Diversify to find success in bond markets

Avoid bonds that are most exposed to inflation and sensitive to interest rate moves

Lorna Tan
Invest Editor

Mr Eagan, who has 24 years of investment industry experience as a portfolio manager and fixed-income analyst, is not expecting a material change in the near-term investment landscape between now and when Mr Trump takes office. ST PHOTO: NIVASH JOYVIN

Mr Matt Eagan, portfolio manager for multi-sector products at Loomis, Sayles & Company, discusses his outlook on fixed income and investing opportunities in the latest in our series featuring fund managers and leading market experts.

Mr Eagan, who has 24 years of investment industry experience as a portfolio manager and fixed-income analyst, is a co-portfolio manager of the Loomis Sayles Multisector Income Fund.

The fund invests in a global investment universe, including US investment-grade corporates, non-US debt, emerging market debt, high yield, convertibles and equities. Launched in 1997, the fund became available to retail investors in Singapore from June 2013.

It notched up a return of 10.31 per cent (7 per cent after taking into account the 3 per cent maximum sales charge) in the 11 months to Nov 30, compared with 3.82 per cent for the Bloomberg Barclays US Government/Credit total return SGD Index.

Q *Can you briefly explain your multi-sector income approach to navigating market volatility and unearthing opportunities?*

A The fund is guided by the belief that financial markets are inefficient over the short term. Our strategy tends to focus on where the market is mispricing risk in credit, currency and rates. The benchmark does not serve as a starting point for portfolio construction; we will look across global sectors for the best investment opportunities on a risk-adjusted basis.

Q *What are the key opportunities in 2017 in the global bond markets?*

A Looking ahead, the macro environment should gain momentum with steady gross domestic product (GDP) growth globally and in the United States. Inflationary pressures are building and may accelerate, given the potential for fiscal stimulus along with strong employment conditions in the US.

Risk assets can benefit from this backdrop and our current exposure to credit in the fund is more than 45 per cent, which is driving the excess return year-to-date. Credit-risk premiums have declined and current valuations are pointing to late stages of the credit cycle but, in our view, a rebound in corporate profitability can extend this current phase of the credit cycle.

Q *In view of the potential rate hikes over time, how do you manage interest rate risks? What are the other risks investors should watch out for this year?*

A The US presidential election outcome raises the prospect for meaningful fiscal stimulus, less regulation and higher inflation in the coming years. We believe the fund is well-positioned, given our forecast for rates, which includes three hikes by the US Federal Reserve over the next 12 months.

A key risk we are monitoring is the potential negative impact on global growth and our non-US$ holdings under the assumption of a stronger US dollar driven higher by loose fiscal policy, tight monetary policy and restrictive trade policies.

Q *US President-elect Donald Trump is an example of the trend of populist movements, which are turning to fiscal spending. How do you see this affecting growth and inflation in the US? What is the impact for the rest of the world?*

A Any Trump fiscal stimulus is expected to have a greater impact in late 2017 and into 2018. That said, post-election, we have seen a pick-up in risk markets on the expectation of faster GDP growth.

The rise in Treasury yields reflects this view, along with improving employment conditions and accelerating wage gains and inflation expectations.

We have seen positive revisions to the second- and third-quarter GDP growth and would expect this trend to continue this year based on the potential impact of fiscal stimulus.

Fiscal expansion along with tighter employment is expected to pressure US and global inflation higher.

Q *Do you expect to see a change in the investment landscape between now and when Mr Trump takes office? If so, why?*

A We are not expecting a material change in the near-term investment landscape, beyond what we are seeing currently. Investors have largely focused on certain sectors that may be positively impacted by less regulation, lower tax rates and increased infrastructure spending. Specific industries include healthcare, pharmaceuticals, metals, media, technology and financials.

Q *Moving into the year, what advice would you give investors?*

A It will be important to remain patient. At this time, we do not know the scope or magnitude of any policy changes. In addition, there are a number of key developments to monitor – central bank action, Opec, regulatory changes – which should provide greater clarity.

We feel our portfolios are well-positioned and have the flexibility to adjust as market conditions unfold and investors attempt to appropriately price the financial implications and risks.

Fixed-income investors have been conditioned to expect low rates and inflation for many years, but they also dislike today's ultra-low yields and the exposure their portfolios have, should these trends one day reverse.

In fact, there are signs now that suggest inflation and yields are indeed poised to rise on a more sustainable basis. We think investors should not be overly concerned about this for two reasons.

First, rising yields will ultimately be good for fixed-income investors as they will be able to earn a better return by boosting reinvestment rate returns.

Second, investors can reduce their exposure to risk arising from shifting market expectations of interest rates.

They can do that while staying in the fixed-income space by investing in multi-sector strategies that can move away from the developed government bond markets that are most exposed to inflation. They can invest in corporate bonds and bonds that are less sensitive to general interest rate moves.

Diversification is the key to success in navigating today's bond market. The goal is to get to a higher level of yields while protecting principal. We believe a multi-sector, unconstrained approach is the best way to reach that goal.

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MR MATT EAGAN, portfolio manager for multi-sector products at Loomis, Sayles & Company, on how investors should view the market this year, at least in the near term.

Gold positions have either been trimmed or sold off following the market rebound after the US elections. Cash levels are now below 1 per cent for all three portfolios, with the money channelled to equities. PHOTO: BLOOMBERG

Save&Invest

Cash is no longer best

Panel of experts reverses defensive position and cuts exposure to gold

Lorna Tan
Invest Editor

The expert panel reversed its defensive position last month after being caught out like many people who opted to build up cash levels ahead of the United States presidential election.

In the 14th part of the series introduced by The Sunday Times a year ago, we look at the performance of the three simulated portfolios last month.

Our investors are 26-year-old communications manager Shona Chee, entrepreneur Getty Goh, 38, who is married with two young children, and retiree Wang Moo Kee, 62.

The Portfolio Series does not involve actual money as it is intended only for illustration and education.

All three portfolios are limited to instruments listed on the Singapore Exchange to keep them simple, accessible and easy to monitor, and to Singapore Savings Bonds, which can be bought via ATMs.

While there are similarities in the three portfolio holdings, the allocation for each profile differs, depending on the individual's risk-return objectives and preferences.

Each portfolio has a different benchmark that best reflects its mix. Mr Goh's portfolio, for example, is heavier on blue-chip shares, while Mr Wang goes for bonds to reflect his more conservative stance.

The simulated portfolios are constructed by CFA Society Singapore (CFAS) for an ideal investment horizon of five to 10 years. We will track them until the middle of this year.

PORTFOLIO PERFORMANCE

Ms Chee's portfolio was down 1.07 per cent for the month, trailing the benchmark (0.09 per cent) by 1.16 percentage points.

Mr Goh's portfolio fell 1.51 per cent, trailing the benchmark (0.77 per cent) by 2.28 percentage points, while Mr Wang's dipped 0.83 per cent, trailing the benchmark (-0.37 per cent) by 0.46 percentage point.

The underperformance was mainly driven by the selection of securities, with the picks in all three equity sub-asset classes trailing their respective benchmarks.

All the Singapore stocks underperformed the Straits Times Index (STI). In terms of real estate investment trusts (Reits), A-Reit and CMT fell more than the S-Reit index. The Asian exchange-traded funds (ETFs) and gold all corrected last month, underperforming MSCI World, whose positive returns were mainly driven by Europe and the US.

The US ETF bucked the downtrend in the global ETF allocation. Only the corporate bond selection outperformed as the sell-off continued in government bonds.

ADJUSTMENTS

The CFAS made major adjustments to the portfolios early last month to fully deploy the cash.

For Ms Chee's portfolio, it sold off the gold ETF instead of selling half of the position as its size was too small and doing so would have incurred relatively high transaction fees. It also bought into SGX, Singtel, Japan ETF and India ETF and increased the exposure to the US ETF.

The panel adjusted Mr Goh's portfolio by trimming the gold ETF, bought Singtel, First Resources and Japan ETF and increased the exposure to SGX and the India ETF.

Mr Wang's portfolio saw a cut in the gold ETF while Singtel, First Resource and Japan ETF were bought and the exposure to SGX, India ETF and US ETF increased.

As a result, cash levels are now below 1 per cent in all three portfolios.

WHAT LIES AHEAD

Looking back, 2016 was indeed a year of unexpected events and, in some cases, unexpected market reactions.

Still, despite the volatility, the US equity market managed to close the year 9.5 per cent higher and emerging markets posted gains of 8.6 per cent. Gold appreciated by 8 per cent and the oil price jumped by 52 per cent last year.

Singapore, on the other hand, seemed to have suffered both on the equity market, albeit slightly, and currency fronts. The STI lost seven basis points last year and the Singapore dollar lost 2 per cent versus the US dollar.

The CFAS panel said it will be carefully monitoring global events in an effort to diversify the risk as much as possible for the three simulated portfolios as political uncertainty will drive capital markets and central bank actions will also remain key.

For instance, if British Prime Minister Theresa May does indeed invoke Article 50 by the end of the first quarter, investors will need to monitor the possible implications of a hard Brexit for trade and other polices.

Apart from a general election in Italy, this year will see presidential elections in Germany and France.

"Investors in Asia will also be watching the Trump administration's expenditure plans in 2017 and what happens with regulations, taxes and trade relationships," said the panel.

"Donald Trump's intention to withdraw from the TPP (Trans-Pacific Partnership) has already caused quite a stir. Coupled with the rise in the oil price, this could mean that inflation returns, and the Fed continues on its rate-hiking cycle."

For Singapore, the risks that investors have to watch for are clear. They are predominantly geopolitical in nature, given the events in Europe and that Mr Trump's "protectionist" rhetoric could have implications for export-oriented economies such as Singapore.

The panel added that this is where the Government's restructuring agenda becomes increasingly important, although it will be a slow and gradual process.

Full-year growth for last year beat expectations, coming in at 1.8 per cent, thanks to an improvement in manufacturing production.

This was higher than the initial forecast range of 1 per cent to 1.5 per cent but still the weakest annual growth rate since 2009, noted the panel.

Apart from global demand and trade, higher interest rates in the US and a continued rise in the dollar also mean investors will need to hedge their currency exposure. The Singdollar's 2 per cent fall against the US dollar over the past year is a case in point.

The panel said: "If the Fed rate rises are accompanied by continually improving growth in the US and supported by strong economic data, this would be good news for equity markets.

"But this would mean the hunt for yield will continue in other markets where policy remains loose and investors will need to hedge currency exposures."

Other central banks, like the Bank of Japan and the European Central Bank, have pledged to maintain their quantitative easing programmes, which means the world will still be flush with liquidity regardless of the Fed.

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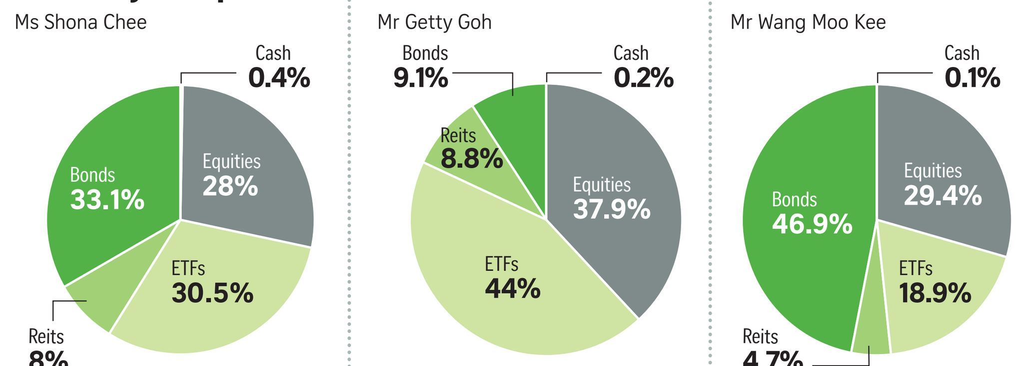
• The sixth seminar in the Save & Invest Portfolio Series, which will include a portfolio construction exercise, will be held on Jan 21 from 9.30am to 3pm at the NTUC Auditorium. To register, visit www.sgx.com/academy

Portfolio performance

Portfolio	Initial investment ($)	Current portfolio value ($)	Net total return (%)	Benchmark return (%)	Dividends and coupons ($)	Realised P/L ($)	Unrealised P/L ($)
Ms Shona Chee	40,000	42,677.47	6.69	9.52	996.60	1,844.35	1,112.98
Mr Getty Goh	200,000	216,031.08	8.02	12.73	4,033.57	6,987.38	6,500.11
Mr Wang Moo Kee	400,000	429,157.31	7.29	7.36	12,744.12	15,419.74	2,285.88

How they compare



NOTES:
- Portfolio start date was Jan 18, 2016.
- Portfolio performance as at Dec 31, 2016.
- As the Portfolio Series is intended for illustrative and educational purposes only, it will not involve actual money, investments or solicitation of funds for actual fund management by CFAS or the advisory panel.
- You are advised to seek independent financial or other professional advice for your own investments.
- CFAS and the advisory panel may provide information and recommendations on investments which they have an interest in.
- All views or recommendations made by the advisory panel are to be attributed to CFAS.
- Figures may not add up to 100% due to rounding off.
- To access past articles and portfolio reports, click on the Save & Invest Portfolio Series banner at www.sgx.com/academy

Source: CFAS SUNDAY TIMES GRAPHICS

Save & Invest Portfolio Series

The Save & Invest Portfolio Series features the simulated portfolios of a young working adult, a married couple with two young children and a retiree over a 12-month period. It guides retail investors in basic investment techniques and on how to build a portfolio in line with their financial goals and risk tolerance.

This initiative involves the Singapore Exchange (SGX) collaborating with CFA Society Singapore (CFAS) and Money-Sense, the national financial education programme.

The CFAS panellists tracking the simulated portfolios are Mr Phoon Chiong Tuck, senior fixed income manager at Lion Global Investors; Mr Jack Wang, partner at Lexico Capital; Mr Praveen Jagwani, chief executive of UTI International, Singapore; and Mr Simon Ng, CEO of CCB International (Singapore).

Due to requests from readers, you can now access past articles in the series, as well as monthly portfolio reports, by clicking on the Save & Invest Portfolio Series banner at www.sgx.com/academy.

Prospects for gold still good for the long term

Wong Wei Han

Gold may have lost some of its lustre recently but analysts still see the precious metal as a solid choice for long-term investment.

The price sat at US$1,147.50 per ounce on Dec 30, down about 16 per cent from the 12-month high of around US$1,366 last July, amid a post-Trump surge on Wall Street and a rocketing greenback.

By last Friday it had hit around US$1,177, a 4 per cent recovery in the past three weeks.

OCBC senior investment strategist Vasu Menon does not expect 2017 to be a good year for gold, but investors should not rush to sell their holding.

"Our view on gold is not overly bullish. Looking at 2017, we think gold may end the year at around US$1,100 per ounce. But asset allocation is critical, so this shouldn't mean you need to get out of gold altogether," he said during a conference last week.

"Gold will always be a good choice for diversification, and you should always have some in your portfolio. It's almost like an insurance policy, and you never know what lies ahead."

Indeed, the traditional strategy of buying gold as a safe haven has not become invalid due to recent price movements.

Mr Geoff Blanning, head of emerging market debt and commodities at Schroders, noted the long-term value of holding gold.

He told the asset management firm's recent annual briefing in London: "Gold is much more than just a safe haven. I think gold is, throughout history, the ultimate store of wealth, the only thing that has maintained its value.

"Now, with all the worry about various geopolitical earthquakes taking place, is particularly the time to think about gold.

"What's against gold now is the US dollar and higher interest rates in the US. From a sentiment point of view, maybe it's still too early to go back into the market, but the long-term prospect is extremely sound. Gold will ultimately be, as it has always been, a core element of our monetary systems again."

One factor to consider is that demand in China and India – the two biggest gold importers and, hence, a decisive driver of the gold price – will likely remain intact.

Indian demand was subdued last month, but Mr Blanning believes the country's recent policy to scrap about 86 per cent of cash value in circulation will compel buyers to look more towards gold to store wealth.

"We also see that in China, where (the yuan) is going down, the government is trying to stop people from taking their money out of the country, and the stock market is just a casino," he said.

"So what do they do? They buy gold, and that alone could drive up prices because bank deposits in China account for nearly 40 per cent of the global total."

Mr Matthew Michael, product director of emerging market debt and commodities at Schroders, said another reason to keep an eye on gold is that it has been a cheap commodity to invest in for many years.

"If you look at gold in relation to the value of other assets – say in a ratio to S&P 500 – you will see that even at the seemingly high level of US$1,300 (last year), gold prices remained very cheap compared to the 1970s," he noted.

Mr Michael believes history also offers signs that gold may be poised for a new rally.

"There is an established trend going all the way back 16 years ago. The last time oil and gold prices started to take off was when the US dollar – having appreciated for quite some time – started to weaken, to the market's surprise."

This was to be the start of the 2000s commodities boom.

That tantalising possibility awaits... should the greenback lose steam.

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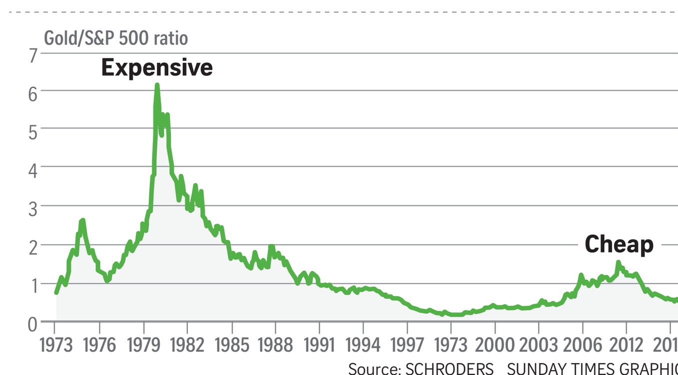
GOOD OPTION

Gold will always be a good choice for diversification, and you should always have some in your portfolio. It's almost like an insurance policy, and you never know what lies ahead.

MR VASU MENON, OCBC senior investment strategist.

Gold historically cheap vs other assets



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