IMAP Specialist series: Implications of Interest Rate rises

Session 2 : Implications on Investments

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Moderated by David Cohen, Evergreen Consultants

IMAP
Institute of Managed Account Professionals

IMAP 2022 Events

IMAP Managed Account Awards

1st April – Submissions Open

Adviser Roadshow

14th June – Melbourne

16th June – Sydney

21st June – Brisbane

How to ask a Question

Key levers in fixed income portfolios

“Active” means the ability to pull on these levers

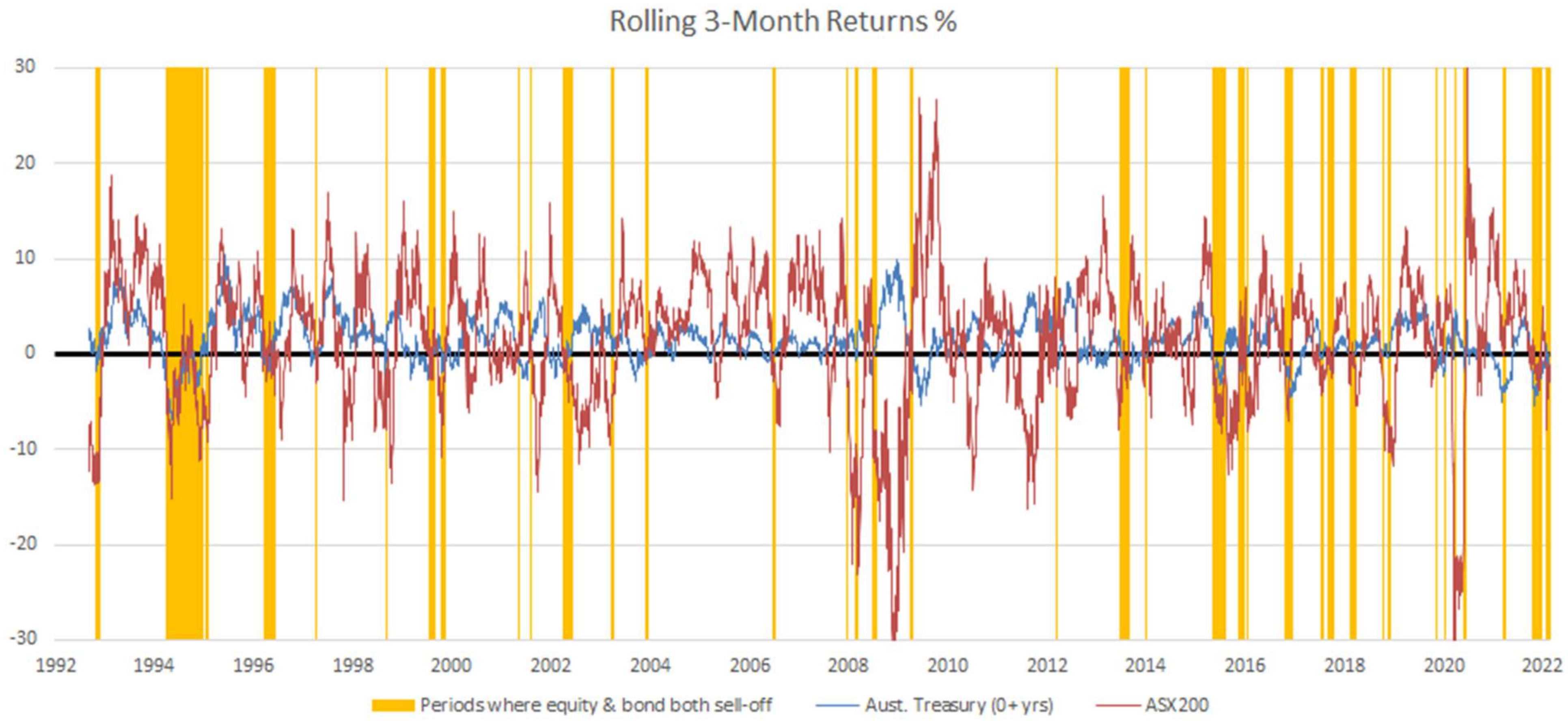
	IG Credit	Duration	Overlays	Other credit
Primary role	Income	Diversification	Protection	Added return
Other benefits	Capital return	Income	Alpha	Boost income
Key limitations	Liquidity	Correlations	Effectiveness	Liquidity[2]; equity-like
Look for…	Quality focus	Active mgmt	Uncorrelated α	Liquid exposure
Carry & roll	1.70%	3.10%	-	~3.0-5.0%

A typical portfolio of fixed-rate Australian IG credit will return close to 5% a year from now if markets stood still

PENDAL

The correlation headache

Bonds and equities rarely sell off together for long



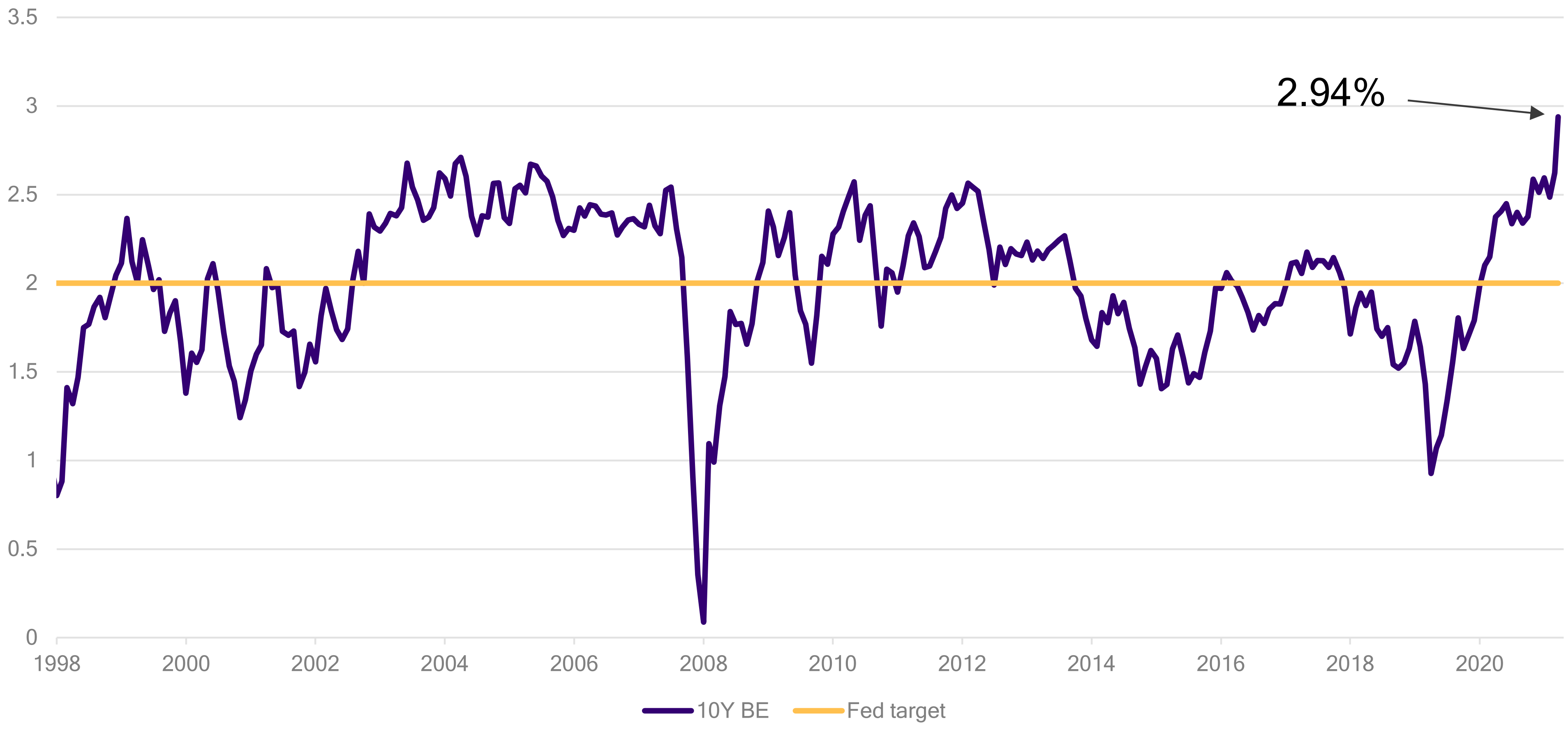
In only 7.5% of the time over the last 30 years have we seen periods where both bonds and equities selling off together. This highlights the tactical nature of any short duration positioning.

Source: Bloomberg

Should you short bonds because of inflation?

There's already a fair bit priced in

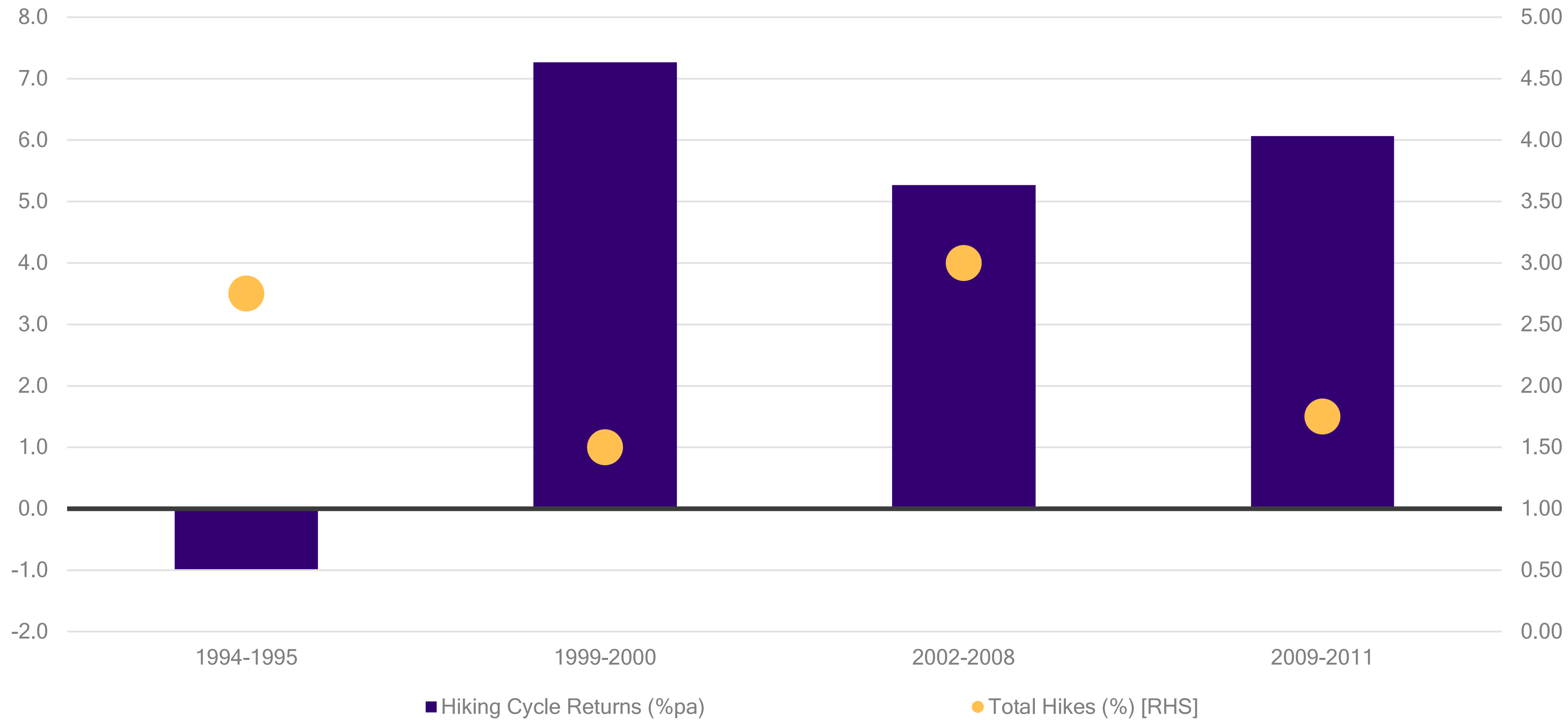
US 10-year breakeven yield vs FOMC inflation target (%)



PENDAL

Hiking cycle bond returns
Surprised?

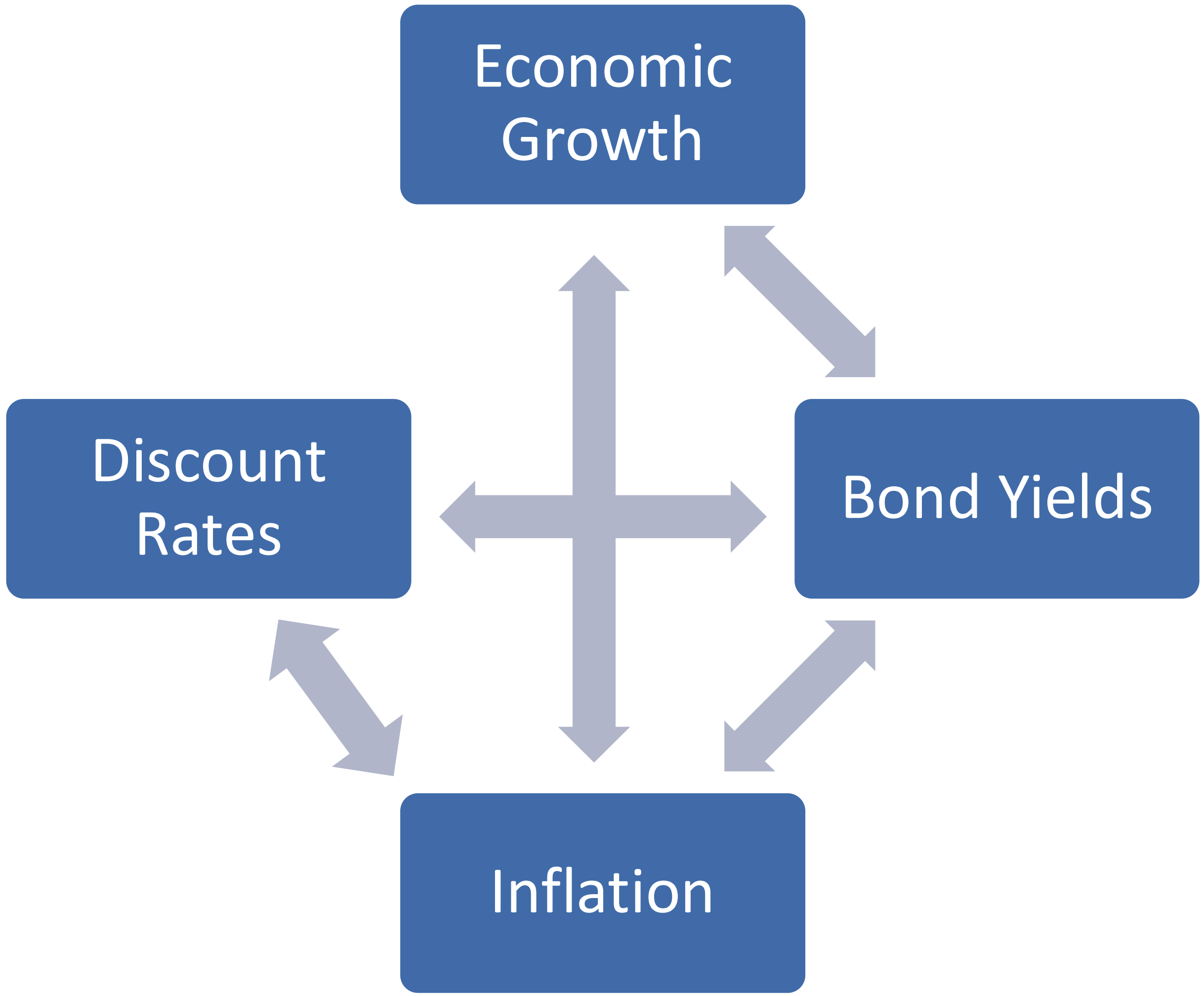
Bond returns during RBA cycles (%)



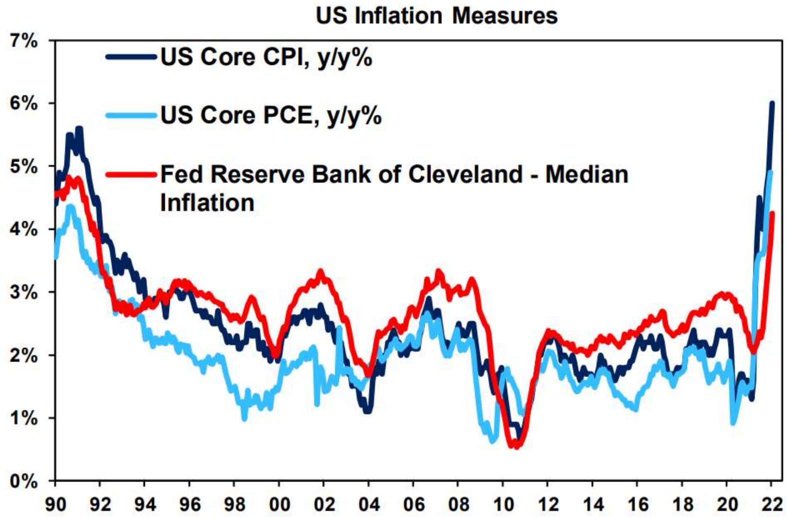
Inflation and Diversified Portfolios

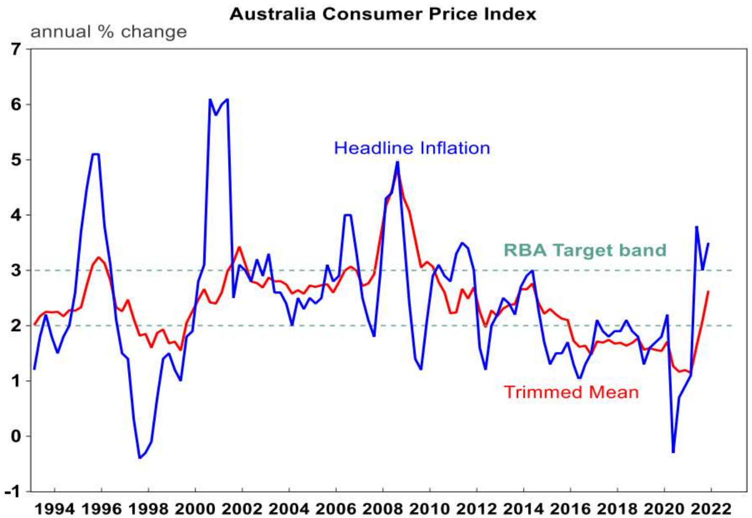
Stephen Flegg – Senior Portfolio Manager

Inflation, Growth, Bond Yields and Discount Rates



Higher Inflation





- 4 **<u>Very</u>** different questions:
    1. Has inflation risen?
    2. Is inflation rising?
    3. Will inflation rise?
    4. Will inflation rise/fall more than expectations?

- Other important questions:
    1. Where is inflation happening?
    2. What type of inflation are we experiencing?
    3. What is driving inflation? (QE?, Capacity Utilisation? Migration? Trade bottle necks? Fiscal spending? Changing consumer behaviour?)
    4. Are those drivers temporary, systematic, predictable/stable?
    5. How are people going to react to inflation?

Source: Bloomberg, Macrobond.

Source: Bloomberg

Questions for Diversified Portfolios

First Order Questions:

- How will inflation rising above consensus affect each of the managers and asset classes in my portfolio?

Second Order Questions:

- What will inflation mean for bond yields and discount rates?
- What will higher bond yields/discount rates mean for managers/asset classes?
- What will inflation mean for the return, volatility and correlation of asset classes?

Third Order Questions:

- Do I really know what is happening with inflation?
- Does anyone really know? And if so, who in my portfolio are the right people to be making decisions?
- Can I get to my objective without taking a view?
- What will bond yields and other evolving factors mean for inflation moving forward?

Be balanced, find the experts, differentiate between good and bad inflation, remember: inflation can help returns

Inflation has **risen** (that's why everyone is talking about it) – it's unlikely to keep **rising** – having an edge over **consensus** should be left to specialists.

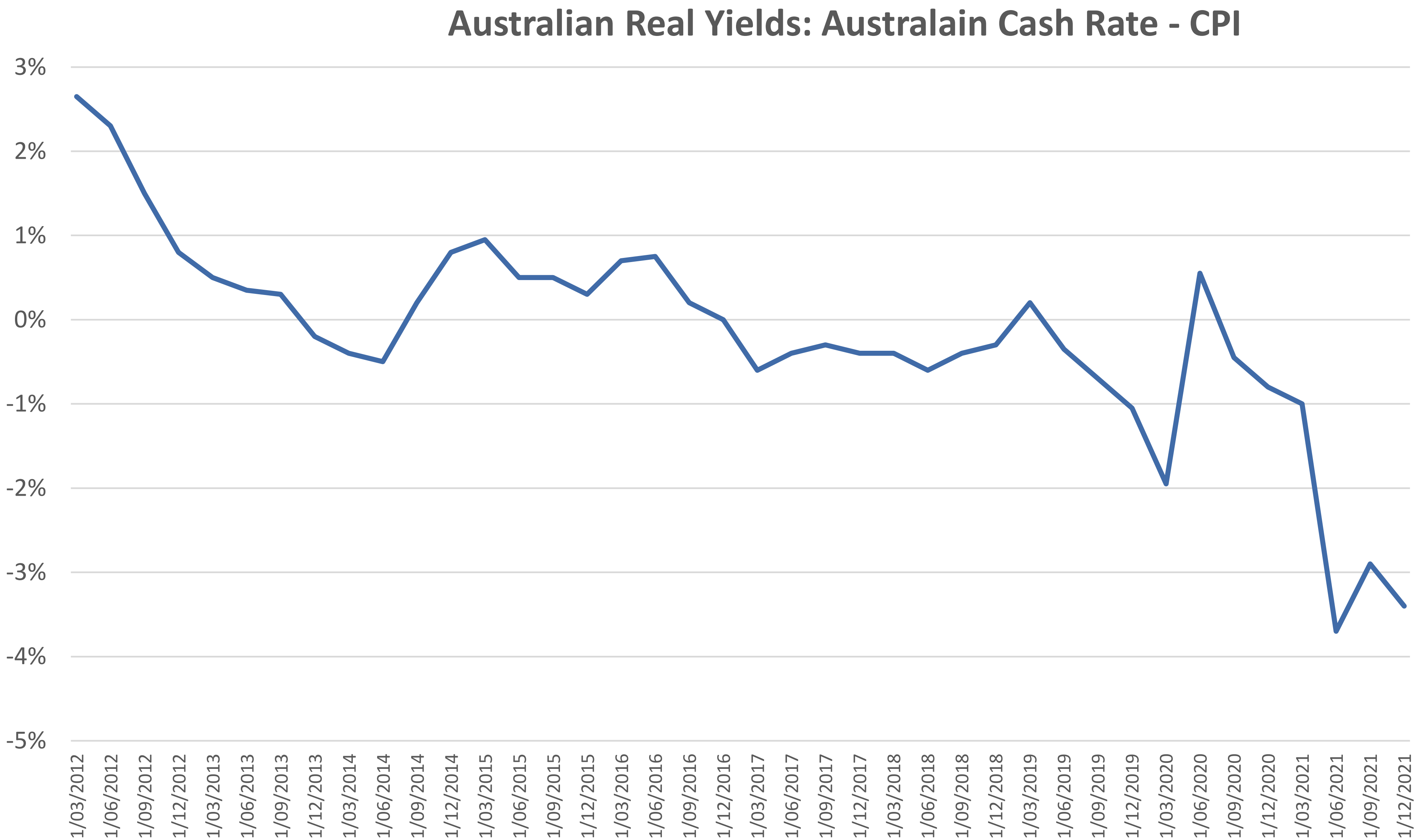
Today's spike is being driven by temporary factors such as – COVID, QE, consumers buying products, trade disruptions, migration, oil/energy, Ukraine. Changes in some long-term factors such counter-globalisation and Western political sensibilities suggest that inflation may be a little structurally higher in the future. But powerful deflationary forces like technological innovation are likely to persist.

Major macro issues can be slow to move, so inflation will be high this year, bond will move higher and economic growth should be higher.

So far, the relationship between inflation, growth and yields appears healthy and shouldn't derail markets. Equities, property and infrastructure should perform okay and provide an inflation hedge.

Correlations may edge higher, particularly as real yields rise.

Get concerned if: wages or real yields spike higher; Australian inflation approaches the level seen in the USA; structural factors such as technology or globalisation change; policy makers look to be making a mistake or overreaction.


Australian Real Yields: Australain Cash Rate - CPI
3%
2%
1%
0%
-1%
-2%
-3%
-4%
-5%
1/03/2012
1/06/2012
1/09/2012
1/12/2012
1/03/2013
1/06/2013
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AMP

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Session 3 : Portfolio Management Considerations

Brad Matthews, BMIS

Brendan Paul, Atrium Investment Management

Moderated by David Cohen, Evergreen Consultants

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