# Addressing the fixed-income challenge

## Time to consider a new investment approach

Traditionally, investors have regarded fixed income bonds as a 'safe' asset class with low volatility and steady, predictable returns. But in today's uncertain financial marketplace, fixed-income investors could find themselves facing a 'worst-case' scenario: holding high-risk assets that have lost value and produce negative returns.

"Being aware of the evolving fixed-income market is the first step when seeking to avoid return-free risks," says David Greene, client portfolio manager, global and euro investment grade fixed income, Pioneer Investments. "Finding an appropriate strategy designed to protect existing capital and create positive returns in all markets should be a priority for fixed-income investors."

Greene notes that the policies of the US Federal Reserve (the Fed) and the central banks of Europe, UK and Japan have dominated the fixed-income sector in recent years. Their quantitative easing (QE) asset purchase programmes have virtually removed volatility from the fixed-income sector, while pushing yields to historic lows.

But a gradual recovery in developed economies, coupled with the commencement of rate hikes in the US, could put upward pressure on bond yields.

Considering the growing level of risk, Greene believes it's time for fixed-income investors to take a careful look at their positions and consider ways to reduce risks, while still aiming to achieve positive returns.

**An absolute return approach offers potential benefits**

We believe an absolute return bond strategy that is uncorrelated to interest rate or duration risk has the potential to generate positive returns regardless of market trends and may be an effective approach for investors seeking to minimise their risks without settling for minimal returns.

Greene says an absolute return strategy should have four key characteristics:

1. Cash benchmark – in order to avoid any duration bias.
2. Negative interest rate and credit spread duration.
3. Highly diversified and uncorrelated sources of alpha.
4. Disciplined risk management process.

Greene notes that a careful use of derivatives is an important tactic in executing a successful absolute return strategy: "Derivatives can be an effective tool to help you manage your fixed-income portfolio. They allow managers to access the swap market and forward interest rate market to uncover pockets of value. You can't do that with cash bonds."

Another advantage is liquidity, leading to more efficient trades. "Liquidity in derivative markets is much better and bigger than in the cash bond markets. You couldn't execute those alpha strategies as quickly and efficiently if you are only using the underlying cash bonds."

Greene believes that investors seeking shelter from today's volatile fixed income markets should look for strategies that use sophisticated tools and disciplined management with the potential to deliver performance in small increments regardless of market conditions.

Pioneer Investments' Absolute Return Bond strategy has been managed according to a process known as the matrix structure since December 2010, a process that has been successfully used in other investment grade fixed income strategies over the past six years.

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