Investment update

22 March 2010

Stephen Snowden, manager of the Old Mutual Corporate Bond Fund

Stephen Snowden is a highly experienced fund manager who has specialised in corporate bonds for the last ten years. Earlier in his career he focused on equities, which gave him a strong grounding in company analysis, which is at the cornerstone of his investment process. Stephen combines top down analysis with bottom up stock selection, believing that selecting good bonds, rather than good companies, is the key to delivering returns for investors.

Stephen Snowden joined OMAM in 2004 and is the manager of the Old Mutual Corporate Bond Fund, as well as the bond element of the Old Mutual Extra Income Fund. He was previously Head of Retail Fixed Income at Aegon Asset Management where he managed the Aegon Extra Income Fund.

Opportunities for active managers

By Stephen Snowden, manager of the Old Mutual Corporate Bond Fund

The corporate bond market has enjoyed a sensational recovery in the last 12 months and we believe that the recovery has further to run, albeit at a more moderate pace. However, the path to long term normalisation of credit markets will be a bumpy one and what will be considered normal in future may not be what credit investors became accustomed to in the 'Goldilocks' years of the mid-noughties.

Sovereign risk is at the forefront of investors' minds today and in many ways credit risk has been transferred from the private to the public sector. In the context of our own country, the taxpayer has become lender of last resort to RBS and Lloyds. On behalf of the taxpayer, the government has also continued to spend in an attempt to fill the void left by the slump in demand.

We have had two bouts of sovereign-related market wobbles so far, Dubai in December and Greece in February. However, most western economies are saddled with a huge debt burden, which is a multi-year problem. Gordon Brown claims that the government will cut the budget deficit in half in four years, but that still leaves a grim borrowing requirement of approximately £80 billion in 2014 - the debt pile just keeps growing. Investors are going to ride many more waves of fear and euphoria resulting from the budget deficit problem. This will of course present active managers with the opportunity to exploit market gyrations, but it also begs the question: what will the new normal be like?

In the mid-noughties liquidity in the credit markets was ample. In our domestic sterling corporate bond market, trading activity was dominated by a small number of banks. The liquidity provided by this quasi-oligopoly was deep enough to accommodate large trades, affording all market participants the ability to change portfolio positioning. But the music stopped in mid-2007 and the party finally came to an abrupt halt in September 2008 following the collapse of Lehman Brothers. Liquidity all but dried up, selling corporate bonds became almost impossible and the absence of liquidity created a negative feedback loop, which pushed prices to the lowest levels in over 100 years. Things got so bad that the Bank of England started its Asset Purchase Facility. The Bank bought £128 million in the last week of March 2009 and continued buying until it had taken £1.5 billion of sterling corporate bonds out of circulation.

The market has recovered and liquidity has returned, but things are substantially different now. The quasi-oligopoly with deep pockets has been replaced by a much broader market as many new entrants have started trading sterling corporate bonds. Banks no longer want to lend vast amounts of money for multi-year periods. They simply can't commit their balance sheets to this type of lending any more, but they are delighted to be able to earn fees by arranging corporate bond issues on behalf of their corporate clients. So the good news is that there are many more banks to trade with, but the bad news is that their pockets are now shallow. Just as banks don't have the balance sheets to lend, neither do they have the balance sheets to commit to large corporate bond trades.

Old Mutual Asset Managers (UK) Limited
2 Lambeth Hill
London, EC4P 4WR, UK

www.omam.co.uk
+44 (0)20 7332 7500

OLD MUTUAL ASSET MANAGERS

Active management is still possible, and in our view essential. Credit markets have recovered materially in the last 12 months and we believe that the recovery has further to run. Concerns over budget deficits are one obvious source of market volatility, but there will be others. Such market movements present opportunities for active managers to exploit.

Old Mutual Asset Managers (UK) Limited
2 Lambeth Hill
London, EC4P 4WR, UK

www.omam.co.uk
+44 (0)20 7332 7500

Important information: Past performance is no guarantee of future results. The value of an investment and the income from it can fall as well as rise and investors may not get back the amount originally invested. OMAM has no house market view and opinions expressed are the views of individual fund manager(s) as at the time of writing. These views may no longer be current and may have already been acted upon. Any underlying research or analysis has been procured by OMAM for its own purposes and may have been acted on by OMAM or an associate for its or their own purposes. OMAM is the appointed investment adviser for Old Mutual Fund Manager's in-house OEIC funds. Old Mutual Asset Managers is the trading name of Old Mutual Asset Managers (UK) Limited and Old Mutual Fund Managers Limited. Old Mutual Fund Managers Limited, 2 Lambeth Hill, London EC4V 4AD. Authorised and regulated by the Financial Services Authority. A member of the IMA. Old Mutual Asset Managers (UK) Limited, 2 Lambeth Hill, London EC4P 4WR. Authorised and regulated by the Financial Services Authority. Telephone calls may be recorded for security purposes and to improve customer service. U5093/03/10