

Strategic bonds webchat transcript

On Thursday 2 December 2010, we hosted a live web chat with investment experts Sheridan Admans, investment adviser at The Share Centre, and Stewart Cowley, Head of fixed income at Old Mutual Asset Managers, to discuss how you could benefit from investing in strategic bond funds.

Thank you to everyone who joined in and asked questions. Here are the responses.

Q: What is a strategic bond fund?

Stewart: With a strategic bond fund you can use lots of levers. You can use corporate bonds, government bonds, currencies or derivatives and what you have is so many more levers compared to a single asset type fund. This means you have much more chance of performing in a range of market conditions rather than just in one.

Q: Why should i invest in a strategic bond?

Sheridan: A strategic bond fund has the ability to be more dynamic and should be able to deliver returns in most economic conditions. As Stewart has already mentioned a strategic bond fund can invest in a wide variety of fixed interest investments. Also, the management of this is with a professional who is watching the markets on a daily basis and therefore is able to be fluid with his or her application.

Q: I have read in the press that corporate bonds are in a bubble. What are your thoughts and what are you doing in the fund?

Stewart: Corporate bonds are not the same as equities where in the telecoms bubble of the late 90's. There is demand for corporate bonds and at the same time there is a need to keep yields low to help companies. So although headline yields may look historically low, they are actually appropriate for the current economic conditions and we would argue that they need to go even lower.

Q: If inflation makes a comeback, how can managers protect investors?

Stewart: First of all we don't expect inflation to come back for quite some time so it might not be something you need to consider in 2011. Because of the process of quantitative easing there is going to be a very strong case for a rapid rise in interest rates in the next few years. No one knows when that exact point will be, but whether at that time inflation is real or just imagined by the markets it is very likely that yields will rise rapidly.

Most bond funds, because of their mandate, will experience capital losses at this point. Fortunately, in our fund we have the capacity to actually benefit from rising yields. If we can capture that turning point we may be able to help investors protect themselves from that environment. Interestingly our global strategic bond fund has gone from £35m to £400m in the past year because investors are looking for this kind of ability from a fund in the future.

Q: What sort of investor should consider investing in a strategic bond fund?

Stewart: I think investors are very uncertain at the moment and strategic bond funds offer a complimentary property aspect to an overall portfolio because they can act as a counterweight against the equity portion in volatile markets. Not only do they have return characteristics, they also have a risk management role within an overall portfolio, hence their popularity.

Sheridan: I echo Stewart's words. We are seeing a significant increase in strategic bond investment since the end of 2009 due to the uncertainty and fear within the markets.

Q: What are the charges levied on Stewart's fund?

Sheridan: The Old Mutual Global Strategic Bond fund has a standard initial charge of 3.5% and an annual management charge of 1%. The Share Centre is currently offering the favourable terms of no purchase commission and 0% initial charge. This fund also features in our list of preferred funds, the Platinum 120.

Q: How much global exposure does the Old Mutual Fund offer?

Stewart: It is a global fund and typically over 50% will be invested outside the UK. That doesn't mean we always have more than 50% exposed to currencies other than the pound. We have great flexibility with, so if the pound is rising against most currencies we can have the fund with no foreign exchange exposure. However, if the pound is falling, for strategic reasons we can have a minority of the fund exposed to the pound. If the pound falls you can get a kicker on the unit price, this is very useful because it is just another one of the levers we can pull when strategically we think it is correct.

Q: Can you explain to me what a bond is?

Sheridan: Bonds are essentially IOU's from an incorporated company or government to an individual or corporation who has lent them money. In return for the loan, the investor will receive an amount of interest (known as a coupon payment) from the company for the period of the loan's life. If held until the end of the loan's term, the amount should be repaid in full.

Q: I read that high yield bonds are the place to invest in 2011, what are your thoughts and is the fund currently exposed to any?

Stewart: The great thing about running a strategic bond fund is that you can allocate to and from corporate bonds. In October of this year we brought our allocation down from about 35% to 20%. Interestingly the recent problems in Ireland, Portugal and Spain have pushed yields up and we now have an opportunity to strategically reallocate to corporate bonds and rebuild the portfolio back up to 35%.

An interesting area is high yield. We are going to recreate a well diversified area of the portfolio in high yield bonds from companies that are going to survive what is going to be a pretty brutal economic environment in 2011. We are going to have to pick out the survivors, which will require a careful credit search, company by company and issue by issue.

Q: How long do you recommend the fund is invested in for a conservative return on your investment?

Sheridan: When investing in funds and also with regards to the complexities of owning the right asset at the right time, we always recommend an investor can afford to invest in a fund for a minimum of three years, preferably five. However, given the benefits offered by a strategic bond fund and its ability to potentially deliver returns in most economic conditions, a fund like Stewart's could be held for much longer and deliver reasonable income and some potential for growth.

Q: On your factsheet you mention that the fund can be hedged back to sterling - I do not understand what this means, could you please explain in simple terms.

Sheridan: If the pound goes down against a currency you will make a gain, which is great for the unit price, however the opposite can also be true. In order to take that volatility away or avoid a possible decline in the unit price, you can hedge your bets. This means selling the Euro, the Dollar or the Yen to cover that exposure and this is what we mean by hedging back into the pound.

Q: Given the question marks that hang over further quantitative easing in the UK and the unpredictable global economics, how much thought do you give to the purchase of assets in the fund based on the unpredictable undated scenarios?

Stewart: We position the portfolio strategically for that horizon, which means we can own assets which have maturity dates which are longer than a year. The important thing is to catch a turning point and strategically we think our ideas will carry us into 2011 and maybe beyond. We are comfortable owning longer dated assets.

Q: How can I research the fund manager in these strategic bonds? Should I follow the fund or follow the manager?

Sheridan: An excellent tool for measuring management performance can be found on Trustnet. Stewart is considered one of their elite managers accredited with the badge "Alpha Manager". We would always recommend that you follow the manager's performance rather than the fund.

Q: How could a strategic bond fund benefit me in an inflationary and deflationary environment?

Stewart: Deflation is associated with falling yields and amazingly one of the leading economies in the world, the USA, is heading into a strongly deflationary environment. And as we know, where America goes, we follow. Although the UK and Europe have the own problems, the West are all strongly integrated. That is why we are looking for declining yields which in bond language means rising prices. The fund is fully invested in bonds right now to capture yield declines and price rise which should propel the price upwards going forwards.

Q: According to Cofunds, strategic bonds are currently the second highest selling funds sector. Do you expect this trend to continue and will they ever match the cautious managed sector in terms of popularity with investors?

Sheridan: Whilst markets remain unpredictable strategic bond funds are likely to remain one of the highest selling sectors. As per this ever matching the cautious managed sector, only time will tell.

Q: What about government bonds from troubled economies like Ireland - are these better than corporate bonds for a decent return?

Stewart: Nobody knows what is going to happen with Portugal and Ireland type bonds in the future. Many of these economies face a decade of austerity given their current debt levels, or at some point governments may attempt to wipe out part of that debt by refusing to repay. This will put risks around them which we consider to be too high at this time. What we need to see in the future is the technical resolution of this issue within Europe. We are waiting for an announcement from the ECB at 2.30pm today which will partially answer this question, but even after that risks will remain high.

Q: Sheridan, why do you like this fund?

Sheridan: Stewart's performance, both at Old Mutual managing this strategy and at previous investment houses, has been consistently exceptional and he is a top performer in his asset class. On the total return basis this fund has delivered attractive numbers against its sector benchmarks and also the forethought given to his portfolio construction makes Stewart a manager we want to be associated with. We also like its global reach.

This fund is within our Platinum 120 range of preferred funds and is also ISA'able. As always, your attitude towards risk, the time period you are looking to invest for and your objectives are key when asset allocating any investment. Not being aware of your personal circumstances it is hard to answer in this instance, we would recommend you seek independent financial advice.

Q: Do you think we will win the World Cup bid? If so will this benefit the Fund?

Stewart: This is an interesting question because it is a well known phenomenon that economies that hold major sporting events experience inflation. This is because of the rise in housing, food and construction prices both in the lead up to the event and afterwards. One only has to look at the last world cup in South Africa where seats on aeroplanes between Cape Town and Johannesburg went from costing just a couple of hundred of pounds to over a thousand pounds. These effects tend to linger after a sporting event, so there are actually inflationary consequences surrounding events like the 2012 Olympics in London and if we win the World Cup. However for Brazil, both an Olympics and a World Cup in the space of a few years could pose a major headache to economic policy centres.

Q: You talk about using currency fluctuations to boost performance yet you also say that the fund is hedged against currency risk. I'm confused as to whether the fund does or does not have currency risk. Can you clarify?

Stewart: We have the ability to take out all currency risk, but strategically. against the pound we like the commodity currencies such as the Australian dollar, Canadian dollar, South African rand and small amount of Japanese Yen, which we expect to appreciate against sterling going forward. That is why we are not totally hedged into the base currency of the fund.

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Sheridan: We hope this has gone some way to demystifying strategic bonds as a form of investment and I'd like to personally thank Stewart for joining us today.

Stewart: Thanks for all your questions.

Don't forget, investments, their value and the income they provide can go down as well as up and you might not get