PLOTTING A NEW COURSE FOR YIELD

Old routes to bond returns are becoming dead ends. What alternative ways have you found to generate yield and which funds and fund managers are you betting on to bring it safely home?

CITYWIRE VERDICT

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If there is one conversation that has dominated discussions over the past few years it is how investors are meeting the demand for yield in a world where central banks seem intent on cutting rates until they fall through the floor.

But, much like nautical traders of old, a stormy outlook doesn't mean you can afford to turn your back on the high seas. You just have to get smarter about the routes you take and the way in which you combat the prevailing conditions.

One idea which has gained a significant tailwind is to back unconstrained bond funds – those with a classic go-anywhere remit, which allows them to venture into yielding areas without compromising their core philosophy. Selectors such as Mia Söderberg of IKC Capital has championed such strategies but has only backed those with adequate experience of riding the waves.

For others, most notably Alexandre Gillard of Fuchs Finance, the idea of unconstrained or global flexible approaches is played out. The Luxembourg-based investor says the popularity of these funds has hampered performance, as they are becoming too big to function in some cases. Gillard has therefore turned his attentions to equity market neutral funds.

Others are braving relatively uncharted waters, with Netherlands-based Arnold Pagen suggesting the now open seas surrounding the Chinese debt market are an enticing hunting ground. Pagen, who works for Petram & Co., believes the successful transformation of the RMB into a truly international currency will make waves in international bond markets.

However, selectors such as Markus Müller of Quirin Privatbank are setting their sights on more niche areas, notably microfinance, but counterparts such as Paul Gambles are concerned about steering clients towards 'exciting' areas that could prove problematic in the future, namely structured notes, which he says have taken on a 'toxic' image in recent years.

Our investment panel are divided over the best passage to take and a lot will depend on both you and your clients' risk appetites. However, with central bank policy due to change dramatically in 2018, what better time than now to see if you are plotting a similar course to your investment peers or are on more individual voyage to yield.

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Both the ECB and the Bank of Japan have continued to print money to support their economic recovery and reach minimum inflation targets. Overall, bonds are expensive, sovereign yields generally do not cover long-term inflation risks, and corporate bonds do not always compensate for their associated credit risk. We recommend a prudent approach as the scheduled end of the ECB's asset purchase programme in 2018 could mark the start of a rise in long-term bond yields. The end is in sight for current unconventional monetary policies. In the current credit landscape, senior loan funds largely invested in floating rate securities, such as **NN Flex Senior Loans**, now probably offer a better risk/return profile than high yield bond funds. Emerging bonds, particularly those denominated in the local currencies, appear to be the most attractive segment of the bond market. They offer higher yields and emerging currencies seem to be moving upwards after underperforming for several years. **PrivilEdge - Ashmore EM Local Currency Bond** fund is our top pick in this segment.