

Absolute Return Fixed Income

The Case for Absolute Return Investing



Grant Peterkin is a senior managing director and head of the Absolute Return Rates Team at Manulife Asset Management, based in London. Previously, Grant was a senior portfolio manager and senior vice president at Lombard Odier Investment Managers. Prior to that, he served as a senior portfolio manager within the Absolute Return Rates Team at Ignis Asset Management. Before that, Grant was a director and senior trader at Citigroup - Australia. Earlier in his career, he worked at Standard Life Investments as an investment director and at JP Morgan Securities Ltd.

Q

A

What is the benefit of an absolute return strategy in the current market environment with concerns around higher volatility, lower liquidity and political uncertainty?

2018 has seen the return of higher volatility fuelled by geopolitical instability coupled with rising US interest rates and the unwinding of quantitative monetary policies. We believe market volatility is likely to continue, as business and financial cycles mature and asset prices, that have been supported by a low interest rate environment, correct. Political uncertainty also appears likely to continue to as trade war tensions refuse to dissipate. In this environment where the market is increasingly fluid and volatile, we believe an unconstrained absolute return strategy with the ability to go long or short and a pragmatic investment approach that is agnostic to the market cycle will be well placed to take advantage of investment opportunities.

Q

A

What role can an absolute return fund play in an investor's portfolio?

There will always be a role for traditional fixed income in investors' portfolios. However, we believe investors could benefit from a complementary approach that focuses on extracting the alpha derived from the investment decisions of the portfolio manager and removing the impact of market performance from the return stream. An absolute return strategy seeks to accomplish this first by not using a traditional market index as a benchmark, thus avoiding the need to position portfolios relative to a specific market, and second, by expanding the investment opportunity set to give managers the ability to take short positions in addition to long positions and consider inflation and currency exposures as well. This approach results in a return stream that speaks fully to the skills of the portfolio manager and is not dependent on positive market performance to generate positive returns.



How can an absolute return strategy mitigate interest rate risk?

With the US Federal Reserve leading the way, we are now on the path to monetary policy normalisation and rising rates can negatively impact traditional fixed income assets. However, an absolute return strategy, not wedded to a specific benchmark, offers a more diversified opportunity set able to dynamically adjust positioning to increase return potential while muting risks. Due to the unconstrained nature of absolute return investing portfolio interest-rate risk can be positioned to benefit in both falling and rising-rate environments. Furthermore, the returns of absolute return fixed income strategies tend to be much less dependent on the overall direction of fixed income markets and far more dependent on manager skill “alpha”.



Top down macro economic themes are key to the investment process, how do you identify these themes?

The flexibility provided by the expanded tool set in an absolute return strategy means we can support longer-term investment themes with short-term trades, allowing us to be active in all markets and not be subjected to the waiting game and timing issues faced by traditional long-only managers. The Team’s top-down view of the global macro environment and the identification of 3–5 longer term themes on G10 rates and currency serve as the foundation for the portfolio. Fundamental research and formal (daily and weekly meetings) and informal dialogue within the Team, alongside third-party research and the firm’s wider research resources are key to forming the investment themes. Key themes during 2018 have included: the desynchronisation of global growth, the withdrawal of Central Bank liquidity and the rise of populism. To express these themes the Team utilises a combination of fundamental analysis, valuation, technical analysis and market sentiment to structure 3–5 distinct investment strategies to support each key theme.



Risk Management: What are the downside risks and how are they managed?

In today’s increasingly complex environment, investors face the challenge of rising rates and resurgent volatility believe monitoring risk is particularly important when managing an absolute return strategy, whose broader opportunity set and wider investment parameters increase the potential for greater risk if not properly managed. Diversification of alpha sources used in expressing a view, setting and adhering to strict stop-loss and profit-taking levels on specific trades as well as active oversight of risk metrics such as maximum drawdown, volatility and contribution to duration are the hallmarks of our definitive risk management process. We believe risk management occurs at the position level, the portfolio level and the firm level. We have a deep understanding of the importance of risk management and are supported by a robust risk control process and an active approach to risk management.

Important Information

For Professional and/or Qualified Investors only. Past performance is not indicative of future results. The value of investments and the income from them may go down as well as up and you may not get back your original investment. Any general discussions or opinions regarding securities or market conditions represent the view of either the source cited or Manulife Asset Management as of the day of writing and are subject to change. There can be no assurance that actual outcomes will match the assumptions or that actual returns will match any expected returns. This material was prepared solely for informational purposes and does not constitute, and is not intended to constitute, a recommendation, professional advice, an offer, solicitation or an invitation by or on behalf of Manulife Asset Management to any person to buy or sell any security or to adopt any investment strategy, and shall not form the basis of, nor may it accompany nor form part of, any right or contract to buy or sell any security or to adopt any investment strategy. The information in this material may contain projections or other forward-looking statements regarding future events, targets, management discipline or other expectations, and is only as current as of the date indicated. The information in this material including statements concerning financial market trends, are based on current market conditions, which will fluctuate and may be superseded by subsequent market events or for other reasons. The information and/or analysis contained in this material have been compiled or arrived at from sources believed to be reliable but Manulife Asset Management does not make any representation as to their accuracy, correctness, usefulness or completeness and does not accept liability for any loss arising from the use hereof or the information and/or analysis contained herein. Issued and approved by Manulife Asset Management (Europe) Limited. Registered in England No.02831891. Registered Office: One London Wall, London EC2Y 5EA. Authorised and regulated by the Financial Conduct Authority.