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MEDIA RELEASE

Active bond management is essential as bond yields jump on rate uncertainty

Bond markets have become increasingly volatile over the last couple of years. In the first few months of this year alone, the market has gone from confidently expecting interest rate cuts to an environment where inflation is sticky and rate cuts are in doubt. Bond yields have accordingly jumped again so far in 2024. Active bond management offers investors downside protection and the potential for higher returns, according to Nigel Jenkins, managing director at Payden & Rygel who shared his views with GSFM during a recent visit.

"The active management of bond investments and flexible asset allocation is more important than ever as economic uncertainty and volatility increases. Just this month, we have seen a sharp rise in Treasury yields to year-high levels as expectations drop that the US central bank will cut interest rates this year, given persistently high inflation in the US.

"This underscores the need for nimble management of bond allocations. Active managers can anticipate and respond to such market events and adjust bond asset positioning accordingly to minimise losses and maximise gains. This agility is crucial in today's uncertain economic environment, especially with more potential shocks to come in 2024," Mr Jenkins observed.

The US presidential and congressional elections take place in November, and those outcomes could also be very influential on bond prices and broader financial markets.

"We are watching for potential fireworks. Even before then, there could be other fireworks and surprises from European Central Bank policy decisions, from inflation releases in developed countries and other elections around the world," he said.

"As we have entered a new regime for financial markets, where close to zero interest rates are no longer the norm, we are likely to see higher volatility not only in interest rates and credit spreads, but also in equity values and economic variables (inflation and growth) for the next one to two years at least. As a result, having flexibility around asset allocation decisions, being able to adjust bond duration and credit risk without being tethered to a benchmark, is very important for fund managers to be in a position to protect investors' capital and produce income.

"Investors need to act quickly to best preserve their capital and take advantage of opportunities, where they emerge. The fixed-income investment universe is very broad, including developed and emerging market government bonds, investment grade and high-yield corporate bonds, bank loans and other debt assets. So, you need experts to navigate such a huge and diverse asset class," Mr Jenkins said.

Importantly, while passive funds offer low fees, they will lock in net of fees underperformance versus benchmark. Active management, on the other hand, is able to prioritise risk management and seek to protect investors' principal.

"An absolute return strategy is untethered from traditional benchmarks, so managers can invest where they see the best risk-adjusted returns in the bond market. In addition, active managers have several tools that can help produce alpha and offset downturns, such as varying bond duration, the careful selection of sectors and securities, as well as the active management of geographic and currency exposures.

"The aim is to generate income and preserve capital while containing volatility. Contrast that to passive managers, where a manager must work with a given bond benchmark and rigidly allocate investments. Managers are not able to reallocate portfolio assets across different sectors or respond to market developments."

Given that opportunities in fixed income will shift over time, asset allocations should not remain fixed during a credit cycle. The active manager can recognise and add value by identifying opportunities across a broad spectrum of perspectives across multiple bond sectors and issues, and add alpha when dispersion is elevated. While some absolute return funds charge higher fees, that can be a small price to pay for the prospect of better capital protection and superior performance over time according to Mr Jenkins.

"As active managers of a fixed income absolute return strategy, before we consider the direction of markets or the value opportunities that are presented, our first responsibility is to protect an investor's principal against the potential for loss. Risk management is paramount.

"The foundation of our strategy is a relatively short-duration fixed income portfolio where risk premia from global credit markets and interest rate curves may provide dependable and repeatable returns.

"Diversification - the ability to move between multiple sectors that aren't perfectly correlated with each other just smooths return over time. It's a good part of the market to have an active manager be in a position to respond quickly to new market developments. And if the last three or four years have shown us anything, it's that things can happen very quickly that cause a rapid change in market perceptions and the value of securities. The fund puts investors' capital in a position to be able to respond promptly to new developments," he said.

The Payden Absolute Return Investing (PARI) strategy is distributed in the Australian market by GSFM.

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About GSFM

GSFM was established in 2007 as a subsidiary of the Grant Samuel Group. In 2016 Canadian wealth manager CI Financial Corp (CI) purchased an 80 per cent stake in the business, previously held by Grant Samuel.

GSFM specialises in marketing funds managed by high calibre local and international managers to Australian and New Zealand institutional and Australian retail investors, and has formed partnerships with eight specialist investment managers:

- New York based Epoch Investment Partners, Inc.
- Tribeca Investment Partners, a successful Australian boutique manager headquartered in Sydney
- Payden & Rygel, a Los Angeles based independent investment management firm
- Munro Partners, an independent global equity manager based in Melbourne
- London-based Man Group plc
- Tanarra Credit Partners, a specialist in private credit instruments
- Access Capital Partners, European independent private asset manager
- Australian Entertainment Partners, to produce the AEP Screen Fund, an investment vehicle dedicated to supporting Australian film and television endeavours.

GSFM represents approximately $9.56 billion funds under management (as at 31 March 2024).

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About Payden & Rygel

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