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Low-risk bond option shines bright in dark days

By **JOHN KAVANAGH**

SHARE investors were counting losses again after a big fall in the June quarter wiped more than 10 per cent off the ASX's All Ordinaries index.

But those who learnt the lesson of the financial crisis and added more defensive assets to their portfolios saw the bond index rise by 3.6 per cent in the quarter.

Fixed-income assets – Commonwealth and state government bonds and investment-grade corporate debt securities – were a counter to volatile equities when global sharemarkets fell heavily in 2008 and again this year.

The benchmark for the fixed-income market, the UBS Composite Bond index, is up 7.9 per cent in the year to June 30 and an average of 7.7 per cent a year over the past three years.

In 2008-09, when the All Ords fell 29 per cent, Australian bonds were the best-performing asset with 12.7 per cent.

But not many investors have adjusted portfolios to add more defensive assets.

"The definition of a balanced portfolio has moved towards higher-than-acceptable allocations to risky assets," says an FIIG Securities analyst, Stephen Nash. "Interest-rate risk, especially in the form of government debt, is a good thing for equity investors as it provides a liquid hedge against equity return volatility."

FIIG used different combinations of equities and bonds and the return data from between September 1999 and June 2010 to see how risks and

returns were affected. The average annual return of the ASX All Ordinaries Accumulation

index was 8.6 per cent and the risk was 16 per cent.

The return of the UBS Composite Bond index was 3.16 per cent; the risk 3.81 per cent. An investor with 70 per cent of investments in share and 30 per cent in bonds would have earned 7.8 per cent a year, with a risk of 10.9 per cent.

"An investor with 50 per cent in shares and 50 per cent in bonds would have earned 7.4 per cent a year with a risk of 7.7 per cent," Nash says. "Adding a 50 per cent allocation of the portfolio to government bonds does not cut return in half, it only marginally reduces return. But it moderates risk substantially."

Pimco Australia, whose Australian Bond Fund is the No. 1 performer, produced a return of 14.9 per cent for the year to June 30 and an average annual return of 9.6 per cent over three years. The head of portfolio management at Pimco Australia, Robert Mead, says over the past year the company did not expect the Reserve Bank to push the cash rate to 6 per cent as many forecasters did and positioned its portfolio for a bonds rally.

The head of fixed income at Aberdeen Asset Management, Victor Rodriguez, says it began "de-risking" portfolios as the European sovereign debt crisis emerged. It reduced corporate debt securities holdings and bought government bonds.

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