Global Views - Issue 17, January 2010

Fixed Income Funds

In recent times, and particularly whilst experiencing more volatile market conditions, greater interest has been shown in Fixed Income funds. These are funds that invest solely in fixed income Investments, such as corporate bonds. These types of investments are seen as more dependable and limiting the amount of risk an investor takes, although that could - of course - mean a lesser return than might be possible with a more risky investment. It is for this reason that in more uncertain investment climates Fixed Income Investments are a necessary component of a well-diversified portfolio across different asset classes.

Because Fixed Income Bonds behave independently from equities, adding Fixed Income Investments to a portfolio can improve its overall diversification. Fixed Income Bonds expand the opportunity of investors to participate in the performance of capital markets and provide a more reliable source of income than other asset classes.

Historically, Fixed Income Bonds have provided greater returns than cash investments whilst exhibiting lower volatility than equities. Additionally, the return on such bonds has often offset the negative return on equities during periods of market downturns. Therefore, including Fixed Income Bonds to an equity portfolio generally lowers the risk and creates a better diversified portfolio.

The performance of Fixed Income Bonds is largely driven by two key factors: bond maturity and credit quality. Bonds that mature further in the future are subject to the risk of unexpected changes in interest rates. Bonds with lower credit quality are subject to the risk of default. Extending bond maturities and reducing credit quality increases potential returns.

So, how do Fixed Income Bonds work?

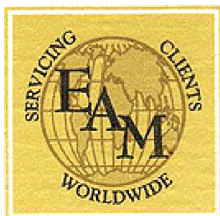
A Fixed Income Bond is a negotiable IOU, issued by a corporation or government. When you buy a bond you are lending a certain sum of money to that institution for a specified period of time. The institution promises to repay the value of the bond on the maturity date and to pay regular interest payments during the term of the bond at an agreed rate of interest. This rate of interest is normally fixed and hence why the bonds are referred to as Fixed Income Investments.

An additional feature of a Fixed Income Bond is that its value may also fluctuate depending on market conditions prior to the maturity date. Bond prices can fluctuate in response to credit quality, market supply and demand, and shifts in interest rates. It is the shift in interest rates that usually has the most impact on bond prices. Generally, the longer a bond has a maturity date, the higher the interest-rate risk, or the more sensitive its price will be to interest rate changes. When interest rates decline, values of existing bonds usually rise. When rates climb, values usually fall.

Currently we favour the VAM Asia Fixed Income Fund. This fund invests in Asian Fixed Income Bonds and is intended to provide an enhanced yield as part of a larger portfolio and/or to provide diversification. This fund provides an excellent investment opportunity in the current low interest rate environment and is well placed to take advantage of attractive Asian fixed income yields currently in excess of 6%+ per annum.

Unlike countries in the West, which have built up large debts to the rest of the world, Asian countries have substantial savings. As a consequence, they are better placed to repay maturing debts. Asian banks remain highly liquid and are able to support local corporations, as they did not invest in the more complex financial products that contributed to the global financial crisis as did their US and European counterparts. The improving economic and liquidity conditions in Asia will support lower refinancing risks and continue to sustain corporate bonds.

Remember, diversification and limiting risk in more uncertain investment conditions are vital to a well-balanced investment strategy.



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House Prices have Much Further to Fall, According to Some Analysts

Prospective buyers must realise that interest rates are being held at artificially low levels. What happens to house prices when rates are forced up, as they inevitably will be? What then? What happens to all those who are on the brink now, but just surviving? What happens to those on tracker rates, who haven't yet felt the crunch because their monthly repayments have fallen so low? What happens to first-time buyers and buy-to-let landlords in a high-interest-rate environment?

House prices remain out of kilter with what people earn. No matter what the government does, they will head lower until they reach a level that people can afford, which history has shown to be about three-times earnings. And they will probably overshoot this to the downside because of the scale of the preceding boom and the oncoming bust. There is nothing anyone, neither tycoon nor politician, can do to stop this inevitable course. All they can do is delay.

Market View

"After two extraordinary years… 2010 will feel a great deal more ordinary."
Tom Stevenson of Fidelity
Quoted in The Daily Telegraph

"The future looks no more stable to me than it did pre-bust… Expect big swings."
Crispin Odey of Odey Asset Management
Quoted in The Sunday Times

"Not only are investors aware they are in yet another bubble, they seem not to care."
Tony Jackson
Quoted in Financial Times

"Shares will get more volatile because nothing goes in a straight line forever, but the market is likely to continue to surprise people by how buoyant it is."
Richard Buxton of Schoroders
Quoted in Sunday Times

How Did You Do?

2008, as most of us will recall, was a horrid year for equity investors. By the time 2009 opened, markets had fallen from their highs - in the case of the FTSE, from about 6,700 in October 2007 to a low of 3,800 in Feb 2009 and closing 2009 at 5,400. The increase from trough to peak was 1600 points, or about 42%. However, the index is still down 1500 points from its all-time high, which was 6,930 - reached on December 30, 1999.

A similar story can be told across the pond with the S&P 500 showing a 26% increase through 2009.

One interesting fact to emerge from a raft of end-of-year figures is the little quoted fact that over the past twenty five years, an investment into the FTSE would have given greater returns, in general, than property. Using the Halifax Housing Index as a benchmark, and the FTSE 100, in virtually any annual period, starting from 1984 - when the average house price was £34,000 - the return on the FTSE was greater than the return on property in the majority of cases.

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Iceland Government to Compensate UK Savers

Well that is the good news, which emerged recently. However, more recent news suggests that a number of strong protest groups are attempting to prevent the payments from being made.

Stamp Duty Holiday Reaches the End

Stamp duty on properties between £125,000 and £175,000 returns to one percent as the government-imposed holiday on the tax comes to an end.

Savings Levels Plunge by £6bn

People are saving less money and falling back into debt, new figures released recently suggest.

Unemployment to Hit 2.8 Million in 2010

The number of unemployed in the UK will peak at 2.8 million in 2010, but the year will be better for job prospects than 2009.

More People Ditch Chequebooks

Further evidence cheques are on their way out has come recently after research showed an increasing reliance on the internet and telephone banking.

Burj Khalifa

Started at the height of the economic boom and built by some 12,000 labourers, the world's tallest building opened in early January in Dubai, as the one glitzy beacon of Westernisation in the Arab World seeks to rekindle optimism after its financial crisis.

The Burj Khalifa, formerly known as the Burj Dubai, whose opening was delayed twice since construction began in 2004, marks another milestone for the deeply indebted emirate with a penchant for seeking new records.

Dubai, one of seven members of the United Arab Emirates, gained a reputation for excess with the creation of man-made islands shaped like palms, a series of man-made islands representing the world, an indoor ski slope, and shopping malls for every occasion. Sadly, many of the man-made islands stand abandoned, which travellers arriving by air can view for themselves.

With investor confidence in Dubai badly bruised by the emirate's announcement in November that it would seek a debt standstill for one of its largest conglomerates, the Burj Khalifa could be viewed as a positive start to the year after a bleak 2009. Others not so kind may consider that this $1.5 billion building illustrates the excesses of the emirate.

The project has been criticised by human rights groups, who have objected to its treatment of labourers, as well as by environmentalists who said the tower would act as a power vacuum, increasing the city's already massive carbon footprint. Regardless as to any rights of wrongs of the building, one can only marvel at the structure which is 800 metres high and dwarfs the previous tallest building by over 300 metres.

Hedge Fund News

Reports suggest that encouraged by strong returns investors poured billions into hedge funds towards the end of 2009.

Pension funds, endowments, and private investors invested almost $19.0 billion into hedge funds in November, twice what was invested in October. In fact the last quarter of 2009 saw inflows in excess of $55 billion.

The total hedge fund industry is reckoned to be around $2.0 trillion.

Poor performance in recent years has led to significant sums being with drawn from the sector. As an indicator Man Investments for many years a barometer of the industry has seen massive outflows of money as many of its funds, including its core fund AHL Diversified, as they failed to deliver expected returns.

However, perhaps the tide is turning, and once again hedge funds will become a common feature in portfolios.

Zero

A zero is a type of share or bond. Its key feature is that it pays no annual dividend, or coupon. Instead, the security is issued at a discount to its face value (also known as its par value), but is redeemed (bought back by the issuer) at face or par value.

The result is the holder should enjoy a capital gain over the life of the security, This type of instrument is often issued by split-capital investments trusts – some of the shares issued are ‘zeros’ and the rest ‘ordinary’.

Zeros are tax efficient – gains are typically tax at the capital-gains tax rate of 18% - and so can be useful to an investor looking to pay a big future bill such as school fees. But there are risks. If, say, the issuer goes bust, the holder may get nothing back.

All Weather Fund:
A Sensible Investment Strategy for all Market Conditions

Question: What do most clients want from their investment?

Answer: For most clients, their minimum expectation is to preserve their capital during difficult financial market conditions and ultimately to beat the returns available from cash deposits, after all fees and expenses.

In Spearpoint's view, the best way to deliver these consistent, absolute returns is to employ an active, highly flexible, multi-strategy and multi-asset investment approach.

The Spearpoint All Weather Fund has been constructed to help meet investors' expectations by providing an actively managed, globally-diversified portfolio with the appropriate combination, given the prevailing market and economic conditions, of equities, bonds, cash and alternative asset classes.

- Active, dynamic and highly flexible multi-asset, multi-strategy absolute return fund.
- Managed with a capital-preservation mindset within prudent investment limits and restrictions.
- The Fund Manager enjoys a very flexible mandate and can invest in the appropriate combination of carefully selected funds, direct stocks, bonds and Exchange Traded Funds (Ishares) in order to meet the investment and risk objectives and maintain the required high levels of liquidity.
- In times of market uncertainty or stress, the extremely flexible investment mandate allows for the Fund Manager to move to a 100% cash position and also to protect the Fund through the use of derivatives (e.g. buying an index put).
- Targeting an annual total return of Sterling (or Euro) cash + 4% to 6% (after all fees & expenses) over rolling 3 year periods.
- +14.99% return in the year to 27th October 2009 and +13.55% since inception (19.9.2008) (Spearpoint All Weather Fund, in Sterling, after all fees and expenses).
- Kevin Boscher, the Lead Fund Manager, is highly experienced, with over 25 years industry experience and a proven track record of successful absolute return investing.
- Regulated by the Guernsey Financial Services Commission and via the Fund's listing on the Channel Islands Stock Exchange.
- Weekly dealing for subscriptions & redemptions, no redemption penalties and no lock-ups.
- Available either through the major international life company platforms or directly.
- Spearpoint "eat their own cooking" as their staff pension fund is invested in the Fund.

In this way the Spearpoint All Weather Fund aims to exceed your clients' investment expectations by adopting a sensible strategy for all market conditions (www.spearpoint.com).

Performance of Spearpoint All Weather Fund since inception (19th September 2008) to 27th October 2009 (in GBP) ***Source: Morningstar***
Fund: +13.55% | FTSE World: +4.08% | Agg bal: +3.87% | Cts bal: +3.43%