

“An investment in knowledge always pays the best interest”

Fund Manager Meeting Notes – Alternatives to fixed interest investments



perfect safe haven.

The challenge for developed market bonds is that interest rates are likely to go one way, and that is up. As the market prices increase it impacts on returns. There are ways to counter this using what is known as short duration, high yielding assets or even equities (for strategic bond funds) however we feel all these are doing are squeezing a small amount of return for little benefit.

The problem is that the FCA continues to see these assets as low risk despite articles indicating that these will deliver negative or flat returns over the next five years. We don't know when the tide will turn but we want to move before it does.

This means we need to find an alternative which has bond like characteristics. We continue to believe that the Standard Life GARS Fund is an excellent alternative, and in 2012 we introduced Emerging Market Bonds which we believe have better characteristics than Developed Market Bonds.

We have identified two potential alternatives to the M&G Optimal Income Fund. This update is a brief overview of each of the options. No final decision will be made until we build the portfolios but both funds will be added to our watch list.

The two options are the Threadneedle Credit Opportunities Fund and GLG Total Return Fund. We have already provided a review of the GLG Fund but below is a brief update on the fund.

The meetings in London were conducted with James Ind who is the Fund Manager of the GLG Total Return Fund and Alasdair Ross who is the co-manager of the Threadneedle Credit Opportunities Fund.

Overview of the fund

GLG Total Return Fund

The fund to some extent is like GARS so it is a concept that we are familiar with. The fund is new, however where we believe it stands out from the competition is that it has the breadth and depth missing from many alternative options.

The fund has been developed over a number of years as a bond replacement strategy. It draws on the hedge fund expertise within the GLG / Man Group and this is a big plus for running this type of fund.

When we search out the characteristics of a fund the key has to be the volatility which in this case is set around 7% (which is comfortably within bond type volatility), but what is more important is a circuit breaker if the volatility hits 12% where they have to automatically cut risk. In reality we discussed this and the fund would look to cut risk before this event occurred.

It is a macro fund and so much is made of the strategy group which discusses macro-economic views, selects themes and then analysis trade opportunities. There are

three pillars that they use – absolute value which looks at longer term horizons (so 2 years plus) and might be for example Brazilian inflation-linked debt, relative value which looks at medium term horizons (so less than two years plus) and might be for example short Australian Dollar vs US Dollar and then opportunistic so for example short US equities.

The aim is that the different themes and trades means that you create an equity and bond neutral fund which means that the fund is not dependent on the rise and fall of the market and it is not dependent on one risk factor. So where we have concerns about bonds this takes that risk away, and equally if we were concerned about equities again it would take the risk away.

We have to look at fixed interest as low volatility and market neutral and this fund can deliver this at a time when we are uncertain where the developed market bond market is heading.

Just touching on the team, the strategy team is six strong with James making the final decision and the wider team is 16 strong. The GARS Fund which has been running since 2008 has just over 30 people and the new Invesco Fund 5 people so for a new fund this shows the support that has been put in place to develop this strategy.

We think over time there will be a difference between GARS and this fund but it is too early to identify at this stage.

Threadneedle Credit Opportunities Fund

We don't want to totally exclude bonds if we can identify a way to extract return from credit markets. One of those options is the Threadneedle Credit Opportunities Fund.

There remain two concerns on this fund – the target return is 3.5% gross, so after charges this is below 3%, and the second is that it seems to do a lot of trades (which are not as easy to understand as a multi asset fund) for little benefit.

None of these are a reason not to use the fund but they remain a nagging worry to us. The aim of the fund is to remove duration and credit risk which are the two worries for bond funds going forward. There are five

strategies, the core strategy is called carry trades which may include long credit but shorter maturities and then this is overlaid by four tactical strategies. These include events which are centred around a corporate event, in 2009 there was a rich source of opportunities now this has reduced significantly and is a small part of the fund. Another is a basis strategy so long the bond of a single issuer versus a short derivative position of that same instrument. In 2009 / 10 basis was a large position in the fund now it is nil.

Other strategies include directional and relative value.

Like GARS and GLG funds you are buying the team and to some extent it is the same with these funds with the multi asset strategy, but this is limited to the global credit market. The fund itself has only a small following in the UK and 80% of sales come from Europe.

We touched on Alasdair's view of the market. He accepts that rates will go up but he thinks that rates will not go up soon. Even if QE stopped economies they need to be robust enough to take an increase in rates and at the moment they are not. If it does happen he believes the fund can withstand this and still deliver the target return.

Conclusion

In summary we think developed market bonds will struggle to deliver flat returns, if we do still want exposure to this we could opt for the Threadneedle Fund however we remain concerned that we could be trying to deliver small returns for maximum effort. The GLG Fund although not a bond fund could be an alternative to GARS and therefore could work alongside it. It is a bond replacement strategy so could be the right replacement. We will model both options before we make a final decision.

The source of information in this note has been provided by Threadneedle and GLG and is correct as at November 2013. These are notes from meeting the fund manager or representative and should not be seen as a recommendation to purchase any fund mentioned. Any reference to shares is not a recommendation to buy or sell. Should you wish to make a decision based on these notes we cannot take responsibility for this and you should carry out your own research before making a decision. You should note that past performance is not a reliable indicator of future returns and the value of your investments can fall as well as rise.