Investment Week

1 February 2009 | The premier publication for the investment industry | www.investmentweek.co.uk

FMF HENDERSON'S STUART O'GORMAN GENERATES IMPRESSIVE RETURNS OVER THREE YEARS P22

RADAR ALERT PAUL BOYNE COMPLETES FIRST YEAR AT HELM OF INVESCO PERPETUAL GLOBAL EQUITY INCOME P26

CHINA SPECIAL FIDELITY'S ANTHONY BOLTON FORECASTS 'HICCUPS' IN STRONG CHINA GROWTH STORY P5

Fixed income specialists believe consensus is exaggerating the long-term view

Managers challenge market's poor long-term outlook for gilts

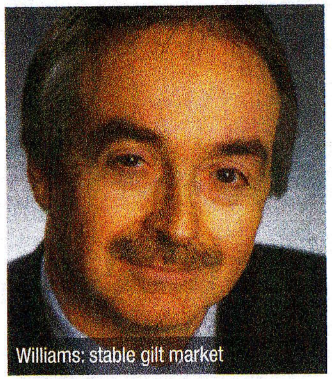
By Hysni Kaso

Highly regarded fixed income managers Richard Woolnough and Ian Williams have challenged the growing bearishness on the gilt market, believing the consensus view is exaggerating the long-term risks.

The managers are responding to last week's warning by Pimco founder Bill Gross, who suggested the gilt market is resting on a "bed of nitroglycerin" due to the UK Government's mounting debt problems.

While Woolnough agrees the gilt market should be avoided in the short-term, the M&G manager says the UK has the chance to adjust to the crisis through fiscal stimulus, financial reform and a falling exchange rate.

Woolnough says the UK Government will have a large annual deficit of 11.5% of GDP, almost four times the level of Germany.



Williams: stable gilt market

However, the UK's total outstanding gross debt stands at 68.7% of GDP, comparing favorably to the US at 84.8% and 78.7% for Germany. "The consensus is exaggerating the risks the UK gilt market faces. Even if one agrees with the consensus, it is important to see if this view is priced into markets and when this will eventually come to an end," he says.

"I agree with the direction of the consensus as absorbing that much new supply will be negative for gilts in the short-term.

"However, the consensus that a 'bed of nitroglycerin' is a dangerous place to rest, like any consensus view, should be challenged."

Top performing City Financial Strategic Gilt fund manager Ian Williams says as universal sentiment in markets is often wrong, there is a plausible case for owning UK Government debt in 2010.

Williams says positive gilt demand in 2010 will be driven by weak economic performance, as already shown by the UK's worse-than-expected 0.1% growth figure for Q4 2009.

"When quantitative easing began in March of last year the consensus view was that it would cause a bull run in the gilt market – this did not happen," Williams says.

"Rather than a surge in gilts, 2009 was characterised by a long and sustained rally in the equities markets. While this may have been simply coincidental to quantitative easing, it suggests that we should consider the possibility that a withdrawal of QE will have an equal, but opposite, effect.

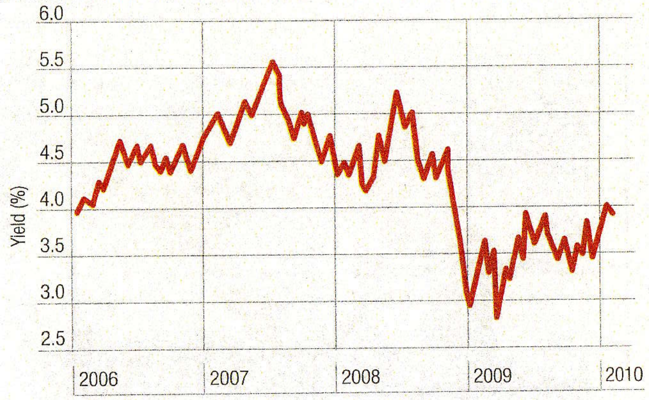
"We could therefore see a retrenchment in equities and a much more stable gilt market than is currently built into most forecasts."

However, Henderson Strategic Bond fund manager John Pattullo remains aggressively short on gilts, expecting the UK to be forced to raise interest rates a number of times in the second half of the year.

"Nothing has changed for us. We went aggressively short earlier than most last year and while it does worry us a little we are now in the consensus, we have no problem keeping the position in place," Pattullo says.

"I can foresee interest rates around 2.5% by the end of this year, with the 10-year gilt yield closer to 5% than 4%."

Benchmark 10-year gilt yield



Source: Bloomberg

FOR BREAKING NEWS GO TO www.investmentweek.co.uk

Policy errors pose highest risk to emerging markets | Bolton China Special