Investment update

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Stewart Cowley, Head of Fixed Income and manager of the Old Mutual Global Strategic Bond Fund

Stewart joined OMAM in June 2009 from Newton Investment Management where he held a similar role and managed the Newton International Bond Fund and BNY Mellon Global Bond Funds, both rated AAA by Standard & Poor's. He has more than 20 years' experience of global fixed income markets, having begun his career in 1987 as a broker before subsequently switching to fund management.

How unimportant is Greece?

The road to a eurozone resolution may be bumpy, but it is unlikely to be fatal. The real issues are huge G6 indebtedness and negative real yields

Investors have been hoping that the upcoming EU and G20 summits will prove to be tipping points in the eurozone sovereign debt crisis. This may happen, but it appears increasingly unlikely. Ultimately, the USD520 billion Greek public debt is something the eurozone can afford. The USD1 trillion that is said to be needed to back the currency is not excessive relative to the amounts held in reserve by other large trading states. It will be difficult to convince the German electorate of the need to pay, but the reward will be German dominance of the Continental economy, with an exchange rate effectively tilted in Germany's favour.

Should a decisive package fail to materialise this month or next month, the process will continue. The politics are clearly difficult, but the outcome is almost certain. The eurozone will remain intact in something very close to its present form. While investors need to manage the volatility that the successive eurozone crises throw up, it is vital to be looking to the far more powerful, even seismic factors which remain unresolved and which are likely to shape bond markets for the next half-generation and possibly for longer still.

Globalisation led to a prolonged 'Goldilocks economy' of high growth and low inflation. Incomes and taxes were kept low by allowing unchecked credit. The result was a bull run in the bond market that saw yields fall from the mid-teens to low single digits. That economy is now in reverse. Growth is low, inflation is high and credit is tight. With the partial exception of Germany - which derives a trade surplus from the favourable exchange rate provided by the euro - the G6 countries are in debt to tens of trillions of dollars.

Will deficit reduction programmes save the day? We see the intractability of the issue in the eurozone. The US was reduced to gridlock earlier this year and, with an election in 2012, will not start to confront decision points at least into 2013 or 2014. In the UK, after 18 months of what we are told is a stringent fiscal policy, our public debt continues to rise at over two million dollars an hour. As things stand, the G5 governments plan to sustain their levels of debt - at least into the medium term - by continuing to offer investors a significant annual loss in real terms. A loan to the UK government gives you an income of 2% and, through inflation, a capital depreciation of 5%. Each year, for your risk, you lose 3%. The US offers similar terms. If credit is tight - so that there is intense competition for borrowing - will it really be possible for governments (whose credit ratings are already falling and whose debts are huge) to continue to attract money by offering their creditors a significant annual loss?

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