Diversifier les techniques de gestion obligataire

Malgré un environnement économique et financier peu porteur, les obligations demeurent une classe d'actifs indispensable. L'année 2004 s'annonçant toutefois difficile pour les obligations d'État, les investisseurs vont se reporter sur les obligations privées. Et pour ces dernières, la diversité des options possibles et les capacités des gestionnaires à gérer activement leurs fonds devraient confirmer, une fois de plus, l'attractivité de cette classe d'actifs.

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Baring Asset Management

■ Bonds remain a core asset class: active management can add value during bad times as well as good. Bond yields have been steadily grinding lower over the first three months of 2004, supported by a combination of softer economic data in Europe and the US, an apparently relaxed attitude to inflation on the part of the US Federal Reserve, some hesitancy in equity markets, increased fears of terrorism, and the continued buying of US Treasuries by the Bank of Japan and other Asian central banks.

But 2004 is going to be a difficult year for government bond markets. Despite recent weaker data, the economy continues to recover in the US and to ensure that inflation is kept under control we think the authorities will have to move more quickly to tighten policy than the market currently believes they will. In addition, government bond issuance in all major markets has been rising strongly for the last few years. While in previous years this supply could be absorbed relatively easily, the picture now, with stronger growth, more signs of inflation, increased demand for corporate bonds, is somewhat different. The recent exceptional performance of most types of fixed income through 2002 and 2003 could drive government bond investors into taking profit and investing in other asset classes. Even Europe, where sluggish economic growth may help government bonds outperform other major markets, will not be immune to this behaviour. 2004 could well be an environment of rising yields in government bond markets.

There are two major reasons why bond investors may be excessively worried about a new « rising yield environment ».

Be aware of a rising yield environment

The first reason is that although bond yields may well rise, they are unlikely to rise as much as they have done at times in the past: bond yields are much more stable than they used to be. Real yields, which strip out the effects of inflation, have actually been very stable over the last twenty years, delivering somewhere between 1 and 4 % over the level of inflation. The reason for this is that they depend on the real level of economic growth, and this itself has become less volatile over the last two decades. Globalisation means that world growth is less dependent on certain key countries, more diversity within economies means less reliance on just a few industries, and flexibility in employment markets means that spare capacity in one area of the economy can more easily be absorbed elsewhere. And what about nominal yields? Inflation has also seen greater stability as central banks adopt inflation control as a specific objective, and deregulation helps push prices lower. Since the two components of nominal yields are real yields and inflation, the result has been that the volatility of nominal yields has also declined. The volatile growth rates and inflation shocks that caused the exceptionally high nominal yields of the late 1970s, for example, are very unlikely to recur.

The second reason why bond investors need not worry so much about a rising yield environment is that by using different types of fixed income assets, active fixed income managers have greater scope than previously to add value for investors, even when government bond yields are rising. Rises in nominal yields are possible over the rest of 2004. It's likely that the benign long-term downward trend for nominal government bond yields is coming to an end, and market participants will have to deal with more difficult conditions. So how can bond investors protect their portfolios and continue to generate strong returns from fixed income?

« There are a number of options available for making money from fixed income even in a rising yield environment. »

The good news is that there are a number of options available for making money from fixed income even in a rising yield environment.

The first point to make here is that active managers are equipped to handle bear markets as well as bull markets.

Generally managers already have flexibility to minimise negative absolute returns, and aim to generate positive absolute returns, when government bond yields are rising. Even if a conventional government fixed income benchmark starts looking like it's going to lose 2% this year, it doesn't mean that an actively-managed portfolio will do the same. Bonds are a core long-term asset class for investors: a skilful manager should be able to add value in relative and even absolute terms when yields are rising as well as when they are falling, outperforming government bond indices over the medium to long run.

There are a number of strategies that active managers can use to protect the value of bond portfolios in adverse conditions. Here we will look at three broad categories: traditional management strategies, other fixed income sectors (including non-government bonds, to which managers can allocate) and alternative fixed income strategies, where the introduction of derivatives can provide new sources of value.

Traditional management

These are strategies that active fixed income managers already have available to minimise losses.

The duration management is the most obvious way of adding value in a market where yields are rising. By reducing the duration of the portfolio, you can reduce its sensitivity to market movements and minimise any losses caused by price falls. Closely related to this is the choice of the best areas of the yield curve to invest in. The use of barbell strategies is a good example. If yield rises are likely to be concentrated in the middle of the curve, (as has often happened) investors could hold a mix of cash and 30-year bonds rather than 5 to 10-year bonds. So, the duration (sensitivity) of the two strategies is equivalent but the barbell strategy will generate better returns.

Country allocation is another important option. In an environment where yields are rising in some countries, we may be able to identify other regional markets which could be behaving in a different way. European bonds, at the moment, are a good example. Europe's economy is looking much more sluggish that that of the US, and we anticipate bonds here to outperform those in the US during 2004.

Currency management is also a potential source of performance. Beneficial positions in currency markets may be able to offset any losses in bond markets.

These strategies are already available to active fixed income managers, so even with a relatively simple mandate there is plenty of scope for adding value in an unhelpful environment.

Other fixed income sectors

Other asset classes (including non-government bonds) that can provide diversification away from government markets include the following.

Inflation-linked bonds provide shelter from rising inflation, by having their coupons and principal adjusted in line with a specified consumer price index. As prices go up, so does the income and the capital you receive from the bond. Fears of higher inflation affect conventional bonds, but have much less impact on inflation-linked bonds. In an environment of potentially rising yields they will continue to be in demand.

High yield corporate bonds can be attractive because they are negatively correlated with government bonds. An environment of strengthening growth will tend to support the asset class, while other bonds may do badly. Historically the downside for US high yield bonds seems somewhat protected, there have been very few calendar years when the asset class has not produced a positive return (and the negative returns have been only mildly negative).

Fundamentals continue to support corporate high yield (default rates are peaking; US companies continue to deleverage) keeping the asset class attractive despite its recent strong performance.

Emerging market debt also has an overall negative correlation with government bonds, making it an attractive diversification option when combined with other asset classes. A number of fundamental factors continue to support the EMD outlook. Investment managers were generally not able to utilise all these instruments during previous periods of rising yields like in 1994 and 1999. The inflation-linked market has grown substantially only recently (the UK was for a long time the only main issuer of these securities but has in the last few years been joined by a number of other countries, including France), while credit markets have become both bigger, and better-understood.

Investors are now more comfortable with the idea of investing in instruments such as high yield bonds and emerging debt, which can provide valuable diversification benefits away from pure government bonds.

For clients who allow the necessary flexibility, active fixed income managers now have a much wider range of strategies and securities available than previously: declining government bond markets do not imply that client portfolios will automatically lose money.

Alternative fixed income strategies

A further step for fixed income investors is to use derivative instruments within portfolios, with the aim of generating positive absolute returns whichever way the market moves. These strategies are not yet widespread, but are potentially a valuable way of adding alpha for those investors that are able to use them.

Directional portfolios are one, relatively simple, example. These invest in the same way as a standard government bond portfolio, but with the additional property that by using futures, portfolio duration can go below zero, effectively taking a position that generates a positive absolute return if the bond market goes down. The more yields rise, and bond prices fall, the more money the position makes.

This management of duration can easily be combined in the same portfolio with more traditional management of country and currency allocations, for example.

A large number of other alternative strategies exist (fixed income hedge funds are one example). While these won't be available to, or desirable for, all investors, this is an asset class we expect to see becoming increasingly important.

The important thing is that there is a rich selection of asset classes and instruments available to the fixed income manager and investor. By making use of them, declines in one or more government markets can be more than compensated by the opportunities available in others. ●