

SHINING A LIGHT ON..... AXA STERLING CREDIT SHORT DURATION BOND FUND

At a glance

Over the past ten plus years bonds have enjoyed a bull market; this is likely coming to an end. Investors can no longer expect the same level of returns and potentially there could be greater volatility. Volatility is what investors hate - this is the swing in the value of their investments, either in a positive or negative direction and for bond investors it's definitely not what they are after!

To tackle this we are seeing bond like funds (with low volatility) and pure bond funds which look to thrive in this environment. We are nervous of bond funds which adopt complex strategies for little perceived return however we are also aware that investors who like bonds will still want bonds.

One fund which is attracting investor attention is the AXA Sterling Credit Short Duration Bond Fund. This is seeing money coming from investors who want to move up the risk scale so from cash to bonds in the hope of better returns, and those who are currently in bond funds but are worried how they will respond to a rising interest rate environment and therefore want to reduce the level of risk they are exposed to.

It's important that investors' expectations are set at the start; this fund is unlikely to deliver double digit returns. In the current environment the manager expects returns to be around 2% but he believes that as interest rates rise so the returns will increase to ensure it continues to deliver above cash returns. The crucial part of this is that the manager will deliver these returns whilst keeping volatility at currently below 2%. For many investors this may be attractive either as a standalone investment or as part of a portfolio of investments.

The returns are not guaranteed and it can deliver negative returns so there remains risk especially for those who are moving out of cash and want their capital protected.

Who are the team behind the fund?

The manager is Nicolas Trindade who joined AXA in 2006 and he has managed the fund since its launch in November 2010. When we met the manager it was clear that his main focus was to deliver an investment where investors can sleep well at night. It is difficult to judge the performance but we can judge the volatility and he has consistently been able to minimise this. He is also aware of the risks of the fund becoming too big and having an adverse impact on both the performance and volatility. Currently this is not an issue but it is something that is constantly followed.

Nicolas has the back up from the wider AXA Group and is supported by Nick Hayes who is the co-manager. As much as you can judge a manager we felt comfortable with the process that Nicolas has adopted to manage this fund.

Fund highlights?

For a large part of the meeting we discussed the current economic environment. The key question is when interest rates will rise. The expectation of this happening sooner has pushed up gilt yields which have seen a rally in gilts this year. The question is how it is tackled; the view is that it will be incremental with the UK going first in Q1 2015 and the US following later in 2015.

Timing is crucial, although there appears to be a housing bubble much of this is concentrated around the South East and therefore the UK is using other tools to slow this down. Banks have more stringent stress tests and the new mortgage requirements are tools to slow down the thirst for property.

The key is around the drivers of the UK economy, although consumer spending is improving much of this is coming from savings. This needs to reverse. Equally companies need to invest more and there is an expectation that increases in wages will start to come through. GDP is also expected to be strong by the end of the year.

With these factors in place there has to be a move towards normalisation at some point because as it stands there are imbalances within the economy and these need to be corrected. To play this the fund has increased its exposure to floating rate notes (floating-rate notes protect investors against rising yields and interest rate hikes). He has increased his exposure to Europe where companies remain cautious and holding cash on their balance sheets. As the US economy improves he believes the outlook for bond holders is less positive and therefore he has started to decrease exposure.

The active management is crucial to the fund and this is done by investing in assets which have a maturity period of up to 5 years meaning around 20% matures each year. It means he can respond a lot quicker than funds which have longer maturity periods and more importantly focus on both capital preservation and reducing exposure to interest rate sensitivity.

In the discussion we talked about capital risk and the answer provided helps in understanding where to place the fund. When the market is rising the fund will capture around 64% of the upside and when the market is falling around 42% of the downside. So effectively the rise and fall of the fund is less than other similar funds but it does this with volatility below 2%.

Investors have to accept that the last five years have been an unusual time for investing. It is clear that there will be greater volatility in the market with reduced upside. There is unlikely to be a bond bubble burst because that would assume that everyone rotates out bonds to another form of asset class. However, with rising interest rates bond returns will be squeezed. Funds like the AXA Fund offer some protection in this environment both on the upside and downside and therefore this may be a good blend with a portfolio of assets or as a standalone fund.

However, investors need to accept especially when coming from cash that it can deliver negative returns and that returns will be more attune to cash plus returns.

In conclusion we see this as a well-managed fund providing a degree of protection in increasingly volatile markets. It is likely to appeal to those investors seeking cash plus returns, or those looking to blend with more volatile assets to reduce down the overall volatility. It possibly won't appeal to the more adventurous investor.

LWM Consultants Ltd

Fund performance

The table below shows performance since launch in November 2011 against the IMA OE Money Market Sector.

	2011	2012	2013	2014	Since Launch
PAXA Sterling Credit Short Duration Bond Fund	2.18%	6.37%	1.38%	1.18%	11.30%
IMA OE Money Market	0.03%	0.49%	0.23%	0.12%	0.92%

Volatility vs IMA Money Market Sector



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. The total return reflects performance without sales charges or the effects of taxation, but is adjusted to reflect all on-going fund expenses and assumes reinvestment of dividends and capital gains. If adjusted for sales charges and the effects of taxation, the performance quoted would be reduced.

Conclusion

The fund does not provide a target return but the manager clearly looks to keep volatility low and protect capital. For those investors looking for bond exposure this may be an option in an environment of increasing interest rates.

The source of information in this note has been provided by AXA and is correct as at June 2014. 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 rise.