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Broad bond horizons protecting downside risk

The JPMorgan Global Strategic Bond Fund targets positive risk-adjusted returns through dynamic allocation to suit different market environments.

As interest rates and bond yields have fallen over the last 30 years, domestic bond allocations have performed well, playing the important role of generating income, preserving capital and providing diversification in equity heavy portfolios.

However, as the income component of bonds has fallen over the past decade, investors have been left to question the asset class' ability to soften negative price movements seen in more volatile equities allocations.

To mitigate this risk investors have had to work harder at achieving solid capital preservation and portfolio diversification by expanding their investment scope. In the fixed income sector, J.P. Morgan Asset Management says investors have generally now moved beyond traditional domestic government bonds and opened their portfolios to other areas including international government bonds and corporate bonds.

The JPMorgan Global Strategic Bond Fund* aims to address this investor demand by exploring the full scope of fixed income return and diversification opportunities. The high-conviction, unconstrained bond fund seeks to maximise total returns through a flexible and dynamic approach to investing in global fixed interest markets.

The investment strategy

International CIO for global fixed Income currency and commodities and fund manager Nick Gartside [01] says the fund benefits from the global firm's fixed income resources to invest across 15 sectors and in more than 50 countries.

"Because this fund is not constrained by a benchmark, it can significantly shift positions as market conditions and opportunities evolve," Gartside says.

"For example, the fund can adopt a conservative stance in uncertain periods, while moving tactically into riskier opportunities as sentiment improves."

As part of J.P. Morgan Asset Management's final weekly bond market update for April, Gartside notes robust earnings growth in Europe and the US corroborates the group's conviction in investment grade corporate credit – "which is also supported by strong technical factors and justified valuations."

"We generally remain positive across fixed income spread sectors based on the strong global growth story, but there are warning signs in some areas of the market, including richer valuations in certain emerging market bonds and persistent outflows from European high yield," Gartside says.

"However, all three factors in our analysis – fundamentals, quantitative valuations and technicals – are aligned in support of investment grade corporate credit."

"While the quantitative valuation side is more nuanced, with spreads below historical averages, strong corporate health metrics and valuations relative to global growth data lead us to have a favourable outlook on both US and European credit – and cleaner positioning suggests the sector could even be poised for a rally."

Working as a team

This investment flexibility is underpinned by the group's top down and bottom up approach. Dedicated unconstrained portfolio managers are able to tap into the best ideas generated by a team of more than 200 investment professionals globally.

As Gartside explains, there's a common research language based on fundamental, quantitative and technical factors. The fund manager is also guided by an integrated, multi-layered risk management process which monitors volatility, correlation and duration. It allows the group to test for 'worst case' and customised scenarios and ensures a regular review of portfolio risk exposures.

The fund aims to achieve a return in excess of the Bloomberg AusBond Bank Bill Index by exploiting investment opportunities in the bond markets, primarily by buying cash bonds, but also able to use financial derivatives instruments primarily for hedging purposes.

Since inception in December 2013, the JPMorgan Global Strategic Bond Fund has returned 4.29% (annualised). The index has returned 2.32%. J.P. Morgan says investors should at least have a three to five-year investment horizon when investing in the fund.

Gartside is among a team of three portfolio managers running the fund – headed by J.P. Morgan Asset Management's head of global fixed income, currency and commodities Robert Michele. The team says the bond fund is for investors looking for an absolute return "that seeks to exceed the return of the benchmark in diverse market environments over time from a combination of capital appreciation and income while reducing the likelihood of capital losses on a medium term basis through a flexible, diversified multi-sector approach."

The quote

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Watch the video on www.fsitv.com

Finding the right fit

The fund sits in a paradigm where it's regarded as a complement to core bond holdings such as Australian sovereign bonds and high-grade corporate bonds. The absolute return strategy also sits lower in the paradigm than products which focus on total return and income – generally these products have a higher sensitivity to interest rates, are currency concentrated and sit in a higher volatility band.

Geographically the fund is heavily weighted to the US (53.2%) with other countries all holding single-digit exposures. Sector weightings are more evenly split with cash (22%), US high-yield corporate bonds (18%), investment grade corporate bonds (18%), and government bonds (15.8%) rounding out the top four.

The group's recent bond market update further explains the high conviction in high quality corporate bonds. It says annual estimates of US earnings per share growth are at their highest levels since 2011 – supported by the weaker US dollar, the recovery in energy prices, and non-domestic factors such as the boost to sales growth provided by strength in China. Earnings growth forecasts in Europe have also increased in 2017 to over 14%.

"This strong fundamental backdrop explains the recent divergence between rate moves and credit spreads," Gartside says.

"While rates have fallen over the past six weeks in the face of rising political and geopolitical risks, with the 10-year US Treasury yield dropping from 2.6% to 2.33% (as of 25 April), US investment grade corporate spreads are unchanged.

"Although this means there may be less scope for spread compression if rates move higher, we believe there is still room for spread tightening, as year-to-date moves have been relatively muted in comparison to other risk assets." **FS**

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