EUREKA report

Safety zone

By Elizabeth Moran
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PORTFOLIO POINT: With minimum investment levels ranging between $1000 and $500,000 there's sure to be a bond here to suit everybody.

Last week investors were bombarded with bad news, and markets reflected a new realisation that not all is well, leading to a broad selloff of risk assets like global equities.

In times of economic volatility, investors often become more focused on capital preservation than capital growth. They seek to protect their investments and of the three major asset classes – equity, property and fixed income – it is fixed income that is best able to provide this protection.

As noted, it appears that even the most optimistic investors have begun to accept all is not well with the US economy. The list of woes is long: poor employment numbers, low spending, growing debts and a lack of consensus on how to fix it all weighed heavily on their stockmarket.

Property also appears to be facing some headwinds, with little capital growth predicted by most analysts over the medium term and concerns over current prices in some areas, particularly at the top end of the market and in the two commodity-driven states of Western Australia and Queensland.

So if like many other investors you are seeking to limit your exposure to risk and preserve capital rather than building a position in the hope of a rebound, I have created a list of what I consider to be conservative fixed-income assets for investors with a minimum investment of $1000.

Conservative assets

Security		Maturity	Fixed/ Floating	Minimum Investment	Return/ Yield
Commonwealth Government bonds		Jun-12	Fixed	$1,000	4.70%
		Jun-14	Fixed	$1,000	4.75%
		Jun-15	Fixed	$1,000	4.85%
Semi-government bonds	Queensland Treasury Corp	Jun-12	Fixed	$5,000	4.90%
	Queensland Treasury Corp	Jun-14	Fixed	$5,000	5.20%
	Queensland Treasury Corp	Jun-15	Fixed	$5,000	5.35%
Financial/corporate bonds	CBA retail bond	Dec-15	FRN	No Minimum	circa 6.70%
	General Electric	Mar-19	Fixed	$50,000*	6.70%
	Rabobank	Apr-18	Fixed	$100,000*	6.75%
	Westpac	Feb-20	Fixed	$500,000*	6.90%
Inflation linked bonds	CBA	Nov-20		$500,000*	CPI + 3.8%
	Rabobank	Aug-20		$500,000*	CPI + 3.8%

* Face value

Source: FIIG Securities

All the securities listed in this table are rated a minimum AA+ (or equivalent) by Standard & Poor's, meaning they are very low risk.

You'll notice that with the exception of the CBA retail bond, about halfway down the list, the assets are fixed, that is the coupon is set for the life of the bond.

When investors expect periods of volatility and low growth, governments would typically cut interest rates to try and stimulate growth (for more on interest rates, click **here**). Under those conditions, investors would want to lock in returns, in preference to a floating-rate note whose yield would decline in line with interest rates.

The reality of a fixed-rate bond is that it will also reflect lower interest rates through an increase in its capital price (for more on this, see ***Fixed or floating?***). So, for investors, a fixed-rate bond ensures a minimum return or yield and has the potential to deliver capital gains through higher bond prices.

The other factor that all investors should be mindful of in troubled markets is liquidity or the ability to sell the asset quickly and without loss of value.

This is a major point of differentiation between asset classes. The Commonwealth and state government bonds listed above are extremely liquid. No other asset offers the combination of very low risk and high liquidity offered by government bonds. While the returns may appear low, the bonds will deliver good returns in low growth or declining markets; a much better proposition than taking a loss from higher risk investments.

Finally, term deposits remain a good alternative to the bonds listed above (see ***Hard to beat***). However, they don't offer the liquidity that bonds do as banks inevitably charge high break fees on term deposits, nor the opportunity for capital gain as interest rates fall and fixed rate bond prices rise as discussed above.

The risks of a low-growth global economy are ever-present and have been widely commented on elsewhere in Eureka Report. Australia's fortunes are related to the rest of the world. This time is no different.

Worried investors need to protect themselves and their families through diversification into fixed-income, an outstanding performer in low or non-growth economies.

Instead of spending time and energy worrying about markets and other events beyond your control you should be asking yourself, 'What have I done to protect my wealth?' and taking action where appropriate.

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