

## High yield credit set to benefit from long-term low rate backdrop



Yesterday's news that the Bank of England is in no hurry to raise interest rates was fully anticipated by the market, with some experts commenting that low rates may become commonplace to counterbalance the Government's ambitious planned spending cuts. This comes as no surprise to Fatima Luis and Rebecca Seabrook, co-managers of the F&C Strategic Bond Fund, who have been adding to higher quality high-yield credit positions in the Fund based on the belief that interest rates and inflation will remain low for some time yet. In a Fund update issued by the fund managers last week, Luis and Seabrook are particularly positive on BB and some B issues as these have priced in the risks from the sovereign debt crisis and offer attractive opportunities. They have added US hospitals group Vanguard, Mexican telecoms group Axtel and South African gaming group Cirsa.

"Another key strategic theme is financials, where we remain overweight despite a bumpy second quarter. We continue to believe there is long-term value to be found, whilst credit spreads still have some way to go before returning to their longer-term norms," Seabrook commented. Elsewhere in the Fund, Luis and Seabrook were among the first to see value in asset backed securities, which have delivered some 9% year to date, benefiting from the flight to quality during this particular period. Seabrook expects volatility to continue as growth in both the UK and Europe comes under pressure as austerity measures start to bite, adding: "Austerity measures being imposed by the Government will hamper economic growth and GDP is likely to remain below trend for the foreseeable future. However, whilst interest rates remain at historic lows across so many markets, investors will continue to search for yield and I expect 2010/2011 to be favourable for high-yield credit. Name selection will however be crucial in delivering positive returns."

For a full copy of the Strategic Bond Update, please contact [jennifer.donohoe@fandc.com](mailto:jennifer.donohoe@fandc.com).

### Multi Manager Team add Legg Mason Opportunity Trust

F&C's Multi Manager Team have recently established positions in the Legg Mason Opportunity Trust across their Lifestyle fund range and the F&C Multi Manager Balanced and

### F&C Multi Manager Growth Funds.

The fund, run by highly regarded fund managers Bill Miller and Samantha McLemore, will join the Robeco US Premium Equities Fund and the SPDR SP 500 ETF (an exchange traded fund tracking the performance of the S&P 500) within the US equity portion of the portfolios.

Fund manager Paul Carne commented: "The managers' value orientated investment style has proved itself capable of delivering impressive returns over the long term. Bill and Samantha adopt a more conviction-based approach with fewer stocks and a meaningful allocation to small and medium sized companies. We believe it ideally complements our existing US positions and will prove to be a positive contributor from here."

The purchase was funded by reducing the allocation to ETFs and the Team added 3% across each of the F&C Lifestyle portfolios (Balanced, Growth, Cautious and Defensive), in addition to 3% in the F&C Multi Manager Balanced and 4% in the F&C Multi Manager Growth Funds.

### UK still "set for period of slow growth" despite FTSE 100 highs

The UK stockmarket has staged an impressive rally in the last month following an earlier decline of some 17%. Part of the reason was that equities were oversold in mid-June with heightened fears about the Eurozone sovereign debt crisis and an economic slowdown centred on the US, where a raft of disappointing data, especially in the housing sector, reawakened concerns about the possibility of a double-dip recession.

Ted Scott, F&C's Director, UK Strategy, notes that since this point there has been an improvement in newsflow, most notably in the Eurozone where conditions have been calmer than at any time since the crisis erupted in April. "This has helped the periphery states raise funds in the bond markets and further confidence was provided by the stress tests for 91 EU banks, which was received well. Soon afterwards, the new rules for banking regulation (Basel III) were published and were received favourably. Although the economic newsflow in the US continues to point to a slowdown, there was better data in Europe - which has benefited from the weak euro - and in the UK the Q2 GDP figure surprised on the upside. Lastly, the Q2 results season has also been positive, with most companies beating expectations. At the same time, the UK market has benefited from increased M&A activity with several bid approaches in the last month," Scott commented. Ultimately, Scott believes that the performance of equities will be determined by the level of earnings and dividend growth. Despite the disappointment of BP, the impressive earnings reports have underpinned the current rally but they reflect what has happened and not what is going to happen.

In this respect, Scott expects the UK economy to show muted growth in 2011 as the austerity programme takes effect and the slowdown in the US and elsewhere makes it more difficult for companies to grow profits, commenting:

"Although we are currently going through a relatively calm period in the sovereign debt crisis, the issue of solvency is still a long way from being solved and it is likely we will have further periods of anxiety that will undermine confidence in risk assets."

Scott anticipates that most economic forecasts are too high for 2011 and with the continuing high levels of debt, especially at government level, the inevitable deleveraging will lead to several years of sub par growth.

He concluded: "Although the equity markets have been buoyant, the bond market's performance has been giving different signals. Yields have fallen sharply in the US and UK, implying slower growth, and the breakeven inflation rate has also fallen a lot, adding to renewed concerns of deflation. While I think that deflation and/or a double dip is unlikely, we are set for a period of slow growth that will increasingly be reflected in decelerating earnings growth. Valuations are modest which means the market will probably continue to be rangebound, with the risk that if the sovereign debt crisis erupts again there could be another sharp sell off."

### US climate legislation disappoints – but renewable energy to survive

This week US Senate leader Harry Reid announced the Senate draft of the Clean Energy Jobs and Oil Company Accountability Act. Vicki Bakhshi, Associate Director in F&C's Governance & Sustainable Investment Team, believes the measures on climate change and clean energy are a pale shadow of what President Obama promised on his election, and of the Climate Bill the House of Representatives passed last year.

Bakhshi commented: "Obama's pleas to view the Gulf of Mexico oil spill as a wake-up call on the need for a radical shift to cleaner energy clearly fell on deaf ears. Even Senator Reid himself admitted "this bill does not address every issue of importance to our nation's energy challenges". Gone is the proposal for a 'cap and trade' system for greenhouse gas emissions, and the idea of a federal renewable energy standard. Instead the Bill focuses on alternative transport fuels to reduce dependence on oil, with measures to boost gas and electric-powered vehicles, and on the continuation of a range of energy efficiency measures." These measures sit alongside swingeing changes to the regulations surrounding offshore oil drilling. The Act now enters a period of complex political negotiation, with the clock ticking ahead of the summer break.

Bakhshi concluded: "The draft Act is undoubtedly disappointing for the renewable energy industry, which has been struggling with the twin burdens of restricted access to finance and regulatory uncertainty – new wind power starts fell by 70% in the second quarter compared with 2009. But there is some good news, with the House of Representatives putting forward proposals to extend the generous tax subsidies for renewable energy which were put in place after the financial crisis. Combined with the continued commitment of 29 individual US states to mandatory renewable portfolio standards, this should support the continued growth of renewable energy in the US, albeit at a slower pace than would have been the case in the presence of a comprehensive climate bill."