

## Thought for the Week: Monday, April 12<sup>th</sup>, 2010

### The Global Search for Low Risk Income

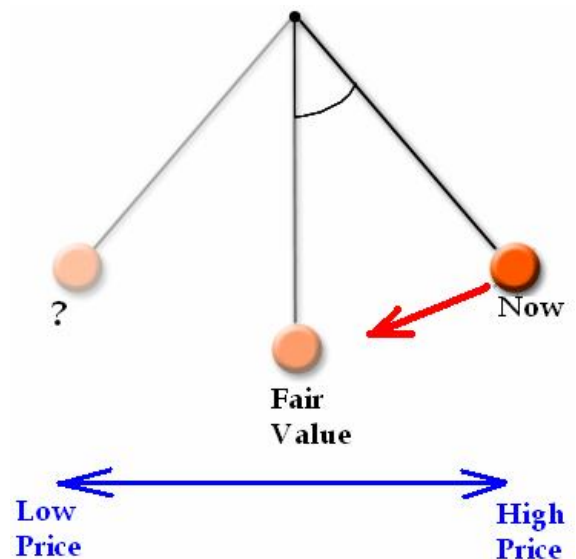
Here's a common discussion between Clients and Advisors over the last few months:

**Q: What has the biggest risk of capital depreciation at the moment: Stocks or Bonds?**

A: Probably Bonds, if you are OK with the potential for a short-term stock market correction.

**Q: Why do you think this?**

A: Bonds have seen 'stock-like' appreciation over the last year or so and now look over valued, if and when interest rates rise. A rising interest rate environment is generally the worst thing for Bond prices, but tends to help Stocks. Think of recent Bond price rises as a Pendulum that has been pulled to one side. When it is let go (the Government will be the major player in timing the 'letting go' of interest rates) the pendulum will swing through fair value and may become undervalued.



**Q: Why not Sell all your Bond Allocation?**

A: Bonds are commonly bought for income, hence the generic term: Fixed Income. Moving capital into non-income generating areas to avoid capital losses from falling Bond prices will therefore deprive investors of the necessary income. Moreover, portfolios with a high Bond allocation are chosen because they are suitable for the risk profile of that client. Therefore, we cannot replace bonds with high risk investments.

**Q: So, What are you Doing?**

A: In addition to adding investments such as TIPS, which should rise in value if interest rates rise, and diversifying into interest bearing investments which may not be as sensitive to interest rates, about **six months ago we reduced the Duration (the sensitivity to interest rate changes) and increased geographical diversification of our Bond portfolios.**

This week's article discusses why we have **Geographically Diversified DIAS fixed income allocations towards Emerging Markets but not European Issuers.**



Emerging market bonds are extending their lead on U.S. and European debt amid signs that **developing nations are growing faster than the world's biggest economies** and are forecast to continue doing so.

Debt issued by emerging market borrowers returned 11.3% this year through April 6, outpacing the 2.79% gains of U.S. company bonds, according to the Bank of America Merrill Lynch index. The International Monetary Fund forecasts developing economies will expand 6 percent this year, almost three times more than advanced nations. The prospects for Emerging Market Bonds are therefore better.

### **Why Not Europe or the U.S.?**

We generally invest the bulk of our bond allocation in the U.S. for risk reasons, however, while the U.S. government issues record amounts of debt to help recover from the worst financial crisis since the 1930s and the European Union tries to contain Greece's budget deficit, we are cautious in both of these developed markets.

"The blowout of developed countries' fiscal deficits has caused people to re-assess emerging markets as an asset class," said Brett Diment of Aberdeen Asset Management Plc. "The days when they were seen as a risky bet are gone."

### **Put simpler – Bond investors are happier with countries that do more to balance their books!**

"Most investors now share the view **that emerging markets will be the driver of global growth over the medium term**," says Credit Agricole CIB in London. "The concept of flight to quality (which has driven much of the demand for U.S. Bond issues) has been fundamentally undermined by the enduring strength of emerging markets. We are witnessing a paradigm shift."

"Investors will continue to **search the globe for attractive fixed income assets**" as the economic outlook in most developed countries remains "subdued," said Mark Kiesel of Pacific Investment Management Co."

"**Emerging markets are now on a much stronger footing relative to developed countries** and we are very optimistic on returns," said Investec's Van Pittius. "The risk of a currency crisis and sovereign default in most emerging markets is pretty low at the moment."

***Contrarian Thought:** China announced a Trade Deficit for March, the first for six years, at the same time the U.S. Government is exerting increasing pressure on China to change its export and currency policies??*

***Surely this is a coincidence?? Worth checking the definition of 'Planned Economy'...?***

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