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South Africa's **fixed income** funds faced trial by fire in May and June

HedgeNews Africa gauges the views of two prominent investors in the space as global market conditions resulted in some widely divergent performance numbers

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It has been a testing time for fixed income. In April, bonds across the curve rallied significantly and interest-rate cuts were still priced in. It's easy to forget that in April global macro influences were very much bond positive, with Japan having announced its massive quantitative stimulus. Then in the first week of May, the rand started sliding relentlessly from about R8.90 to the dollar. With that, yields across the curve started climbing (along with US Federal Reserve chairman Ben Bernanke's tapering comments), and then accelerated towards month-end. At the same time, liquidity dropped, particularly for those trying to get out of long positions. So managers with a long bias and some leverage got hurt. It was a reversal from April, when the market almost overnight (or so it felt) went from pricing in cuts to pricing in hikes.

In June the volatility was immense and managers got whipsawed as value versus fear played on the minds of market participants.

There was a very wide range of results from the fixed income managers as some saw the largest losses they've ever experienced, others cut risk quickly and limited the downside, while very few actually made gains.

Those who made gains were typically contrarian in April, had very low risk on, and were hence able to address the May and June markets 'on the front foot'. Credit strategies were largely unscathed during this period.

Looking forward, firstly one has to consider investor reaction. Some outflows may occur, particularly from investors who had exposure to the higher-risk styles in fixed income. Generally the higher-volatility managers in our market manage the large funds, which is unusual and probably not sustainable long-term. So some form of correction is warranted.


Theron van Wyk

However, if the reaction is panic across the board, even lower-risk managers (ironically even those who made money through all this) may suffer. Fortunately the fixed income market (ex-credit) is generally liquid so price action due to outflows should be limited. Outflows from all fixed income is a global theme right now, so we see very similar trends via our London office as well.

With regards to the universe of managers and their ability going forward to continue adding value: no doubt the one-way trade is gone. For managers with one-dimensional views or skills, it is going to be very difficult as we go into a volatile or rising yield environment.

However, there are many managers who can adjust to the new market environment. Some have always been flexible in their approach; in other cases we have already seen managers adjust to address bear-market conditions (which will not be a straight-line rise in yields).

Managers with a more trading-type style will also probably handle the markets we expect better. Importantly, an adjustment in mindset or flexibility should not be accompanied by a change in philosophy. These are two very different things, a change in philosophy is a recipe for failure more often than not.

All in all, we expect more clear winners and losers going forward, not the one-way traffic of everybody consistently making gains.

For the near term, the tumultuous markets are not over in our view, we are going through a period of adjustment globally in bond markets and that always results in volatility. So we tend to prefer tactical approaches right now rather than large structural position-taking. But over the long-term fundamentals will prevail, those who judge that appropriately will come out on top and, in the hedge fund world, can actually make significant absolute gains in the end.

One shouldn't ignore the potential fall-out in the traditional asset manager space from a new market environment. It is not impossible that both bonds and equities could go through a bear market in South Africa. Hedge funds, including fixed income and macro funds, may have an opportunity to prove their structural place in portfolios over the coming months and years