



New Breed of Fixed Interest Funds Has Arrived Says Zenith

Friday March 17 2014. Zenith has created a new “Unconstrained” fixed interest sub-category in its 2014 Global Fixed Interest Sector Report released this week. The creation of this new category has been driven by the number of new funds that have been or are about to be offered to market by fund managers, designed to fulfil the perceived current and future fixed interest needs of investors.

2013 provided investors with a possible preview of this future in global fixed interest markets. No longer will long-term rates be anchored as central banks look to remove stimulus from economies that are perceived to be recovering; volatility becomes more prevalent in credit markets; and Emerging Market Debt returns become more idiosyncratic, with investors discerning between countries.

Cognisant of this more challenging environment, fund managers have sought to construct fixed interest solutions that are more capable of navigating the evolving fixed interest environment than more traditional, benchmark relative offerings. Fund managers have achieved this through a number of ways.

Firstly, they have relaxed or removed the majority of constraints, particularly in regards to duration, sector and country limits. Of particular note, is the ability of many of these funds to assume a negative duration position.

Secondly, they have typically removed the link to traditional benchmarks by adopting a cash (or equivalent) benchmark. This results in the strategies starting the portfolio construction process from essentially a blank canvas rather than with the structural risks embedded in more traditional benchmarks.

While the rationale for and the attractiveness of these strategies is apparent, they are not without added risks. Notwithstanding the increased complexity of these strategies that accompanies their wide mandates and use of the full spectrum of fixed interest strategies and instruments, including derivatives, Zenith highlights two we have observed.

This includes the fact that many of the strategies in this sub-category have relatively short performance histories. This makes it more difficult to gain comfort in the ability of the manager to deliver on the strategy objectives over the market cycle.

Also, many managers have selected to use a master/feeder structure to launch these funds into the Australian market. While there are benefits to this structure, predominantly the ability to gain scale from the outset, we note the structure adds another layer of complexity to these offerings.

From an initial universe of 74 global fixed interest funds, across International Bond, International Corporate, International Diversified, International Specialist and International

Unconstrained categories: 1 was rated “Highly Recommended”, 28 “Recommended” and 8 “Approved”.

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