

seeking value

October 2009

John Anderson explains why he believes corporate bonds still offer value.



For the casual observer, the semi-mysterious world of corporate bonds appears to offer a story of either famine or feast. Most will remember the great collapse in these stocks in late 2007 and early 2008 that gave rise to the very expression 'credit crunch'. The demise of Northern Rock, AIG and Lehman Brothers saw the yields on bonds issued by any institution other than governments rise sharply, as investors sought safe havens for their money and shunned such issues whatever their price.

Now, fast forward to today and people are talking of a bond 'bubble', following a six month rally in prices that has seen the returns on some issues appear more like those on equities. So is now the time to be buying these seemingly volatile instruments? Should they really be part of a balanced portfolio given such fickle behaviour?

market context

Although investors have varying goals, at Gartmore we have always believed that bonds could form part of a balanced portfolio, particularly when (as in the case of sterling corporate bonds today) I believe that they offer value. At the start of 2009 this market had collapsed, leading most commentators to fear that dividends would not be paid and that many issuers would not be around to repay investors their capital in the years ahead. Yield spreads (the additional yield earned on a corporate bond over and above that available on a risk-free government bond) blew out to their widest levels ever, such was the fear amongst investors who had just seen the mighty

Lehman Brothers collapse in the USA. One man's fear, however, proves to be another man's opportunity and before long the market was rallying back as many investors saw the yields on offer as a 'once in a lifetime opportunity'. We are now at a situation where the average high quality (investment grade) corporate bond has a spread of just over 2.1% above UK gilts (debt issued by the British government), as at 21 September 2009. When compared to spread levels of around 4.5% that were available in March of this year, you could argue that the party is well and truly over and that the market is no longer worth buying. When you look at such yield spreads over a longer time horizon, however, you can see that it may not appear as expensive as first thought.

In recent years, the average sterling investment grade yield spread has been less than 1%, making today's level appear good value even after the strong rally of recent months. Now, it is true that during the heady days of 2005/06 the market got ridiculously expensive with spreads approaching a mere 0.4% (barely enough to compensate an investor for the lower liquidity in these markets, let alone the additional credit risk) – but the current 2.1% does appear to have overshot the mark in the opposite direction, despite the levels earlier this year. From the massively oversold market of March to today's levels, we appear to have moved from discounting a re-run of the Great Depression to a 'mere' recession, a basis of valuation that is more in keeping with the current economic environment.

careful selection

So, a carefully selected, diversified portfolio of high quality corporate bonds still appears to be an attractive option for investors seeking a secure, stable level of income. It is true that the yields on the underlying government issues have fallen to very low levels as interest rates have been cut dramatically, but corporate issues that yield 5.5% on average still offer great value in relative terms.

'Value' has indeed been the key word throughout my 25 years experience in managing bond funds. I went into the 2007 market crisis holding virtually no financial issues as I largely foresaw the oncoming crunch. Since the crisis unfolded I have been in a good position to assess the value of the market and have bought stocks on a selective basis. I am not wedded to an index in the Gartmore Corporate Bond Fund and I refuse to 'chase yield'. As an investor who was battenning down the hatches in early 2007, I currently believe that the sterling corporate bond market now offers good value in relative terms and I feel comfortable holding such issues at present.

John Anderson is manager of the Gartmore Corporate Bond Fund and is AAA-rated by Citywire.

The Gartmore Corporate Bond Fund is available through the Skandia Investment Solutions platform and Skandia's Life and Pensions fund ranges.

www.skandia.co.uk

Calls may be monitored and recorded for training purposes and to avoid misunderstandings.

Skandia provides you with access to its investment platform, known as Skandia Investment Solutions. Within this platform you can open an ISA and Collective Investment Account provided by Skandia MultiFUNDS Limited, a Collective Retirement Account and Collective Investment Bond provided by Skandia MultiFUNDS Assurance Limited and an Offshore Collective Investment Bond, distributed by Skandia MultiFUNDS Limited but provided by Old Mutual International (Guernsey) Limited.

Skandia Life Assurance Company Limited, Skandia MultiFUNDS Limited, Skandia Investment Management Limited and Skandia MultiFUNDS Assurance Limited are registered in England & Wales under numbers 1363932, 1680071, 4227837 and 4163431 respectively. Registered Office at Skandia House, Portland Terrace, Southampton SO14 7EJ, United Kingdom.

All companies are authorised and regulated by the Financial Services Authority with FSA register numbers 110462, 165359, 208543 and 207977. VAT number for all above companies is 386 1301 59.

Old Mutual International (Guernsey) Limited is regulated by the Guernsey Financial Services Commission and is licensed to write long-term business under the Insurance Business (Bailiwick of Guernsey) Law 2002. Registered number 2424. Registered Office at The Beehive, PO Box 121, Collings Road, St Peter Port, Guernsey GY1 3HE, Channel Islands.