

► City Financial's Williams says presently vast sections of the bond market are un-tradable Illiquidity could lead to redemption deferral by fixed interest funds

By Gary Shepherd

Illiquidity in the corporate bond market could lead to some fixed interest funds



Williams

following commercial property vehicles in deferring redemptions, according to Ian Williams, manager of City Financial's Strategic Gilt fund.

Williams explained that most corporate bonds are illiquid even at normal times. However, given current adverse market conditions, he warns that presently vast sections of the bond market are "virtually un-tradable".

"This means that there is a risk that as investors wake up to the downside risks inherent in these funds, they will seek to redeem," he said. "In this event, the prices obtained will be 'firesale' prices at best and it cannot be ruled out that some funds will defer redemptions."

Faced with this scenario, Williams said it is "simply mad" for investors to remain in corporate bond funds.

"Clients will accept risk

where there is the prospect of reward, such as the equity market," he explained. "What clients will not accept is unrewarded risk – exactly what corporate bond funds offer at present."

Eric Holt, head of credit at Royal London Asset Management, rejected Williams' views, stressing that corporate bond funds are not as likely to struggle against the problems that have impacted property vehicles.

"Typically, we'd have 150 bonds in an investment grade corporate bond portfolio, so there's a lot of scope to manage liquidity in a complex portfolio," he said. "In property funds, there's a much bigger unit size and much more illiquid environment."

Holt acknowledged that adverse conditions in credit markets had been challenging, though he is optimistic for the future.

"At the margin, we've seen a continued inflow into the corporate bond funds," he explained. "The change in the pricing in credit risk has been massive, due to economic uncertainty going forward and there has been an element of retrenchment in leverage systems."

"It's been a pretty painful process of credit re-pricing, but on a medium to longer term horizon we actually think risk is attractively priced at the moment."

Amanda Davidson, director at Baigrie Davies, said that she would have no qualms about investing in corporate bonds.

"As part of an overall portfolio, clients should have some exposure to fixed interest investments," she said. "You have to ride through the bad times, and hold on to the principles that compelled you to invest in the first place."

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