

RADAR ALERT – CITY FINANCIAL STRATEGIC GILT

City Financial fund manager uses 25 years' experience of fixed income markets to put Strategic Gilt vehicle top of the IMA UK Gilt sector

Williams juggles conventional and index-linked gilts buys to bring consistent performance

By Barney Hatt

Ian Williams, chairman and chief executive of Charteris, has managed the City Financial Strategic Gilt fund since its launch in December 2006.

With more than 25 years' experience of equity and fixed income markets, Williams also puts this knowledge to work on Charteris' Elite Premium growth equity fund – launched in 2001 – which uses a covered option writing strategy.

The £57.6m City Financial Strategic Gilt fund is ranked top of the IMA UK Gilts sector over the year to 20 July, up 15.5% against an average 10% increase, according to Morningstar.

A distinctive feature of the fund is that it switches between conventional and index-linked gilts, depending on which Williams feels is the best option at the time.

"We would maintain – and the evidence so far this year has proven it – that this is the only way to make money in the gilt market," Williams says.

"You do not make money by being long on the index-linked all the time, and you probably do not make much being long on the conventionals all the time. But you can make money by switching between the two.

"There have been times in the past when index-linked gilts have quite badly underperformed, and you would not want to have the fund in that sector during that period."

Williams says his outperformance is down to the decision to

switch the portfolio from 100% invested in conventional gilts to around 80% in index-linked vehicles at the start of the year.

"And the 20% in conventional gilts was only short-dated ones," he adds.

Williams claims he initially made the changes because he believed interest rate-tied assets looked cheap.

"We took a view at the start of the year that index-linked gilts were going to outperform conventional gilts," he says.

"We put the bulk of the fund into index-linked gilts and they have outperformed conventional gilts. That is why our results have been so good."

Williams stuck with the weighting until early July, because of effects of quantitative easing.

"The gilt markets had quite a torrid time over the first six months of the year and the net result is that virtually every gilt fund in the IMA sector went down apart from our fund, which has gone up," he says.

"It seemed logical to us that when quantitative easing was introduced and the equity market was at a very depressed level we thought it would lead to a rebound.

"We thought investors would value index-linked gilts more highly at a time when the Government was printing lots of money than conventional gilts. And so it has proved."

In the first week of July, the manager moved out of index-

linked gilts and back into the conventional market.

"We think that particular trade has pushed too far. We think the real value yields, particularly on the longer valued index-linked got pushed down to levels that were far too low, and effectively unsustainable," Williams says.

"We think over the next three months deflationary trades will outperform inflationary ones, and the equity market, having had its big rally, is now going to have a bit of a setback."

Williams acknowledges that it was fortuitous he made the switch back to conventional gilts in July.

"Shortly after we switched, index-linked gilts had quite a torrid time, particularly during the last two weeks of the month.

"You do not make money by being long on the index-linked all the time, and you probably do not make much being long on the conventionals all the time.

But you can make money by switching between the two"

So we did actually save quite a lot of outperformance.

"If we had stayed in the index-linked sector we probably would have given back maybe 2% of our outperformance – so that has worked out well. We are happy at the moment to be in the conventional gilts rather than the index-linked."



IAN WILLIAMS

- Manager of City Financial Strategic Gilt fund since December 2006, when City Financial selected Charteris to run the fund.
- Chairman and chief executive of Charteris since September 2002.
- He also manages Elite Charteris Premium Growth, launched in 2001.
- Previously head of bond options at Dresdner Kleinwort Benson.

He says he has no plans to redress the balance for the next three or four months, and will then take a view depending

value at the time between the index-linked and the conventionals. If index-linked gilts start to look cheap, relative to conventionals we might well switch back. If we still perceive conventionals are better value then we will stay in them, and we would be getting long and relative yield differences at the time between the two," he says.

Williams describes the style of his investment strategy as macro top-down.

"We believe that all the markets are inter-related so if there is a move in one market it tends to have a domino effect on all the markets," he says.

"We do not just purely look at gilts – we look at equities, commodity markets, gold, foreign exchange, and money rates.

"We look at the entire picture and then form a global view of the world, which also affects how we run our equity funds. It is a fairly consistent and logical view across all the funds we run."

The manager says that for 24 out of the 30 months in existence the fund has had a modified duration less its benchmark.

"So what it has delivered is higher reward for lower risk. We have not made this extra return by betting the ranch and putting huge bets. It is actually run as a very cautiously managed fund – higher reward for less risk," Williams says.

"It has only really underperformed for three months out of its two and half year life, and that was at a time when our competitors were putting big bets on when the market was rising strongly and we declined to participate. The fund is very much run with a low-risk strategy."

MEERAPATEL

Senior analyst, Hargreaves Lansdown

This is one of two funds in the peer group that is marginally in positive territory since the start of this year. It is the only gilt fund I know of that can switch between conventional gilts and index-linked gilts, making it a more interesting play compared to its peer group. When there were fears of inflation seeping back into the system towards the end of last year, Ian Williams prudently increased the fund's exposure to index-linked gilts which proved helpful. At one point the fund had 80% in index-linked gilts, and this was a good call.

More recently, Ian Williams has significantly repositioned the portfolio into conventional gilts as inflation fears have eased in the short term. Following the government's quantitative easing programme, conventional gilts have seen a fall in prices, and are now looking more attractive compared to index-linked gilts. With this in mind, the portfolio now has about 80% in conventional gilts.

What makes this fund unusual is that it has the ability to also write covered call options on conventional gilts. This strategy can help to boost the yield on the fund which is why it has had a higher yield than the market. This strategy has also contributed towards 3% of the fund's total return, while the remainder of the performance has come from market movements, switching between conventional and index-linked gilts, and duration management.

