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Ian Williams on Bonds

(IA) £ Corporate Bonds: Over three years

	3yr % chg	Rank	Vol monthly	Fund size (£m)	Morningstar rating™
Top 5					
F&C Institutional Lng Dated Corp	25.60	1	2.73	41.61	★★★★★
Schroder Instl Long Dated Corp Bd	24.45	2	2.93	351.95	★★★★★
Fidelity Instl UK Lng Corp Bd	23.19	3	2.49	533.15	★★★★★
PIMCO GIS UK L/T Corp Bd	22.43	4	2.48	421.38	★★★★★
Janus Henderson Instl Lg Dated Crdt	21.56	5	3.09	415.74	★★★★★
Bottom 5					
Threadneedle Stlg SD Corp Bd	7.02	75	0.42	1,183.68	★
M&G Short Dated Corp Bd	6.20	76	0.50	473.45	★
Vanguard UK Short-Term IG Bd Idx	5.96	77	0.38	1,168.01	★
AXA Sterling Crdt Shrt Dura Bd	4.86	78	0.34	603.59	
SVS Brown Shipley Sterling Bond	2.15	79	1.05	46.41	★★
SECTOR AVERAGE	**14.00**		**1.48**	**832.77**	

Performances calculated bid to bid, net income re-invested, GBP to 03/06/18. Source: © 2018 Morningstar.

With the death of the 30-year bull market in bonds, the outlook for fixed income investors is grim at best and panic-inducing at worst.

From a global perspective, US government bond yields will continue to rise gradually despite their safe-haven status during any geopolitical flare-up.

Euro bonds also look vulnerable amid renewed fears over Italy as well as their poor relative value.

For UK gilts and all other forms of sterling debt, the implications of a possible rise in UK interest rates late this year is also bearish. The idea that somehow investment-grade UK corporate bonds can be immune from rising gilt yields is palpable nonsense as these trade on a spread over a similar maturity government bond.

If gilts fall in value, so too will corporate paper as sure as night follows day. A capital loss due to rising yields measured in nominal terms is bad enough. But the insidious effects of compound inflation on the real value of a bond (any bond) would be devastating.

For example, a 30-year gilt on a current gross redemption yield of 1.92% would lose 22% of its capital value if the yield rises to 3% – in line with what has already happened in the US – but still very low in historical terms.

A major additional risk in corporate bonds is liquidity – poor in a bull market and likely to be virtually non-existent in a downturn. Switching from conventional gilts into index-linked gilts (ILGs) may provide no shelter as potential losses in linkers would dwarf those from ordinary gilts. This is because the price of ILGs is determined by the real yield (relative to conventional gilts) not the rate of inflation, per se.

Given the risks, bond investors should move heavily into counter-cyclical assets, such as floating rate notes, instead of fixed income securities. But many seem ill-prepared.

Bull Points

Government bonds are the most liquid of all securities

Bonds are less volatile than equities

Bear Points

Rising yields and compound inflation will destroy value of long-term bonds

All corporate bonds are highly illiquid in a bear market

Ian Williams is chairman and chief investment officer of Charteris Treasury Portfolio Managers