

# EUREKA *report*



## Investors' missed opportunity

By Elizabeth Moran

May 9, 2011

**PORTFOLIO POINT: Globally the bond market is growing, but investors in Australia are yet to embrace debt markets as they have done elsewhere.**

A few weeks ago I caught up with an acquaintance who started telling me about their investment portfolio when I mentioned by role as director of fixed income research. Now this person is a highly intelligent professional but I was shocked that despite their investment experience that they did not have even have the most basic understanding of bonds.

When I started explaining the capital structure they made the comment: "That's right, bonds pay really low returns." It struck me yet again that the majority of investors have no idea about the function of bonds and that you can earn excellent returns, when compared to equities, for much less risk.

Some people I speak to look at me with a kind of scepticism when I talk about bonds, as though I'm fabricating an entire asset class that they've never heard of, so it couldn't possibly exist or have any merit. Although most Eureka Report readers do appreciate and understand the benefits of bonds, I thought perhaps now was time to fill in some detail about the global and domestic bond markets and join the dots for the more casual reader.

Last year the global bond market grew by 9.9% to \$US49.7 trillion, just slightly higher than the 10-year cumulative average annual growth rate of 9.8%. In 2009, growth was 18.5%, fuelled by fears around the global financial crisis as governments provided guarantees over debt to curtail potential failures.

Decelerating global growth is good for bondholders because less supply boosts prices and narrows spreads. Basically demand starts to outweigh supply. A good example of this took place recently in the Australian market with a corporate issue by Woolworths.

The \$500 million, five-year transaction was oversubscribed four times and priced within 24 hours at 105 basis points (bps) over swap, 5bps lower than the most recent comparable major bank five year issue.

Clearly there is pent-up demand from the market for high quality corporate debt.

Some other interesting points to note about the global market in 2010:

- Corporate bond issuance fell to \$US3.1 trillion from \$US3.88 trillion in 2010, that was the greatest decline since 1999.
- The investment-grade market grew by 3.7%, down from 25% in 2009. Worldwide, the slower growth rate helped propel demand for high yield or sub-investment-grade bonds, which grew 17.8%, higher than the 4.4% growth rate the previous year.
- Emerging market debt expanded by 17.5% higher than growth of 12.5% in 2009
- The extra yield demanded by investors to own company bonds over government bonds remained unchanged at 164bps.

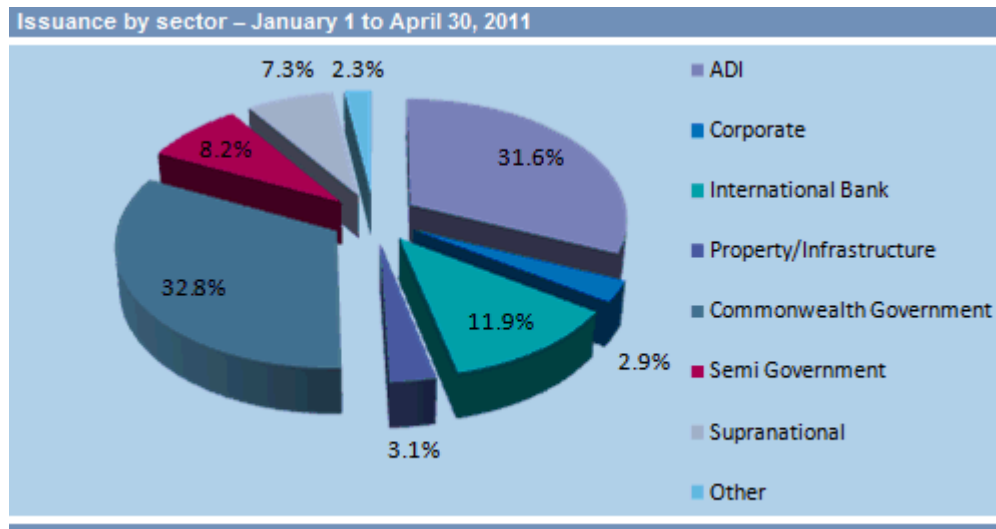
### The Australian market

Issuance for the year to date is about \$105 billion, compared to \$118.7 billion for the same period last year. Commonwealth government issuance was virtually unchanged over the same period last year, with \$34.4 billion issued to April 30, 2011, versus \$34.1 billion in 2010.

Issuance in 2010 was about \$225.4 billion, a decline of 26% from a bumper 2009 year, which reached \$305.9 billion largely due to higher Commonwealth government issuance.

From January 1 to April 30, 2011, there were 55 Australian bond issuers, with some Australian companies also issuing in foreign markets. See the **attached table** for a summary. The largest issuer was the AOFM on behalf of the Commonwealth government, with \$34.4 billion issued. ANZ was next with an Australian dollar equivalent of \$12.4 billion, then Queensland Investment Corp (QIC) with \$7.1 billion. Other notable issuers included CBA, with the Australian dollar equivalent of \$6.7 billion, and NAB, with \$5.1 billion. The largest foreign issuer was Lloyds TSB, which issued \$2.1 billion.

By sector, the Commonwealth government was the largest issuer with 33% of the total, closely followed by authorised deposit-taking institutions (ADIs), issuing 31% for the year to date. International banks accounted for 12% and semi-government 8%, see the graph below.



Source: FIIG Securities

The above chart of ADI issuance is interesting because it shows that more than 60% of debt issued this year has been in foreign currencies.

#### -ADI issuance by currency, in \$A terms

Issue	Total (\$Am)
Australian dollar issues	12,152
US dollar issues	8,345
Euro issues	1,990
Sterling issues	306
Yen issues	10,258
Total	33,051

Source: INSTO

The theme that is emerging here is that the Australian market has not grown in line with the global market, however it is less developed than those in other Western nations and to a large extent the population has not embraced debt markets as they have elsewhere. Given the size of the global market and the encouraging signs from recent domestic corporate issues, investors should make the effort to understand the benefits of bonds.



Australian bond issuers, January 1 to April 30, 2011 (click [here](#)).

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