic and there are many large issues. These securities offer an excess carry compared with High Yield⁴ bonds for very comfortable

fundamentals, with issuers generally benefiting from higher ratings. We believe it is a good time to be exposed to them.

Know-how at the heart of our Fixed Income expertise

All these factors make financial subordinated bonds an asset class worth considering, especially in the current environment. The volatility that is likely to continue to drive the markets will be a source of opportunities. However, while these securities still offer an attractive premium, it is becoming necessary to be selective within the capital structure.

We have long-standing expertise in analysing and managing this type of bond. They have historically played an important role in the allocation of most of our Fixed Income strategies; for example, they account for half the allocation of our flagship R-co Conviction Credit Euro fund. At the end of 2021, we launched R-co Conviction Subfin, a fund invested exclusively in this market segment. Much more than a simple diversification tool, this investment solution provides direct exposure to one of the main performance drivers of our credit management.

Learn more about the fund(s)

R-co Conviction Subfin



R-co Conviction Credit Euro



Check this document on our website



(1) A financial derivative, swaps are contracts between two parties to exchange cash flows for other cash flows over a given period.

(2) The difference in yield between a bond and a loan of equivalent maturity considered to be 'risk-free'.

(3) Halfway between a share and a bond, their characteristics are similar to those of convertible bonds. These securities are issued by banks to strengthen their capital base. They can be converted into shares as soon as the equity ratio falls below a defined threshold, providing a cushion in the event of financial stress. Because of the higher risk of loss associated with their potential conversion, they offer higher yields than 'conventional' bonds.

(4) High-yield bonds are issued by companies or governments with a high credit risk. Their financial rating is below BBB- on the Standard & Poor's scale.

Disclaimers

R-co Conviction Credit Euro

Recommended investment horizon: 3 years SRI : 2/7

The risk indicator assumes you keep the product for 3 years. The actual risk can be significantly different if you choose to exit before maturity, and you may get back less. The synthetic risk indicator provides an assessment of the level of risk of this product compared to others. It indicates the likelihood of this product incurring losses in the event of market movements or if we are unable to pay you. We have classified this product as being in risk category 2 out of 7, which is a low risk class. This reflects primarily its positioning on private debt products while maintaining a sensitivity between 0 and +8. In other words, the potential losses from the product's future performance are low, and if markets were to deteriorate, it is very unlikely that our ability to pay you would be affected. This product does not include any protection from future market performance or a capital guarantee, so you could lose some or all of your investment.

R-co Conviction Subfin

Recommended investment horizon: 3 years SRI : 2/7

The risk indicator assumes that you hold the product for 3 years. The real risk may be very different if you opt to exit before maturity, and you may get less in return. The synthetic risk indicator enables you to assess the level of risk of this product compared with others. It indicates the likelihood of this product incurring losses in the event of market movements or our inability to pay you. We have classified this product in risk class 2 out of 7, which is a low risk class and mainly reflects a discretionary management policy that exposes the portfolio to the bond markets in a diversified manner over the medium term. In other words, the potential losses linked to the future performance of the product are low and, if the situation were to deteriorate on the markets, it is very unlikely that our ability to pay you would be affected. As this product does not provide protection against the vagaries of the market or a capital guarantee, you could lose all or part of your investment. Other materially relevant risks not taken into account by the indicator: credit risk, liquidity risk, impact of techniques such as derivatives. For more information on risks, please refer to the fund's prospectus.

Advertising communication. Please note that past performance is not a reliable indicator of future performance and is not constant over time. The value of investments and the income derived from them may go down as well as up, and is not guaranteed. You may not get back the amount you originally invested. Changes in exchange rates may increase or decrease the value of investments and the income derived therefrom when the reference currency of the UCI is different from the currency of your country of residence. UCIs whose investment policy is aimed more specifically at specialised markets or sectors (such as emerging markets) are generally more volatile than more generalist funds with a diversified allocation. For a volatile fund, fluctuations can be particularly large, and the value of the investment may therefore fall sharply. The performance shown does not take into account any fees and commissions charged on the subscription and redemption of units or shares in the fund concerned. The portfolios, products or securities presented are subject to market fluctuations and no guarantee can be given as to their future performance. Tax treatment depends on the individual situation of each investor and may be subject to change. The information, comments and analyses contained in this document are provided for information purposes only and should not be considered as investment advice, tax advice, a recommendation or investment advice from Rothschild & Co Asset Management. The information/opinions/data contained in this document, considered legitimate and correct on the day of publication, in accordance with the economic and financial environment in place on that date, may change at any time. Although this document has been prepared with the utmost care from sources deemed reliable by Rothschild & Co Asset Management, it offers no guarantee as to the accuracy or completeness of the information and assessments it contains, which are for information purposes only and are subject to change without notice. Rothschild & Co Asset Management has not independently verified the information contained in this document and therefore assumes no responsibility for any errors or omissions, nor for the interpretation of the information contained herein. All these data have been established on the basis of accounting or market information. Not all accounting data has been audited by a statutory auditor. Furthermore, given the subjective nature of certain analyses, it should be emphasised that any information, projections, estimates, expectations, assumptions and/or opinions are not necessarily put into practice by the management teams of Rothschild & Co Asset Management or its affiliates, who act according to their own convictions. Certain forward-looking statements are prepared on the basis of certain assumptions, which are likely to differ either partially or totally from reality. Any hypothetical estimate is, by its nature, speculative and it is possible that some, if not all, of the assumptions relating to these hypothetical illustrations may not materialise or may differ significantly from current determinations. This analysis is valid only at the time of writing. R-co Conviction Credit Euro is a sub-fund of the French Société d'Investissement à Capital Variable 'R-Co', whose registered office is at 29, avenue de Messine - 75008 Paris, registered under number 844 443 390 RCS PARIS. R-co Conviction Subfin is a sub-fund of the French Société d'Investissement à Capital Variable 'R-Co 2', whose registered office is at 29, avenue de Messine - 75008 Paris, registered under the number 889 511 747 RCS PARIS. The information does not presume the suitability of the UCI presented to the profile and experience of each individual investor. Rothschild & Co Asset Management shall not be held liable for any decision taken on the basis of or inspired by the information contained in this document. In case of doubt, and before any decision to invest, we recommend that you contact your financial or tax advisor. The Undertaking for Collective Investment (UCI) presented above is organised under French law and regulated by the Autorité des marchés financiers (AMF). The net asset value (NAV) is available on our website. The information presented is not intended for distribution and does not constitute an invitation to US persons or their representatives. The units or shares of the UCI presented in this document have not been and will not be registered in the United States under the U.S. Securities Act of 1933, as amended ('Securities Act 1933') or admitted under any U.S. law. These units or shares must not be offered, sold or transferred in the United States (including its territories and possessions) or benefit, directly or indirectly, a 'U.S. Person' (within the meaning of Regulation S of the Securities Act of 1933) and assimilated persons (as referred to in the American 'HIRE' law of 18/03/2010 and in the FATCA system). Published by Rothschild & Co Asset Management, a portfolio management company with capital of €1,818,181.89, 29, avenue de Messine - 75008 Paris. AMF approval no. GP 17000014, RCS Paris 824 540 173. This document may not be reproduced in whole or in part without the prior permission of Rothschild & Co Asset Management, under penalty of prosecution.

About the Asset Management's division of Rothschild & Co

As the specialised asset management division of the Rothschild & Co group, we offer personalised asset management services to a broad client base of institutional investors, financial intermediaries and distributors. Our development is focused on a range of open-ended funds leveraging our long-term expertise in active management with conviction as well as in delegated management. Based in Paris and operating in 10 European countries, we manage more than 50 billion euros and employ nearly 200 people⁽¹⁾. More information at: www.am.eu.rothschildandco.com

(1) Source: Rothschild & Co Asset Management, 31/07/2026.

France

29, Avenue de Messine
75008 Paris
+33 1 40 74 40 74

Belgium – Netherlands – Luxembourg

Rue de la Régence 52
1000 Bruxelles
+32 2 627 77 30

Switzerland

Rothschild & Co Bank AG
Rue de la Corraterie 6
1204 Genève
+41 22 818 59 00

Italy

Passaggio Centrale 3
20 123 Milano
+39 02 7244 31

Germany - Austria

Börsenstraße 2 - 4
Frankfurt am Main 60313
+49 69 299 8840

Spain

Paseo de la Castellana 40 bis
28046 Madrid
+39 02 7244 31

[Visit our internet site](#)



[Follow us on LinkedIn](#)

