

## The corporate bond waiting game continues, says AAA-rated Luis



The publication this week of the Bank of England's Money Policy Committee minutes has revealed that the committee was split 5-4 over whether or not to raise UK interest rates with the more hawkish Governor, Mervyn King, voted down. According to Citywire AAA-rated Fatima Luis, manager of the F&C Strategic Bond Fund, this is a further signal that the end is not yet in sight for the cautious climate facing corporate bonds.

"At the start of the year the market was concerned about a housing led slowdown in the US which would likely have resulted in rate reductions," said Luis, whose Strategic Bond Fund has a brief to invest across the credit spectrum, "but my view is that the major risk has all along been a continued rise in yields due to a strong labour market and inflationary pressures." "As it turns out, US growth has been pretty stable and unemployment remains low. Both the Fed and the Bank of England remain concerned about inflation and the MPC minutes clearly suggest that it is too soon to call the top of the rate cycle." Luis points out that there is a wall of liquidity in global capital markets and that, in her view, there is "too much risk taking – which makes corporate bond managers uncomfortable: we're paid to assess the downside".

"As a consequence of this seemingly insatiable appetite for risk, corporate bond yields remain tight and they haven't risen sufficiently to reflect the risk of rising rates. Investment grade yields in particular do not look especially attractive," she said. "However, as risk is reassessed, yields will rise."

Luis has currently positioned the Strategic Bond Fund relatively defensively, holding shorter dated stocks within its investment grade component, raising cash levels to

7% of the portfolio and also increasing exposure to Floating Rate Notes. She warns that the leveraged loan market, generally considered to be more secure than the corporate bond market, is starting to display 'bubble-like' characteristics as loan providers are rushing to offer to re-price company loans at ever lower rates, and with weaker covenants, just to stop companies re-financing elsewhere. "All of this has been accompanied by the easing of loan conditions and a general deterioration in the credit quality of borrowers. This has echoes of some of the developments that preceded the problems in the sub-prime loan market, the full scale of which has yet to be understood. It is clearly an unfolding story as witnessed this week with the fire sale of sub-prime assets from two Bear Stearns hedge funds" she said. Luis argues that the trigger point for a turnaround in credit markets will be clear signs that the tough medicine of rate rises is starting to have an impact. "It is clear from the views at the latest MPC meeting that we are not there yet," she added, "but when the turning point comes investors need to be in a position to respond quickly. For the retail investor that means being in a bond fund with a very flexible remit rather than those narrowly boxed into one part of the fixed income spectrum."

### HEWITT ZEROS IN ON UTILICO ZDPS

Peter Hewitt snapped up some stock this week in the first major new issue of a zero dividend preference share in recent years. Utilico plc, an investment trust, issued two tranches of shares, one winding up in 2014 and the other in 2016, both with Gross Redemption Yields of 7.25% at issue. Hewitt has taken holdings in both tranches within his F&C Progressive Growth Fund. "This issue has been very well received by the market," said Hewitt. "It began as a £50 million issue but it was increased to £75 million. Even at this level it was oversubscribed to the extent that subscriptions were scaled back." "The yield is clearly attractive given interest rate expectations and the issue was very conservatively financed. The

shares that redeem in 2014 are 2.5x covered and the 2016 shares by 1.8x. Both shares have traded up since issue."

"The success of this issue shows that investor demand for well financed zeros is strong, providing they are attractively priced. With base rates on the rise and bond yields moving upwards, issuing a zero is a competitive form of financing in terms of cost and the absence of any interest charges to service. Let's hope more issues will follow," he concluded.

### CASH IN ON THE SMOKING BAN

As the UK's smokers mull the impending ban on lighting up in public, one incentive to stub out their last fag is the potential profits to be made from investing their ciggy money in the markets instead.

"With the typical packet of fags costing £5.40, a twenty-a-day smoker is blowing around £165 a month – and that's assuming the matches are gratis," mused F&C's Jason Hollands.

"Just storing the cash in a piggy bank would collect a tidy sum of £1,980 a year but had the money had been invested in a monthly savings scheme with Foreign & Colonial Investment Trust over the last 12 months, you'd now be sitting on a pot of £2,460. That's more than enough to buy plenty of patches and a subscription to a fancy health club."

### SALES TEAM STRENGTHENED

F&C has strengthened its UK retail sales team with the appointment of Alex Antonius as Sales Director. Reporting to Barry Neilson, Director of Business Development, Alex will focus on third-party links and developing professional connections, including the roll-out of F&C's Lifestyle funds business.

"Alex is a technical specialist who has excellent knowledge of the issues intermediaries face. F&C has a strong reputation of developing business partnerships and Alex's appointment will further reinforce this," said Barry Neilson.

### 130 / 30 FUNDS DEMYSTIFIED

Richard Wilson, Head of Equities at F&C, will be hosting a breakfast press briefing at 9:30am on Wednesday 25 July to discuss 130/30 funds. For details contact:

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