

No 'credit bubble' in sight, says F&C's Seabrook



Despite the growing debate amongst fund managers and industry commentators on the potential emergence of a speculative bubble in credit markets, this is actually far from being the case, according to Rebecca Seabrook, Director, UK credit at F&C. She highlighted a number of factors which lead to this conclusion, including the current level of credit spreads, the flow of new issuance, quantitative easing, increased risk controls from institutional investors and market dislocation and a polarisation across sectors.

"The current debate seems to have started because spreads narrowed quite sharply in a relatively short space of time at the end 2008 and into 2009. But this shows investors looking to benefit from the attractive valuations on offer as a result of the indiscriminate fall-out across all sectors resulting from the credit crunch and banking crisis," Seabrook commented. In the first two months of the year we have already seen around £25bn of new issuance. "With bank lending still frozen and therefore effectively closed to many potential borrowers, this is a trend that is set to continue as more and more companies turn to the credit markets to raise finance. Such a flow of new issuance will increase supply in the market reducing the build-up of any 'speculative pressure'," she added. Quantitative easing could follow 'credit crunch' and almost become part of everyday

language. The Bank of England has announced that it will inject £75bn into the UK economy by directly purchasing securities.

"Originally this was thought to involve predominantly corporate bonds, but it will actually include gilts, commercial paper, paper issued under credit guarantee, syndicated loans and some asset backed securities.

Understandably, the response of corporate bond markets has been fairly muted," she said.

Seabrook also believes that, as part of the fall-out from the credit crunch and the effective freezing of credit markets, there will be increased attention on risk management by the big institutional investors including both life and pensions funds. This may, in fact lead to a lower weighting towards credit overall, which could see a slowdown in the demand for corporate bonds.

"The current market conditions are clearly focusing on risk and quality, with poorly performing companies seeing the value of their bonds punished severely. It is this disparity in performance which shows we are not in a speculative bubble. We are still in a highly uncertain environment and certainly bond values will over-shoot on both the upside and downside, creating opportunities for both selling and buying"

She concluded: "Speculative bubbles tend to build over time as more and more investors start to follow the same sorts of trades and in an environment with a limited supply of investments. We feel we are a long-way from such a case with, in particular, the supply of new issuance set to increase and the clear polarisation of performance across sectors and quality. We need to see a normalisation of markets before we are likely to see the development of any speculative bubble".

Bright spots in property investment

Despite the problems affecting the financial markets and the recessionary economic environment, the situation for property is not without some bright spots

according to Zvi Noé, European Investment Director at F&C REIT.

Although the coming year is expected to be difficult for real estate, the UK, Europe and some Emerging Markets still offer opportunities to profit from property in a recessionary environment.

The UK property market may offer value on an opportunistic basis. There will be forced sales this year as funds are compelled to dispose of assets to meet redemptions and some debt purchasers breach covenants. Given the restricted availability of credit, which limits effective demand, this could provide investors with cash the chance to acquire quality stock at attractive prices. With equivalent yields on IPD (institutional) stock now close to 9%, well above borrowing rates and the risk free rate, some deals may be too good to miss.

"The European property investment market is diverse with different property market cycles, dynamics and structures," Noé explains. "Investors here are tending to focus on low risk markets. Germany, excluding Frankfurt, is perceived as a low risk option with upside potential. It is anticipated that cheap money will begin flowing into this region in the coming months, when signs that the floor of the economic downturn may finally be in sight. The French market has proved resilient, helped by the indexation of rents and the size, limited supply and relative transparency/liquidity of the central Paris office market". Noé expects that the main Nordic countries may also recover sooner than elsewhere helped by strong public finances and currency movements.

Elsewhere, Noé believes that the emerging markets property sector offers opportunities on a selective basis. "There are growth areas where the economy is restructuring and developing to meet present day requirements. Here, structural factors such as the political and legal systems together with specialist local knowledge are key determinants of performance. We favour areas such as India and Turkey as regions who both offer the best potential for long-term growth" he concluded.

Press Contact: +44 (0)20 7011 4600

Jason Hollands (Corporate)
Tel: +44 20 7011 4168
jason.hollands@fandc.com

Paula Garrido (Institutional)
Tel: +44 20 7011 4190
paula.garrido@fandc.com

Jennifer Donohoe (OEICs)
+44 20 7011 5017
jennifer.donohoe@fandc.com

Véronique Sant (SICAVs)
Tel: +44 20 7011 4278
veronique.sant@fandc.com

Sarah Godfrey (Investment Trusts)
Tel: +44 20 7011 4215
sarah.godfrey@fandc.com