

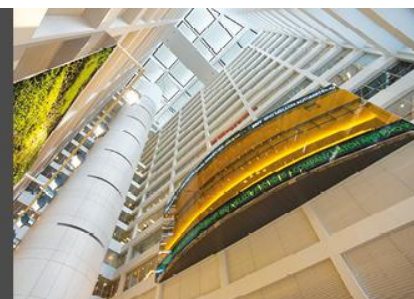
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News & Views

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BNY MELLON



PAUL BRAIN: WHAT TO EXPECT FROM BONDS THIS YEAR

The manager of the Newton Global Dynamic Bond strategy expects a positive year for fixed income, despite the mixed economic outlook.

Paul Brain, portfolio manager of Newton's Global Dynamic Bond strategy, believes 2016 could be a decent year for bond investors with yields rising and a greater opportunity to invest in certain areas as companies restructure. "I'd expect a return of 3-5% this year but most of it in the second half – it is still an uncertain environment though given the extent of ongoing central bank manipulations."

Among the potential hurdles over the first half of the year stands the fortune of the high yield market, particularly those issuances connected to the US energy sector.

US high yield energy is a sub-sector Brain sees as most likely to experience defaults and he believes these are needed. Defaults have been rising but Brain says much of this is already priced in so shouldn't surprise drastically on the downside and should bring some reality back to the market.

Building resilience

What of any unexpected upsets? Brain believes the way the portfolio is currently positioned would result in the strategy trading sideways rather than falling in the event of a surprise upset. "It would have to be quite a serious credit or emerging market crisis for us to lose money, I think, as most of our risk asset exposure is in high quality, short-duration paper." In such a scenario he believes bond positions would rise, offsetting any losses on the credit side, he adds.

Over the course of 2015 Brain reduced exposure to high yield. He started last year with a position of around 25%, dropping to around 5% today (as at 14.1.2016).

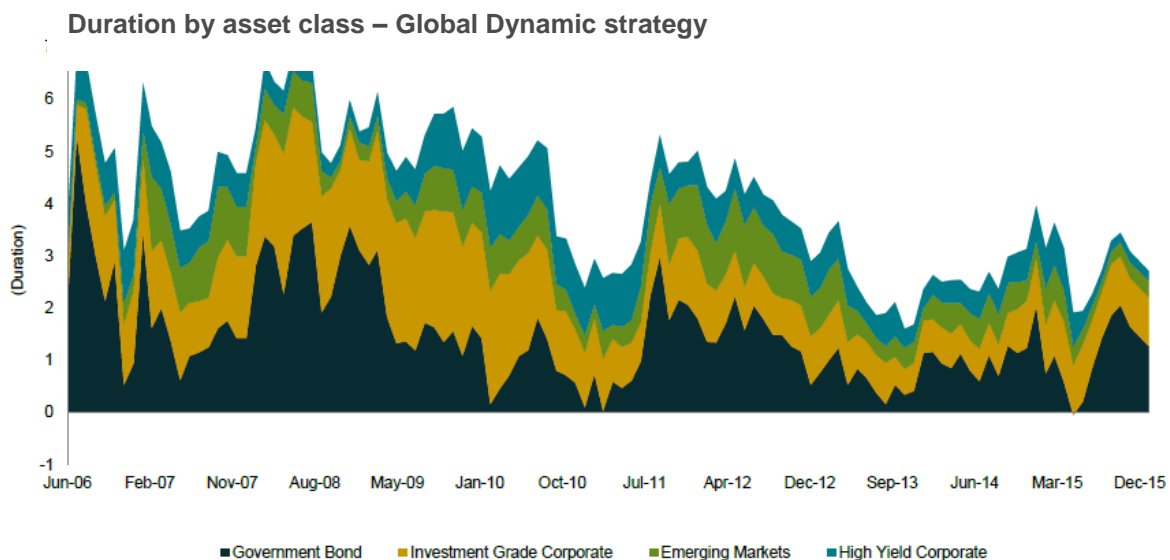
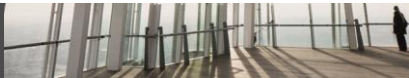
The strategy retains a relatively large position in investment grade, making up the core of the portfolio at around 30%. However, over the course of the year exposure at this end of the fixed income spectrum has been adjusted slightly to favour financials, some of which Brain describes as now being run like a utility. "Many banks are now being run to pay their debts rather than to reward shareholders."

Retaining a defensive stance within the portfolio, the c9% (as at 14.1.2016) in emerging market debt is on a very selective basis, according to Brain. He has limited positions in countries such as Mexico, Morocco and Peru while reducing exposure to Brazil and shorting currencies from vulnerable countries like South Africa.

Recent positioning

In December Brain introduced a 5% short position on the five-year Treasury in the belief the yield curve will flatten. (He has also gone long the 30-year end of the market). Adding a short in some Asian currencies (and the South African rand towards the end of the year), he has gone long the euro and the US dollar – a shift from his previous position of being long solely to the dollar. "With volatile markets and in light of how many rate increases are priced into the US, the euro could benefit from a 'safe haven' period," he adds.

Duration in the Global Dynamic Bond strategy is around 2.7 years at present, much of which is taken via developed market government debt rather than low-grade corporates.



Source: Newton, 31 December 2015

Looking at the economic backdrop, Brain believes US interest rates will peak at 1% and may come back down to zero as the year progresses. While many are watching China carefully and certainly the start to 2016 was not a stellar one, Brain is more sanguine about the Asian giant. “China is no disaster; it is an economy that is transitioning and that will take a long time; consequently there will be periods of volatility and short term noise.”

With respect to other emerging markets, in particular Latin America, Brain is watchful. He does expect bad news will emanate from Venezuela and any sovereign defaults in the region are likely to have a contagion effect on the continent.



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Past performance is not a guide to future performance.

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