Investment update

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Christine Johnson, manager of the Old Mutual Corporate Bond Fund

Christine Johnson joined OMAM in September 2010 from Halbis Capital Management (formerly HSBC Asset Management), where she was a senior fixed income fund manager, initially focusing on sterling credit before also managing global portfolios. She moved to Halbis from Investec Asset Management, which she joined as a high yield credit analyst, becoming a high yield fixed income fund manager a year later. She began her asset management career as a credit analyst at Royal & Sun Alliance Investment Management, having previously been a relationship manager at NatWest Bank. Christine has a BA in Economics from Manchester University.

Old Mutual Corporate Bond Fund

Old-fashioned values

The focus of the fund will be minimising defaults and ensuring an appropriate yield

You've just taken up the role of permanent manager. What changes are you making?

The overriding change is that the fund will be managed in a more conservative manner. The active positions will be more modest and the focus will be on minimising default risk while ensuring an appropriate level of yield. That is the traditional way to manage a bond fund, protecting capital, clipping coupons and letting compound interest work its magic. However, we clearly face a complex, volatile environment where we will need to focus on liquidity and flexibility. We expect to be more active in asset allocation and duration management, as well as retaining the emphasis on stock picking and sector rotation.

You've talked in the past about corporate bonds being the new safe haven. What do you mean by that?

I think what changed in 2011 was the illusion of government bonds or sovereign debt being risk free almost by right. As major countries had their credit ratings downgraded, and investors became increasingly focused on their enormous public sector debts, you started to see that they needed to be looked at as if they were credits. And what you saw was that they're actually fairly poor credits. In contrast, corporates never really re-levered after 2008 and in many cases their balance sheets are strong. Yes, going into this difficult economic environment we are expecting they will suffer falling revenues and some margin compression, but those things are much less important to corporate bond investors than they are to equity investors. What matters to corporate bond investors is cash generation and liquidity, and one thing corporates have learned in the last three or four years is to keep a very, very close eye on their cash generation and to maintain significant balances. So compared to sovereigns, corporates are a much better credit risk and give you a much better return for your risk.

How will you cope if the UK goes back into recession?

It's actually pretty much our central scenario that either the UK goes into recession or that we trundle along with weak growth. In that respect, we're already defensively positioned. But the Bank of England has been very clear that they are happy to continue with quantitative easing and if they see further weakness in the economy there will be more of the same. In practical terms, that means support for the real economy and ultimately that's good for corporates.

You're significantly underweight financials. Are you expecting to maintain that position?

We sometimes talk about financials as having left us in terms of an investible universe. In too many cases they are exhibiting characteristics you would expect to see from distressed investing - missed coupons, impaired recovery values - characteristics that are not right for

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an investment grade corporate bond fund. So we're happy not to hold them for the moment. Looking ahead, however, we see that bank capital is simplifying and polarising. As they re-capitalise over the next year or two, there will be big waves of new paper - covered bonds, senior and secured and equity. A lot of volume is expected, and as a result much of it will be issued at a substantial discount to the secondary market. This will give us an opportunity to rebuild our position.

In a sluggish economy, how are corporate bonds going to attract investors?
The level of growth that interests us is where it is sufficient to keep companies viable, thereby minimising defaults. Slow growth should also dampen inflationary pressures, which is good for investment grade bonds. In that environment, if you're looking for a relatively stable, inflation-beating return, then corporate bonds are an asset you should seriously consider.

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