

Yield chaser

Income investments can fund your lifestyle or supplement your returns



The benefits of bonds

A growing need by investors for safe-haven options for their funds underlies the case for allowing trading in government bonds on our sharemarket, Philip Baker writes.

One of the key features of the global credit crisis was the switch to term deposits that were guaranteed by the government. There was a massive swing to safety. But what happens to all those funds when that guarantee runs out next year?

Investors with billions of dollars will be mulling over what to do with that money. Sharemarkets are still in bipolar mode, so it's a fair bet that many investors will look for safety despite many experts saying that share valuations look attractive.

Enter the debate about listing Australian government bonds on the ASX. In this year's federal budget Treasurer Wayne Swan made an all-out effort to get a retail corporate bond market up and running.

But it's tall order to get that to work and it would be beneficial to take steps to get a retail government bond market up and running first. That in itself would make a viable corporate market, at the margin, a little easier.

FIG Securities is about to launch a new "small parcels" service that will give retail investors access to corporate bonds for the first time. This is significant for self-managed super funds in particular, and also has some interesting tie-ins with the government's attempt to encourage retail investment in the corporate bond market.

The financial crisis is evidence that investors could do with a listed market on the ASX for bonds issued by the federal government and state and territory governments as well

as, of course, corporate bonds.

The case for government bond trading is strong. Having so much money tied up in bank term deposits, investors will be looking for other options and a listed government bond market is the obvious and ideal alternative.

Investors are crying out for capital and income protection for some of their superannuation assets. Many, especially older investors, will start to turn their attention from equities to fixed income markets.

Without listing, investment in government bonds is not readily available. Investors can get access through various brokers or the Reserve Bank of Australia (see breakout), but that can be a drawn-out process.

There are managed bond funds, with their fees, but a listed market would provide simple, direct and economical access to the public.

Government bonds used to be listed and were a traditional part of conservatively managed portfolios. Commonwealth bonds, which the government issues when it borrows money, are the safest of all securities. But in 2002, when the federal government promised to pay off all its debt using the proceeds of the sale of Telstra, alarm bells started ringing in the heart of Australia's financial markets.

For many of those labouring to pay off credit cards and mortgages, zero government debt may sound like a good thing.

But a shortage of bonds can create a dilemma for large and small investors because it results in a shortage of risk-free, safe-

► Buying bonds from the RBA

- Subject to availability, the Reserve Bank will sell selected series of Treasury Fixed Coupon Bonds and Treasury Capital Indexed Bonds. For the former, coupon interest payments are made each half year. Coupon interest on the latter is paid quarterly.
- Applications may be made for amounts of \$1000 face value and in multiples of \$1000 up to \$250,000 per investor per day.
- The yield quoted by the RBA is the "yield to maturity", which represents the annual rate of return, if the security is held to the maturity date.
- The coupon rate on a Treasury Fixed Coupon Bond or a Treasury Capital Indexed Bond is set when the bond is first issued by the Commonwealth of Australia, and remains fixed for the life of the bond.

Source: Reserve Bank of Australia

haven assets for super funds.

A lack of government bonds lured investors into high-yielding securities like hybrids, which are listed on the ASX. Liquidity in the debt-equity type of instrument is not very good, however, and it can be difficult for investors to transact.

Local investors need to be giving more thought to bonds. In Europe, many pension funds have reduced their exposure to equities after weak sharemarket performances in recent years.

In Britain, defined-benefit pension funds have traditionally held a high proportion of equities. But this preference has been questioned because of the decline in the benchmark FTSE 100 Index and pressure from new accounting standards for the pension funds' corporate sponsors to avoid unfunded liabilities.

If the federal government wants to encourage Australians to save more – and use the extra savings sensibly – it will have to do more than offer some form of tax deductibility on savings deposits. Allowing bond trading on the

ASX would be one way to do this and would also make it easier for a retail corporate bond market to get under way. By tradition, fixed interest allocations have insured Australian superannuation funds against uncertainty. Unpopular when markets are bullish, they give funds a portfolio safety net when the going gets tough.

But many analysts detect a growing understanding of fixed interest and believe an increase in the supply of government bonds would be likely to encourage that to develop further.

There's little doubt that bonds, and perhaps fixed interest as a whole, are likely to become more interesting for all investors – retail and institutional.

The global financial crisis has tested the assumptions of many on risk and the correlation between various asset classes. One thing is certain, however: fixed income is set to become a larger chunk of every portfolio. **Si**

Philip Baker is a former bond trader who heads the Market Wrap section of The AFR.