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Jamieson Coote Bonds

The ultimate flight to quality investment

Bond assets have performed well in the midst of interest rate hikes. But will the same hold true in a rate cutting environment? Jamieson Coote Bonds thinks so.

With economies having struggled under the weight of a rate hiking environment, those invested in bond assets now stand to benefit materially as the trend begins to reverse.

It is likely bond assets would thrive should the US Federal Reserve or other central banks need to cut rates or provide more accommodation for economies where there would be substantial capital gains to be made.

That is the view of fixed income specialist Jamieson Coote Bonds, which officially introduced its global bond fund to Australian investors in February 2019 following an initial seeding of the strategy in early 2018.

Distributed by Channel Capital, the CC JCB Global Bond Fund is designed to provide a defensive source of allocation across the G7 global governments, invested back into a US dollar class.

Not only does it provide Australian investors with significant diversification benefits, they can also choose between an AUD hedged or unhedged exposure sitting in US dollars.

"The global strategy is a natural extension of our investment process and it picks up on specialties that the investment team has a lot of experience in in our prior careers," Jamieson Coote Bonds chief investment officer Charlie Jamieson says.

"With the switching optionality regarding hedging that we're offering investors at no cost, it allows investors to make their own choices about their currency needs or their currency outlook, and switch between an unhedged allocation towards a very high quality, defensive series of assets or a hedged allocation as they see fit on a daily basis."

Jamieson co-manages the fund with Singapore-based deputy chief investment officer Kate Samranvedhya. Both have vast experience in fixed income investing, having held senior portfolio management positions with the likes of Bank of America Merrill Lynch and the Hong Kong Monetary Authority.

As investors suffered through a grueling end to 2018, on an unhedged basis, the JCB global bond strategy held strong, Jamieson says.

"At a time of material stress, we often see the US dollar appreciates very quickly in a 'flight to safety' or a 'flight to quality' environment, which can make this a very powerful hedging solution for a portfolio in material stress and we saw the strategy perform really well on an unhedged basis in Q4 2018," he says.

According to Jamieson, investors with exposure to global high grade bonds ($USD) in 2018 would have achieved double digit returns on an unhedged basis, in a year where most asset classes merely saw low to negative returns.

This is because the fund offers up a large opportunity set via the sovereign space, making it a high-grade and defensive solution with the added currency benefit.

"Very similar to our domestic strategy, we want to provide something that is very transparent, very highly rated and very liquid so investors can have great certainty that their capital is working hard and generating returns backed by governments," he says.

Why now?

At the moment, the portfolio's largest overweight is US Treasury bonds, Jamieson says. This is because interest rate hikes by the US Federal Reserve have ensured a stable return stream in recent years and therefore high rates of income for investors.

However, the sands are now shifting and the Fed is expected to initiate rate cuts, on the back of slowing global trade data and weaker US employment.

Jamieson Coote Bonds believes any rate cut would generate a powerful tailwind for US Government bonds, with the potential for strong performance for investors.

"As we've all now experienced from AUD interest rates over the last six months, the major challenge for investors remains how to view this allocation in a 'forward' context," the bond manager says.

"A few people have now admitted that cash has burnt a solid hole in their own portfolio attributions, particularly in the fourth quarter of last year," Jamieson Coote Bonds says.

For those in need of convincing, Jamieson Coote Bonds points to the economic slumps of 1987, 1995 and 1997 that saw the Fed cut interest rates by up to 100 basis points.

"In this instance you bought bonds, but didn't need them to save the day for portfolios as most assets valuations held up thanks to the Fed that stayed ahead of the curve. The returns from bonds were strong during these times," the firm says.

But that was then, and now there is also the possibility of the Fed falling behind the curve and requiring much deeper cuts. With only 250 basis points to work with, it could struggle to deliver and require additional Quantitative Easing (QE) – think the Global Financial Crisis.

"We think these investment themes are powerful and any allocation arguments are highly compelling. The last Fed cutting cycle started more than 12 years ago. It could be years and years until investors get this type of set up again," the firm says.

And as we all know, diversification helps to reduce overall portfolio risk. While global bond market performance and returns can differ, the JCB global bond strategy invests across a range of different countries, deriving returns from multiple sources.

The strategy invests in the United States and Canada, France, Germany, Italy, and the United Kingdom. It also invests in Asia, predominantly in Japan. There are satellite exposures to similar countries, provided they are investment-grade and government or sovereign backed, Jamieson explains.

Jamieson Coote Bonds considers five levers when determining allocations for the global bond fund strategy.

These include alpha generation, bond capital gains, bond coupon or income, Foreign Exchange forward hedging benefit, and AUD FX depreciation.

Of these, Jamieson Coote Bonds says AUD FX is the hardest to predict.

"In serious times of crisis, the AUD has historically depreciated more often, than not. During the GFC this was hugely material, with the AUD depreciating from 0.9850 on 15 July 2008, to just 0.6009 on 27 October 2008, providing substantial returns for holders of global bonds on an unhedged basis," the firm says.

So, how should investors – existing or prospective – be viewing the asset class now?

With the Reserve Bank of Australia dropping rates to historic lows, and the Fed possibly at the start of their own cutting journey, the gift of a second chance may have arrived for defensive asset holders.

And don't forget - any rate cuts are usually good for government bonds, the fund manager adds. **FS**

The quote

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Watch the video on www.fsitv.com