

# A challenging year for bonds

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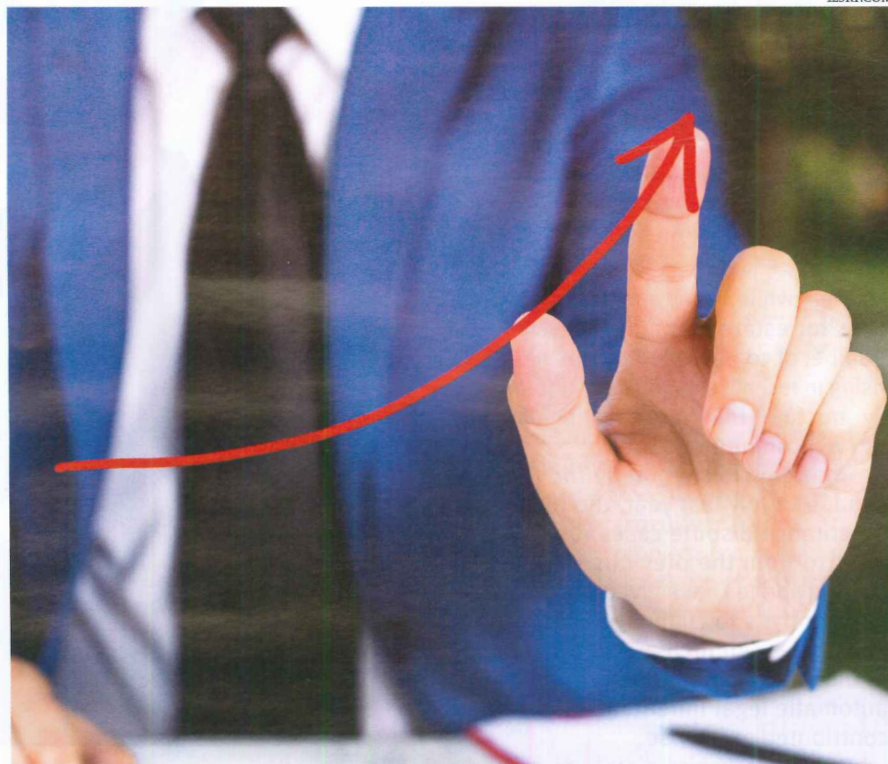
The 10-year US Treasury bond yield is expected to climb higher in the coming months, forming the backdrop for a challenging year for the bond market. Equities, on the other hand, would provide investors with better returns than fixed income, say some market players.

Ng Lee Peng, head of fixed income at Opus Asset Management Sdn Bhd, expects the 10-year US Treasury bond yield to rise further on the back of the vaccine rollout, a reopening of the US economy and the US\$1.9 trillion fiscal stimuli. The country is expected to post strong GDP growth this year, giving rise to expectations of a higher inflation rate.

Just like the 10-year Malaysian Government Securities (MGS) yield, the 10-year US Treasury yield could rise above its pre-pandemic level of about 1.9% from 1.67% at the time of writing (March 18). This means bond prices, which move inversely against bond yields, could dip further, says Ng.

"Yields of long-term Malaysian government bonds, those of 10 years and above, had risen by 40 to 50 basis points since the beginning of last year before the pandemic happened. If we draw a comparison between the 10-year US Treasury and MGS, it seems that our bond market has moved ahead. And the 10-year US Treasury yield still has room to move up."

As at March 18, the 10-year US



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Treasury yield had risen to 1.67% from 0.52% in August last year. The 10-year MGS yield had crept up to 3.46% from about 2.5% during the same period, nearing its all-time-high of 3.59% in 2020. Such a sharp increase in yields have resulted in the underperformance of several local bond funds.

"Bond funds had recorded good returns in the last two to three years when investors were cautious about the global economic growth. But this

year is very challenging for bond fund managers," says Ng.

Fund managers are also expected to face redemptions from investors as the performance of bond funds has taken a hit in the past few months.

"Investors have the impression that bond funds are doing badly now. Funds with insufficient liquidity to meet redemption requirements will face challenges. They would have to sell their illiquid papers at a low price. Or they

would have to sell their liquid papers and leave their portfolios with more toxic, illiquid bonds. The latter is not likely to happen in Malaysia, but it has happened globally," says Ng.

Daniel Brown, head of fixed income at CGS-CIMB Securities Sdn Bhd, agrees. He says MGS in general would have generated returns of about 7% last year. But more than half of the gain had been wiped out as at March this year.

He adds that some industry players are projecting the 10-year US Treasury yield to hit 2% this year, which would translate into another 5% to 10% drop in bond prices. "This year is a challenging one for the bond market. It is a good year to put your bond fund manager to the test."

Sani Hamid, director of economics and market strategy at independent financial advisory firm Financial Alliance Pte Ltd, says equities are expected to outperform bonds this year from an asset class perspective. He adds that the fast increase in the 10-year US Treasury yield reflects the positive market sentiment towards a strong economic recovery moving forward.

"A higher-than-expected inflation rate plays a role, but it is not the main driver of the rise in bond yields. Markets expect inflation to rise, but it is more probably a one-off spike if it does happen. They are not worrying about a consistently high inflation rate that would lead to the economy overheating," says Sani.

"The key reason is strong expectations of an economic recovery, where pent-up demand is coming due to supply disruptions during the pandemic period. It is a reflation theme and the massive amount of liquidity pumped into the economic system by central banks since last year. Combined, it is hard for investors to be bearish this year."

However, investors should remain cautious in the equity market. "It is hard for prices to come down at this point. But it does not mean the equity market is not overpriced," he says.

Clement Chew, CEO of Apex Investment Services Bhd, is overweight on equities compared with bonds. While equity markets globally have not been spared by the rise in bond yields, they have rebounded quickly and are expected to climb this year.

Chew says historical data also show that the S&P 500 tends to rise with bond yields when the global economy emerges out of a recession. "There have been four major recessions since 1990. The 10-year US Treasury yield went up each time the global economy came out of a recession."

"However, the S&P 500 and its valuation typically also went up. It makes sense as companies' earnings do well when the global economy recovers and is growing. We are now experiencing the same pattern as in the past."

He adds that some market players compare the current rise in the 10-year US Treasury yield to the taper tantrum event in 2013. The US Federal Reserve had announced that it would reduce the pace of its purchases of Treasury bonds that year, and the 10-year bond yield rose to 2.9% from 1.6% within six



KENNY YAP/THE EDGE

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MOHD IZWAN MOHD NAZAM/THE EDGE

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# Growing demand for non-market-correlated products

Sani Hamid, director of economics and market strategy at independent financial advisory firm Financial Alliance Pte Ltd, says investors are increasingly allocating their money to non-market-correlated investment products, despite the positive views on equity markets.

He adds that investors, including many fund managers around the world, believe that the global economy is at the tail end of its cycle. "Investors stayed invested in the markets. Because whether you like it or not, markets are going up on the back of vaccination programmes, the reopening of economies and ample market liquidity. It is also in everyone's head that we are at the tail end of the economic cycle."

"The main reason for markets going higher is because of the central banks' quantitative easing programmes. The Fed's balance sheet has expanded from US\$4 trillion to US\$7 trillion. And it is almost guaranteed that it will go to about US\$10 trillion. Imagine this going

on in the next three years. Eventually, the markets will be worried and things could start falling.

"This is the reason for the rise in demand for non-market-correlated products. People who are long equity today, at one point, will want to put some money into these products, or asset classes such as Bitcoin."

Sani also questions how sustainable the global economic growth will be after this

year. "My view is that global growth will not be strong in the longer run, especially if you look at the global economic recovery post the global financial crisis. It was one of the longest economic recoveries in the world's history, but it was also the slowest in the past. Economic growth in many parts of the world remains sluggish," he says.

"A reason for this is that corporate entities and sovereigns were not allowed to clear debts off their balance sheets

as central banks came in to support the market very quickly. As the debts remain, how much will they be able to grow sustainably?"

"The formula for sustained growth is perhaps for the global economy to go through a traditional recession and start anew. And the rise of Bitcoin and similar trends reflect that people are worried about how things will pan out a few years down the road."



CHU JUCK SENG/THE EDGE

**“This year is a challenging one for the bond market. It is a good year to put your bond fund manager to the test.”**

> Brown



months. However, the S&P 500 trended up subsequently.

"The underlying crux of the argument is whether there will be economic recovery and earnings acceleration. If yes, the likelihood is that markets will move up to cope with the positive news," says Chew.

He is not too worried about major central banks tightening their monetary policies over the next two years, which means equity markets are expected to be well supported by ample market liquidity. "Their balance sheets are not expected to shrink and market liquidity won't be withdrawn. The likelihood of the Fed raising interest rates seems more likely to happen at end-2023 or even in 2024, based on what it said on March 18. They want to see sustained inflation before hiking interest rates, which we do not see yet," he says.



## Become a Rational Investor

When it comes to managing your money, you may find yourself feeling stressed over what and where to invest. Externally, the volume of potential ventures to consider can be overwhelming, and the myriad of financial gurus offering varied advice on the topic only adds to this. Internally, we as human beings can easily be influenced by loss aversion, mental accounting, and overconfidence biases in a particular venture – or, more easily summarized as 'behavioral finance'. Consequently, it can be difficult to formulate an optimum investment strategy if one does not have a clear mind to receive and analyze the information.

A rational investor observes the global market with clarity and makes rational decisions about where to invest with a clear mind and objective. To block the "noises on the market", a rational investor performs his or her own fundamental research by looking at the available data, financial performance, and long-term prospects of a company before having any conviction in a company.

## A Clear Objective

With rationality comes a degree of mindfulness, a concept first popularized by its principles of patience, acceptance, and trust in self. This often prompts a shift in priorities – usually from focusing on the material goods, towards embracing your essential needs. Following this philosophy of living simple lives of consciousness and awareness, our belief at Nomura Asset Management Malaysia Sdn Bhd ("NAMM") is investing for long-term sustainable goals rather than trading for short-term pleasures- the principle of deferred gratification.

It is this ideology that drives the Nomura Global High Conviction Fund ("the Fund") strategy in NAMM's commitment to deliver a fund with a strong investment discipline at affordable fees. To achieve financial and emotional equilibrium, the Fund, through its investments into the Nomura Funds Ireland plc- Global High Conviction Fund ("Target Fund") is geographically diversified and constructed based on fundamental, bottom-up approach of investing in high quality companies at a discounted valuation.

## Quality over Quantity

'Quality over quantity' is a familiar saying that drives many decisions in one's life. From friendships to material goods, having more does not always equal to a higher degree of happiness or fulfilment. Often times, a 'less is more' mindset works better to optimize one's decision-making process. As counterintuitive as it may seem, minimizing choices can be effective in maximizing potential.

When it comes to investing, the Fund operates along similar lines. We believe that quality stocks purchased at reasonable prices will outperform in the long-term. Because of this, we conduct a rigorous and disciplined research process on potential companies before deeming them eligible for investment.

Certain features of a 'quality' company include strong competitive advantages, consistent cash returns to shareholders, historically attractive returns on capital, and skilled management. Our research shows that companies of such features often either sustain their returns for longer than the market recognizes or are less likely to experience irreversible declines in profitability. As such, we search for and invest in companies that exhibit these defining characteristics.

We fully believe in the importance of choosing suitable stocks without being affected by forces out of our control. This is why we make no explicit forecasts of macroeconomic factors in our bottom-up selection process and instead, focus on making a decision based on our assessment of the company's intrinsic value and profitability with minimal style bias. In addition, having a mindful mindset helps us to navigate through different market situations as investor sentiment is usually more volatile than the fundamental value of a company.

## Better Together

As much as one would perceive oneself as a rational human being, there are certainly times when emotional thinking overtakes rational thinking. Recognizing the inherent psychological biases of being human, we have thus opted for a team-oriented investing approach.

The Target Fund's investment process is designed in such a way so as to help tackle human cognitive biases through analytical rigor and peer scrutiny. With Nomura Asset Management's global-reaching network, we are able to integrate and leverage on our global resources for idea generation to achieve a collaborative decision-making outcome. After all, we stand firm that a team-based collective investment decision is the best bias mitigant and portfolio risk diversifier.

## Do Good Things

The simple matter of where you put your money is a powerful act that drives the landscape of future products. NAMM is firmly committed to investing responsibly and strive to offer our clients the same investment opportunities. Towards this end, considerations of Environmental, Social and Corporate Governance ("ESG") factors are integrated into the Fund on a bottom-up basis and implemented by:

1. Assessing the non-financial impact of the company on all stakeholders
2. Identifying key issues during investment decision discussions
3. Assigning the company an ESG rating

The Fund enables you to make a conscious choice for a high quality investment portfolio while reaping the social benefits of your rewards. To find out more about the Nomura Global High Conviction Fund, please contact us at [namm@nomura-asset.com.my](mailto:namm@nomura-asset.com.my).

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