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City Financial Strategic: Gilt-edged year predicted

By Elaine Moore
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Ian Williams, manager of City Financial Strategic Gilt fund, believes 2008 will be characterised by a movement of investor money from corporate bond funds to government bond funds.

"A lot of asset managers are aware of this and are looking," he said. "We have started to pick up indicators that this is going to be a big subject for the first quarter of the year."

The fund, which was launched in December 2006, invests only in UK gilts and writes covered call options against the underlying portfolio.

"The idea is that the money received from selling the options is added to the total return and provides the fund's

outperformance," said Mr Williams.

The fund aims to deliver superior returns to alternative gilt portfolios and corporate bond funds without deviating from the gilt market. This, says Mr Williams, means it has all of the attractive qualities of the gilt market: high liquidity and a low risk investment.

The fund has a 5 per cent initial charge and has a minimum initial investment requirement of £500.

Investors choose corporate bond funds because they hope to get a higher yield than is possible from government bond funds but Mr Williams believes they are taking disproportionate risk for the rewards available.

"Investors have to ask themselves what, in the current environment, they are doing in bond funds when they can invest in gilt funds," said Mr Williams.

Over one year the fund has returned 6.47 per cent to investors - a result that compares favourably with many corporate bond funds over the same period according to Mr Williams. The IMA Gilt sector had an average return of 2.83 per cent over the same time.

At the end of 2007 the UK gilt market rose as a result of institutions divesting surplus cash for the year end but overall the fund describes the backdrop of 2007 as "quiet".

Over the next year the performance of the fund will depend heavily on the situation of the wider market. If bonds have a bad time overall the fund will be affected, but Mr Williams says the options should provide the fund with a cushion against possible future falls.

"You can dissect the gilt market into two parts," he said. "There are long dated and short dated gilts. Long dated gilts could be affected by the realisation that inflation is in fact higher than it had been assumed. But that wouldn't affect short dated gilts. So we could have a tale of two markets."

At the moment the monoline insurance companies in the US look like they may have problems, which could strike another blow against corporate bonds, says Mr Williams. If the triple-A wrappers the companies put around corporate bonds to sell to corporate bond funds are devalued then investors in corporate bond funds could be at risk.

"The smart money in corporate bond funds are the ones who get out first," said Mr Williams.

Over 2008 Mr Williams believes there could be some problems with the wider economy and has positioned the fund accordingly but believes that the change could result in even more people switching from corporate bonds to gilt funds.

Total expense ratio: 1.48%

UK sector average: 1.09%

Source: Lipper

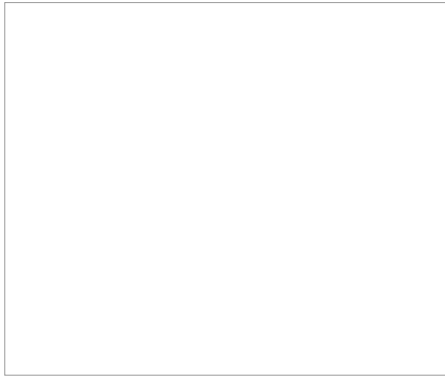
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