The Opportunity of Riding the Bond Rollercoaster

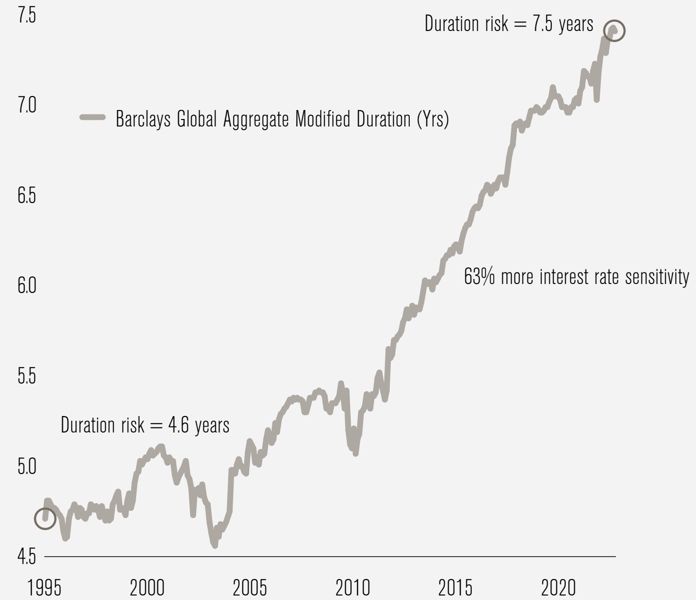
DYNAMIC private INVESTMENT POOLS

The trend of declining interest rates has been an overriding force in the bond market since the early 1980s. For investors seeking current yield, it has encouraged them to look for fixed-income instruments which can generate higher total returns.

These have included longer-maturity bonds or those which carry greater credit risk, such as high yield. A repeat of the past forty years is hard to imagine with interest rates now sitting near 0% across most economies in the developed world. Investors might be staring in the face of a new paradigm, one which can no longer depend on the never-ending decline in interest rates to guide portfolio strategy. We outline some pressing issues for this asset class and how to turn potential challenges into opportunity.

Expect More Ups and Downs

The variability of a high-quality bond, such as a government bond, is primarily impacted by its coupon and time to maturity. A bond with a lower coupon or longer time to maturity will be more sensitive to interest rate changes than its comparable higher-yielding or shorter-dated counterpart. With interest rates near 0% in developed economies, low coupons and longer maturities have become a pervasive characteristic of the bond market. The resulting risks from these changes can be summarized with a measure called duration. This is a measurement of interest rate risk. As you can see in the accompanying chart, the interest rate risk - or duration - embedded in the global bond market has never been higher than it is today at 7.5 years. As a result, investors can expect to see larger fluctuations in the bond market now than in the past as the interest rate environment changes.

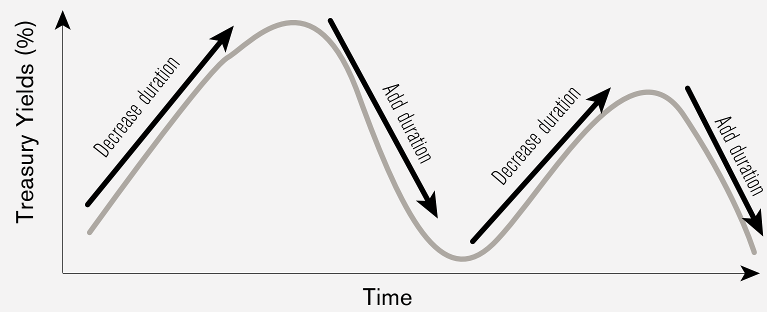


Source: 1832 Asset Mgmt, Bloomberg

Profiting from the Ups and Downs

Volatility is synonymous with opportunity for an active manager. Returns can be enhanced, and downside risk mitigated, by adjusting the duration of a fixed-income portfolio. How can we adjust duration to benefit performance? As there is an inverse relationship between interest rates and portfolio duration, we can increase portfolio duration as interest rates decrease or decrease portfolio duration as interest rates increase. An Adaptive Duration Policy can be used to take advantage of these inevitable interest rate fluctuations. By being flexible, interest rate volatility can be turned into opportunities for capital gains. The application of an Adaptive Duration Policy also means that an investor can continue to hold a portfolio of bonds that can not only generate moderately positive returns, but can become an even more effective diversifier against equity losses independent of interest rate changes taking place in the market.

Adaptive Duration Policy



Source: Haver Analytics, 1832 Asset Mgmt

An Adaptive Duration Solution: Dynamic Tactical Bond Private Pool

The Dynamic Tactical Bond Private Pool adapts to the changing interest rate environment, while maintaining a focus on high-quality investments. Portfolio Manager, Romas Budd and his team's process is guided by a 1 to 3 month view of interest rates and the shape of the yield curve in order to position the portfolio. The return profile is enhanced by implementing tactical trades around core positions and opportunistic hedges against both interest rate and credit risk. Tools used to mitigate risk and enhance returns include active security selection, sector diversification, yield curve, duration management, and portfolio diversification.

For more information, please contact your Financial Advisor.

dynamic.ca/PrivatePools

Invest with advice.

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