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Focus fixed on stability

Investors are looking to improve returns without taking on too much risk

BEN POWER

FIXED-INCOME brokers are reporting a surge in investor demand in the wake of sharemarket volatility as they seek more stable investment products. Investors are also seeking higher-yielding instruments, including corporate bonds and hybrid securities, as they roll out of term deposits.

Laurie Conheady, executive director of fixed-income strategy at JBWere, said his firm was seeing more of a permanent allocation to fixed income across its Australia-wide network.

"I came on board two years ago and there's been significant demand across our network for fixed income," he said.

Investors are also increasingly looking at direct fixed-income holdings to improve portfolio transparency, manage cashflows and lower fees. But fixed-income players say there is a long way to go before fixed-income investments are afforded the same respect as cash and equities.

"The investment culture in Australia needs to change," said Jim Stening, managing director of FIIG Securities. "What people tend to do is agonise over 'when do I get out of cash and into equities; and out of equities into cash?' But there are all these investments in the middle of that risk spectrum that could easily satisfy their target return while taking on limited or less risk."

Fixed income has long been seen as a defensive asset. The asset class includes term deposits, government bonds, semi-government bonds, corporate bonds, hybrid securities and international bonds. But during the GFC many investors were shocked by big losses in fixed-income funds, in part due to issues of unclear labelling of funds.

"It's been a tough asset class through the GFC," said Paul Banner, principal financial adviser at Provenance Advice. "It didn't act like a defensive asset class, which is why a lot of clients lost a lot of value and why people were overwhelmingly frightened by the GFC when they saw bond investments potentially going down at the same time (as equities). But in the wash-up, (fixed income is) still a defensive asset class," Banner added. With equity markets slumping again, investors are turning to fixed-income securities to maintain security of capital.

"We're seeing a lot of inquiries and a lot of demand for a whole range of fixed-income assets," Stening said. "The other thing coming into play is that term deposits and that sort of thing don't seem to be as attractive. A huge number of deposits are rolling off from higher levels from a couple of years ago and people are looking to maintain higher returns." Stening said investors were heavily weighted in cash. "In order to get better returns they're considering corporate bonds and higher-yielding corporate bonds," he said.

The most popular — and most easily accessed — fixed-interest investment in recent years has been term deposits. But investors are now deserting them for more marketable instruments like hybrids and corporate bonds as they look for yield and flexibility. Just last Thursday, index provider S&P announced seven new indices that should in time provide a way for exchange traded fund issuers to list fixed-interest ETFs on the ASX, but regulator ASIC will have to approve changes to the ASX Listing Rules before that happens.

JBWere's Conheady said term deposits had been the best risk/return investments with strong rates backed by the government guarantee. But that is over and with many term deposits rolling off to lower rates, investors are now looking more and more at direct holdings.

"Managed funds are just on the nose really," Banner said, adding clients "got a bit despondent

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Investors' focus fixed on stability amid volatility

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by it all. That push into direct investments is broader (and includes equities). People want to own and control and smell and taste their investments."

Banner said the demand for term deposits — "the most simple way of playing this (fixed income) game" — has been partly a result of distrust of managed funds.

He said that many investors who didn't have a sufficient understanding of bond instruments still shifted away from managed funds. In term deposits they earned good returns "and at least you knew who the hell you're dealing with".

Banner says likewise if you hold, for example, a CBA bond you know where that money is and you can easily quantify/qualify the risk versus return.

The likes of JBWere and FIIG are tapping into the demand for direct holdings by offering smaller-sized bond parcels.

"What we're doing is opening it up to the smaller investors," Stening said.

Stening says managed funds do provide diversification for investors. But he views direct holdings and managed funds as two different propositions. Many investors, particularly SMSFs, are using direct holdings to control and tailor cashflows. With direct fixed income, if you have certain income requirements, you can match requirements with investment maturities and coupon payments. "Most fixed income managed funds have no cash flow and you don't know what's in there," Stening said. "Predictable income is not something these funds provide."

Stening also said index-based managed funds were "a direction bet". He said: "If interest rates go up you're going to underperform. If you have a direct portfolio you have complete control over the underlying assets."

Conheady said Australia for historical and cultural reasons lacked a retail-focused bond market, unlike Britain, New Zealand and Canada, where he used to work. He said in New Zealand 40-50 per cent of clients' total portfolios were typically in fixed income.

Conheady said the generally strong performance of the Australian equity market (until recently) coupled with the tax benefit of franking credits had contributed to a higher allocation of equities vis-a-vis fixed income. In Britain, smaller parcel sizes and existence of more retail-oriented bond brokers provided ease of access.

He added that developing and improving the Australian retail corporate bond market required a long-term multi-pronged effort, including education.

He said for the corporate bond market generally to develop, there also had to be willingness of Australian companies to issue more bonds domestically and not head offshore. They also had to be issued in a format suited to the retail investor, either as ASX-listed or in smaller parcel sizes.

"Getting the product in the hands of investors will involve the development of distribution channels by investment houses, banks and brokers," he said.

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Jim Stening of FIIG Securities says a direct portfolio gives you control over underlying assets