

# citywire

## FUND SELECTOR

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# A new world awaits for top bond star

Stewart Cowley has outstripped his fellow managers by a huge margin, and now he has a new fund to play with. He tells Angus Foote that a turning point is approaching and reputations will be won and lost.

Stewart Cowley is already the top-ranked manager in the global bond sector over three years. Now he has a new fund which will give him greater powers and, he believes, greater potential for outperformance.

His new fund will also give investors across Europe more ready access to a manager who has built a strong following in the UK.

Our fund manager league tables reveal why. Over the three years to the end of October, Cowley has posted a total return of 31.29%, putting him well clear of the second manager in the 164-strong sector and our Bond Star in last month's magazine, Cédric Morisseau of CAAM.

Cowley built up an impressive track record in his time at Newton before joining Old Mutual Asset Managers as head of fixed interest and macro in June. He appears in our rankings as manager of two funds, the Old Mutual Dynamic Bond and Global Strategic Bond portfolios.

He says his new fund, the Old Mutual Global Bond fund, will bring techniques into mainstream fund management that were learned in the long-short space.

It is the 'son of' the funds he ran previously, he explains, but the Ucits III structure gives him 'more levers to play with'. The fund is domiciled in Dublin, recognised in the UK, and OMAM is in the process of applying for registration in continental Europe, initially in Switzerland, France and Sweden.

Pictet fund selector Mussie Kidane told me recently that he liked canvassing the views of bond managers, as they tended to be more pessimistic than equity managers – some of whom are perennially bullish.

He recalled a bond manager who told him that even if you hold a bond for several years, the issuer can go bust the day before it matures.

Cowley, however, reveals that psychometric tests have shown him to be an optimist. He acknowledges there is some basis for the image of the bond manager as a dour pes-

simist, but says equity managers have perhaps been guilty of being over-optimistic.

'We're taught to look for bad news,' he says. 'Many bond managers can only make money in one circumstance – when the world's going to hell in a handcart.' His new fund, he believes, will help him move further away from that stereotype, as he will be able to make money in a rising or falling market.

The optimism shown in his testing can also be seen in his view on the current economic environment. 'You have to believe the mending is under way,' he says. 'Liquidity offered by the ECB and Bank of England is providing support... I would say the crisis is over. At some point we will get through this and see the normalisation of bond yields.'

'With the new fund we can short the bond markets by using futures in an unleveraged way. If we can get that timing right, we can make a positive return for the unit price in a variety of different situations.'

'There are reputations to be won and lost here. I'd rather give up the last six months' returns, and be very low risk, to be well-positioned when the turning point comes, because it's going to be brutal.'

He is not among those who feel the crisis-ridden banks have yet to fully grasp what has happened to them. 'The banks definitely 'get it,' he says.

'They based their businesses on the model of an infinite financial system where you could buy and sell anything you want to. I think that's gone now. The assumption of a fully-functioning money market that was open all the time has been shown to be wrong. A lot more of their business has got to be based on deposits.'

Back in 2008, when arguments were raging about how the Fed and Bank of England should respond to the crisis engulfing the financial sector, Cowley offered the view that central banks should slash rates and start issuing mortgages.

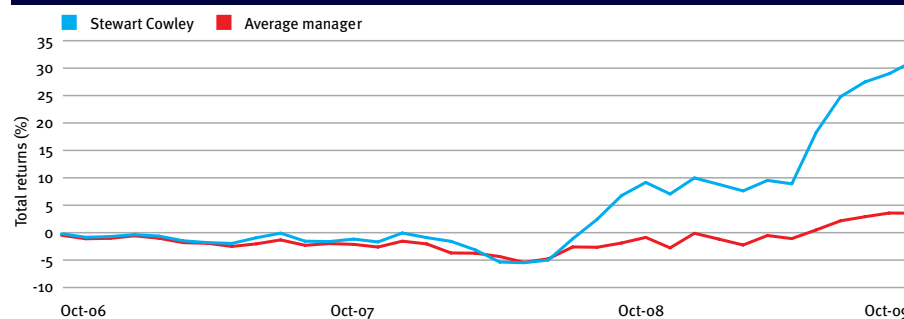
Reflecting on the current situation in the UK, he says: 'Effectively they have done that, in a roundabout way.'

'I'm still slightly concerned about the US – there's a lot to come out from under the stones. They're going to have to truly embrace quantitative easing in the US to keep interest rates under control.'

In the UK, many observers have started speculating about what will happen when the current programme of quantitative easing ends but Cowley believes this may be missing the point. The Bank of England's website provides a spreadsheet giving details of the QE programme so far, he points out.

'It's absolutely clear they've been buying about £4 billion a week. Early next year they

STEWART COWLEY'S THREE-YEAR PERFORMANCE



Source: Citywire

## COWLEY'S VIEWS IN SUMMARY

**Inflation will rise in Q1 2010 and then fall again by the summer**

**Interest rates to stay low into 2011 with no exit strategy from quantitative easing before that point**

**QE in the UK will be extended during 2010 and may hit £300bn before the process is over**

**Mounting problems in the US banking system mean the US will have to embrace QE again**

**Western bond yields will converge on their Japanese equivalents before this process is over**

will be back for even more. This could easily go up to £300 billion just to keep interest rates down.'

He expects interest rates to stay low into 2011, with no exit strategy implemented from QE before that point.

Inflation has also been the subject of intense debate in recent months and Cowley believes the argument will continue for some time yet. 'There's going to be an almighty row between the inflationistas and the deflationistas. I expect deflation in Q4, inflation in the first quarter of 2010, then deflation in the second quarter of 2010. So each group will claim victory. But that's not the same argument as the end of quantitative easing.'

The make-up of his portfolio is built around high level ideas, the first of which is the post-apologetic theme in the banking sector.

'We have 12% in financials but we judge it issue by issue, company by company – you've got to know your issues, you've got to know your structure.'

'One of our themes is the new America, meaning China. Long-term, they just win. For the first time ever, we're seeing a global economic superpower emerging onto the world stage with money in its bank account. They can smooth their way through this over the next 20 to 30 years in a way that we can't.'

So he favours owning commodity currencies but also Japanese yen, because Japan's penetration into China is growing and this will mitigate the country's potentially nasty demographics.



**The US dollar is a loser, and we want to avoid it. We're seeing a long attritional decline of a once-great reserve currency**

**Stewart Cowley  
Old Mutual**

He also likes the Australian dollar, because it's so closely aligned with Chinese development – to the extent that Australia has put interest rates up during the credit crunch. The South African rand makes up 5% of the portfolio. 'It's just an emblem of that penetration of the Chinese into Africa,' Cowley explains.

Long-dated government bonds in the US and Europe are also a theme. He is looking for high headline duration, 'trying to play the last hurrah of the global bond market rally.'

Peak oil is another of those high-level ideas Cowley describes, and he is trying to find what he calls the 'twitching point', as opposed to the tipping point.

Rather than debating whether we've reached peak oil, he believes the important issue is when the date of the turning point becomes clear. That is when people will start to get twitchy and that's the point Cowley is keen to identify.

During the transition to a non-carbon economy, the oil price will rise before it falls. 'It's difficult to find a better proxy for that than the Canadian dollar,' he says.

'The US dollar is a loser, and we want to avoid it. There's absolutely no sign of reform yet. We're seeing a long attritional decline of a once-great reserve currency. Stimulus measures are propping up the economy but there has been no structural change – America needs to have the recession it never had.'

'We have a very small amount of US dollar in our portfolios, for risk management, but I'd like to have none. The winner will be the euro, because it's the deepest, most liquid market in the world, so 30% of the portfolio is in euro.'

He is also avoiding investment-grade corporate bonds, where he believes massive flows into a handful of big funds have drained the value out of some areas of the market.

'I'm looking lower down the investment grade area, BBB to B names, in areas which we think win in the future. So we're looking for technology bonds, for example, commodity-related companies; intellectually these are right. Financials are a recovery story.'

The aim, he says, is to have income generation 'chugging away at the centre of the portfolio.'

'Indiscriminate buying is gone – you have to know your companies, research them well, then buy them reluctantly. It's almost like going back to old-style fund management. Stuff that people have stopped doing.' <<<