

Golden Triangle of Bond Investments – Interest Rates, Credit and Currency

Content Highlights:

1. What do you think are the best opportunities in the bond market now?

- We like high yield bonds the best. When we look at emerging markets and corporate bonds, high yield market still offer opportunities over treasuries, a roughly between 700 and 900 basis points over, not as easy as they were 2000 basis points over, so your total return should be expected to clip the coupon, roughly 8-9% in a little bit on price appreciation, but the best opportunity for us in a relative sense is in high yield bonds.

2. As the US dollar continue to decline, where do you think the best opportunities are globally?

- When we look at the dollar, we had a decline at almost all major currencies. Going forward, you have to divide the currency situation into blocks. The Asia block -ex Japan is where the currency strength will force itself versus the dollar. Looking at China, India, Malaysia, Taiwan, Korea, Indonesia and Singapore, we think these currencies over the next 2-5 years will express this trend relative to the dollar.
- The G7 dollar countries like the Europe and UK and to a lesser extent, the Canadian dollar, we think that those will be a tactical trade more than a structural trade. When you look at Australia New Zealand and Brazil, currencies have ties to Asia. As they grow, those currencies should appreciate also.

3. Australia and Norway have increased the interest rate recently, do you think the other countries will follow trend and what's the impact to the bond investors?

- If interest rates go up, the bond price goes down, so that negatively impacts the principals. In any rate rise environment, if you have a high quality bond the price goes down, so it impacts negatively.
- Other countries besides Australia and Norway that could raise rates would be Korea, and over time, potentially the US, to a lesser extent, Europe. With all the stimulus in the markets there is an ability for rates to go up, especially in Korean and in the US, that may take 6-9 months. The markets anticipate that so you have to be careful when you are in quality rates.
- Our strategy allows us to be very flexible. Countries where we can avoid interest rates going up, is i.e. Brazil because right now they're not going to raise rates, we now have a currency appreciation, maybe some Latin America locations where rates are not going to go up. When we look at on the credit side that have less interest rates sensitivity, credit situation can also be a place to hide when rates go up.
- With the floating rate debt. As rates go up, the floating rate bonds will appreciate, because they are tie to rates going high. So in those three incidents, we can be in markets that avoid losing principals and actually gain as the rates go up around the globe.

4. Do you think inflation will become an issue in the next 6-9 months?

- Inflation moves with expectation in the market. With the stimulus in the market in the US, we've had lowering the rates around the globe and we start to see some countries like Australia, Norway start to pull rates back to take some of that easing pressure off.
- As we go forward in the US, the plans, the TARP plans, the TALF plans and all these plans together with lower rates will lead to traction in the economy and that will lead to expectations of higher rates.
- So the window of higher expectations should be between 9 and 18 months. And at that period of time you will have an inflection point where the market starts to price in rate hikes. The federal reserve will start to realize that the rates structure is too low, but the market will move the rates up first then they'll talk about it and adjust the rate after, so they'll follow what the market tells them.

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