

Interesting Returns

Three bond fund managers that are delivering in 2008

BY BHAVNA HINDUJA

In 2007, many bond managers looked for shelter from the credit storm and turned to lower-risk government debt. Some others were a bit bolder and tried to tread through corporate debt while steering away from the sectors that are more directly tied to the whims of the credit debacle.

However, investors expecting a fresh start in 2008 have continued to see a rocky ride in the bond markets. Credit-market turbulence, interest-rate uncertainty, record-high oil prices, risk of a recession and a deflated U.S. dollar have, thus far, clouded the investment picture in 2008. And with investors leery of taking on more credit risk with corporate debt, the jobs of bond managers haven't been any easier this year.

That being said, there are a handful of managers who are having success navigating the bond market's tricky waters.

The managers discussed below have not only enjoyed success recently, but over the long term as well. And considering their proven track records, we believe their respective portfolios are well positioned to benefit from a turn-

around in the bond market.

PH&N'S STEPHEN BURKE

The fixed-income team at PH&N has continued to deliver in 2008 across all its bond mandates, and especially with PH&N Total Return Bond, managed by Stephen Burke. Although this fund hasn't put up big numbers recently, its 2.6% return year-to-date through May 31 is the second highest in the Canadian Fixed Income category. Furthermore, it beat the TSX DEX Universe Bond Index by 30 basis points.

Burke recognized the high degree of uncertainty in the bond markets and underweighted longer-term bonds while preferring shorter-term bonds in order to benefit from a steeper yield curve. This was one of the key drivers of the fund's outperformance over the past few months. Also contributing significantly to its returns is the team's decision to leave the fund's exposure to U.S. treasuries and foreign government bonds unhedged after having traditionally kept that portion hedged. As a result, the fund benefited from the Canadian dollar's weakness early this year.

While investors are herding into the safe haven of government bonds, the fixed-income managers are shifting assets to higher-grade corporate bonds because they believe this area provides some of the most attractive risk/return opportunities in the fixed-income market. The team eliminated the fund's exposure to PH&N High Yield Bond a year ago as it shifted to a more defensive posture due to very tight credit spreads. But we expect the team to eventually re-establish a position in that fund as high-yield spreads widen further.

Although we've made a special mention of this team's Total Return mandate, PH&N Bond and PH&N High Yield Bond have also performed very well for the year to date.

BEUTEL GOODMAN & CO. LTD.'S BRUCE CORNEIL

Despite tough market conditions, lead manager Bruce Corneil has kept his Beutel Goodman Income at the front of the pack so far this year. Its 2.5% year-to-date return follows a strong showing in 2007, when it ranked second in the Canadian Fixed Income category. Furthermore, its lowly 0.69%

management-expense ratio gives it a formidable lead over the majority of its peers in the low-return world of fixed-income investing.

A significant contributor to the fund's recent success is its zero exposure to bonds issued by financial companies.

Corneil and his team are among the few managers that have long avoided this area of the bond market, believing that banks lack transparency and are too cyclical. Instead, he has focused his attention mainly on low-growth but stable companies in the utility and pipeline industries.

With a shorter duration stance, the portfolio is positioned to take advantage of a steepening of the yield curve that the team expects over the near term. The team doesn't believe that the credit squeeze is over. Given the lack of exposure to the troubled financial sector, the fund should continue to be insulated from the effects of the unfolding credit crunch. On the other hand, it is likely to lag its peers should we see a sharp rally in financial sector debt.

PH&N'S HANIF MAMDANI

Although not a core bond fund manager, PH&N High Yield Bond's long-time skipper Hanif Mamdani makes for a noteworthy mention. He has navigated the fund to a year-to-date return of 2.9%, which ranks second in the High Yield Bond cat-

egory. And such strong performance comes amid one of the most difficult periods in the credit markets in nearly three decades.

The fund's recent success can be attributed to Mamdani's sensible conservative strategy. For the core of the portfolio, he buys higher-quality credit, typically debt rated BBB or BB, instead of reaching for yield. This has helped returns in the currently tumultuous high-yield markets, but it can also cause performance to lag during good times. While the core is conservative, the periphery (about a quarter of the portfolio) is dedicated to more opportunistic positions that can often carry higher default risk.

Recently, he has maintained an overall defensive position. Like most of PH&N's bond mandates, he has shown a bias toward shorter maturity and higher-quality issues, which have been the key contributors to its outperformance.

Looking ahead, Mamdani expects high-yield markets to undergo further correction over the next year or so and will continue to maintain a cautious approach. And given his past track record in keeping losses to a minimum, we expect this fund to hold up better than its peers in a bear market for credit.

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