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Iain Stealey
head of global aggregate strategies for global fixed income, J. P. Morgan

More choice means more opportunity

For most fixed income investors, one's appetite for bonds is based on a binary view of monetary policy: buy when there is an expectation for rate cuts; sell when central banks are tightening. But by taking in the entire global opportunity set, decision making needn't be steeped in a single direction.

The 34-year run down in government bond interest rates globally has led to bull market in fixed income assets the world is unlikely to witness again. With bond yields at record lows in a number of developed countries – including Australia – nervy investors are rightly asking whether they can go any lower.

But this is nothing new. Industry experts, fund managers, economists and investment strategists have for many years been saying there is simply no room left for bonds to run. The pessimism for fixed income assets reached a zenith in the second half of 2014 when most commentators had a hike in the Federal funds rate all but nailed on for mid-2015. Though Federal Reserve chair Janet Yellen has issued fresh hints that a rise may come in the near future, it has yet to materialise.

A new phenomenon

Amid paltry global growth figures, the new phenomenon of negative interest rates sees investors pay governments for the privilege of lending them money. While this is bad news for lenders who rely on income payments from bonds to generate a return, J. P. Morgan Asset Management's head of global aggregate strategies for global fixed income, Iain Stealey[01], says it has removed the market's theoretical bottom and opened the door for the multi-decade bond rally to march on and on.

"We've seen central banks adopt unconventional monetary policy – quantitative easing – and that push down in yields has been a big benefit to fixed income investing across the world as people are hunting for income and looking for assets that can offer yield," he says.

"When we look at the global economy in total we see pretty low growth around the world and pretty low inflation. Typically those are two enemies of the bond investor but, those issues aside, we're actually pretty positive about fixed income markets as we look forward."

While Stealey, who heads up the investment team behind the JPMorgan Global Bond Fund, acknowledges there will be volatile periods for fixed income, he believes there are still pockets of value for managers with the flexibility to invest globally.

"We may see some rate hikes coming out of the Federal Reserve but it's going to be pretty contained because when you look at the rest of the global economy – whether it's the European Central Bank, the Bank of Japan or the Reserve Bank of Australia – we're likely to see more accommodative monetary policy than less, which will again have a big impact on the global bond market," Stealey says.

"One of the benefits of the global bond space is it's a very big pot of assets for us to invest in. In global fixed income markets there's about US$100 trillion worth of bonds so a wide range of opportunities.

During the last 15 months the Reserve Bank of Australia has cut its official cash rate four times from 2.5% to just 1.50% today. Many investors who have been used to term deposits paying more than 6% are sceptical the central bank will loosen further. Stealey is not one of them. The 10-year Australia Treasury bonds he holds in the JPMorgan Global Bond Fund portfolio have contributed materially to performance in recent months.

"The lesson Australian investors can take from the rest of the world is that rates here are still pretty high," he explains. "It's important not to look at where they have been but where they could go. We could still see rates fall quite aggressively here which will be very supportive for the Australian fixed income market. And while this is great for capital, it's not so good for those seeking income. That's why it is so important to continue to look further afield into sectors like investment grade in order to generate that income."

Global diversification

"What I will say is what investors have learned on a global basis is: think diversification; look at those US$100 trillion worth of fixed income assets globally and get access to a nice diversified portfolio which should give you strong risk-adjusted returns for your clients."

Negative interest rates have certainly made finding a positive return in fixed income markets tougher – some $10 trillion worth of global government debt in issue today is yielding less than zero – but Stealey says the basic principles of bond investing still apply.

The quote

It's important not to look at where they have been but where they could go.

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"When we think about the global market being fairly supportive going forward I like to think about the three 'highers'. You want to have higher duration; in a world with low inflation and a lot of accommodative policy, assets with a positive yield like Treasuries and Australian Government Bonds should do well. You also want to think about higher quality assets; we're coming to the end of the credit cycle so make sure you do your research and know exactly what countries and companies you're investing in. The other area to look at is assets offering higher yields; you want to be look to enhance that income for clients in a world where there is actually very little available at the moment."

The investment objective of the JPMorgan Global Bond Fund is to achieve a return in excess of the global bond markets by investing primarily in global investment grade debt securities, using financial derivative instruments where appropriate.

A deep bench

Stealey says one of the most reliable ways to find the most attractive opportunities is to have a team of experienced analysts combing the world's corporate credit, high yield debt and government bond markets.

"The most important thing is to be research driven. When we're thinking about how we invest in the JPMorgan Global Bond fund, we think it's really important to have a deep bench. You need to have analysts across the world looking for the best opportunities, looking at areas of value and areas where bonds could actually go up in price. You need to have a consistent and repeatable investment process. We have one that starts on a quarterly basis and is reinforced on a weekly basis to make sure those best ideas are being filtered into the fund," explains Stealey.

"At J. P. Morgan Asset Management, we approach fixed income investing with the utmost due diligence and a fiduciary mindset. As lenders of clients' money we want that money back at the end of the bond's life and we want it back with interest. That's absolutely critical when we think about how we should evaluate bonds." FS