Date: 26.03.2018
Publication: Daily Telegraph

The Daily Telegraph

Bonds set to be shaken (or stirred) as interest rate uncertainty rises

ANTHONY KEANE, News Corp Australia Network
March 26, 2018 2:40pm
Subscriber only

RISING interest rates globally threaten to dent investment returns from bonds, that widely unknown asset class holding more than 20 per cent of most people's superannuation.

Despite their conservative nature, bond investments can fall sharply when interest rates climb — although a growing diversification of fixed interest assets by investment managers and super funds has reduced some of the pain potential.

Bonds — traditionally government debts — are much broader today and include corporate and private debt in Australia and offshore, and bond-like investments such as infrastructure.

Most bonds are bought through funds rather than directly from issuers, but anyone with money sitting in older-style funds risks capital loss when interest rates rise because older lower-rate bonds become less attractive than the new ones.

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Statewide Super chief investment officer Con Michalakis said a good example of a previous bond blow-up was almost 25 years ago, in 1994 when US authorities raised interest rates quickly and bond markets got spooked.

"A lot of people had bought capital stable funds, long bond rates went through the roof, prices collapsed and all the capital stable funds went negative," he said. "People freaked out."

"Here we are today with near-record low interest rates and now we are in a regime of rate rises."

Mr Michalakis said that if interest rates rose quickly both shares and property investments could also suffer, and even the Reserve Bank of Australia had voiced concerns about higher volatility in bond markets.

Reserve Bank deputy governor Guy Debelle says the future of interest rates is uncertain.

RBA deputy governor Guy Debelle said this month there was "inherent uncertainty" about the future of interest rates.

"We have been living in a period of unusually low nominal bond yields. How long will this period last?" he said.

Con Michalakis from Statewide Super says bonds still have a place for investors.

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Mr Michalakis said there was still a place for bonds in investment portfolios. "You are getting a lot more variation to your traditional fixed income," he said.

"There are more ways to get bonds or bond-like investments than we have ever had."

Exchange traded funds are one example, as is Metrics Credit Partners' listed income trust which debuted on the stock exchange last October.

The MCP Master Income Trust, Australia's only listed trust dedicated to corporate lending, lends to companies including Woolworths, Origin Energy and Lend Lease and is now seeking to raise another $303 million to lend.

MCP managing partner Andrew Lockhart said his fund's corporate loans, unlike traditional fixed-rate bonds that fell when rates rose, were a floating rate. "If interest rates rise, the total return to investors goes up and they don't lose capital value", he said.

"We think loans are better than bonds. There are limited opportunities for you to invest in a capital stable investment class with predictable interest income flows."

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