

HOLD OR FOLD?

M&G Gilt and Fixed Interest Income vs Schroder Gilt and Fixed Interest

Our advisers weigh up two gilt and fixed interest funds, and find that M&G's established position gives it the edge over Schroders', which has suffered long-term outperformance. **Tim Cooper** reports.

M&G Gilt and Fixed Interest Income

What New Model Adviser[®] says:

This fund was launched in December 1980 and has assets of £855 million. It is managed on a total return basis and aims to outperform its peer group. Jim Leaviss is the fund manager.

What M&G says:

'Gilts are one of the few asset classes to have enjoyed a rally since the credit crunch broke,' says Leaviss.

'Falling inflation and interest rate expectations are very supportive for gilts. I think the rally has further to go.'

'Until recently, investors were worried about a return to the stagflation of the 1970s, but markets are slowly coming around to our long-held view that there is a greater risk of deflation than serious inflation. Inflation fell in the aftermath of past banking crises, for example the Wall Street Crash, the US savings and loans crisis and Japan in the 1990s.'

'Inflation fell because liquidity was withdrawn from the system and spare capacity was created as economic growth stuttered. We believe the same thing will happen this time. UK inflation should plummet in 2009.'

'UK interest rates have been cut to 4.5% and the market expects rates to be 3.5% in a year's time. But if my inflation view is right, rates will have to fall further than this, which would be very positive for gilts.'

M&G GILT AND FIXED INTEREST INCOME

Source: M&G Investments



What the advisers say:

Andrew Merricks
Head of Investments
Skerritt Consultants

M&G probably has the best reputation in the UK fund management world for its fixed interest research capabilities. Gilts became the one safe haven during the post-Lehman panic. If you think the equity markets have bottomed, and a V-shaped recovery is imminent, ignore gilts. If, like me, you think that the recovery is going to be long and arduous, then a gilt fund such as M&G's is a must for any balanced portfolio.

Gilts have always been boring but sadly, boring is quite exciting these days. This fund has 50% of its holdings in just four issues, which one would not expect to see in any unit trusts investing in other asset classes. But a large holding in one issue is not such a concern in a gilt fund because it has bought certainty of income and repayment in the purchase of that individual asset. This fund has to be a **hold**, at least until the current volatility has disappeared. If recovery miraculously happens, this hold becomes a very quick fold – but I can't see this happening for many months.

Mike Deverell
Investment manager
Applewood Asset Management

This fund has marginally underperformed over a five-year period, but is ahead of its sector over one year. Leaviss also heads M&G's fixed income team. But, despite his expertise, the performance of this fund – while certainly not terrible – leaves something to be desired.

Our favoured fund in this sector is the Legal & General All Stocks Gilt Index fund, which is a tracker. In a generally low-risk and low-return asset class, the effect of charges can have a real impact on performance. We therefore favour passive management in this sector.

M&G's fund has an above-average annual charge of 0.75%. To be better than our favoured fund, after charges, M&G would need to outperform by 0.5% every year, which is difficult in this sector. The charges will have dragged down performance.

The good news is that Leaviss and M&G's reputation as fixed income managers may lead to periods where they can add value compared with a tracker, so this fund is a **hold**.

Nicola Downs
Director
Trentham Invest

This fund aims to secure the value of capital and income from the effects of inflation with a long-term total return, consistent with investment in index-linked bonds. It has achieved total returns of 7.1% over one year, 3.1% over three years and 4.0% over five years.

The top 10 holdings make up 85% of the portfolio and are spread across UK, Germany and European Government Stock. The fund is called Gilt and Fixed Interest, but is 85% invested in sovereign debt. If there is a big inflow of money, which is likely under current conditions, then what is the manager buying? If he is buying more of the same, he will probably be buying over par.

There is 10% exposure to the euro, so if the euro strengthens against sterling, this will benefit the fund. There is then a small hedge included in the fund.

M&G's position is second out of 27 over two and three years. Volatility is slightly below the sector average at 4.05% and the risk is also lower than the sector average. But it is a **fold**.



If you think the recovery is going to be long and arduous, then a gilt fund such as M&G's is a must for any balanced portfolio.

Andrew Merricks

HSBC Open Global Property Fund.

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HOLD OR FOLD?

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Schroder Gilt and Fixed Interest

What New Model Adviser[®] says:

This fund was launched in October 1989 and assets total £429 million. Its objective is to achieve a high level of income with the potential for capital growth, from investment in a diversified portfolio of sterling denominated fixed interest securities. David Scammell has managed the fund since November 2004.

What Schroders says:

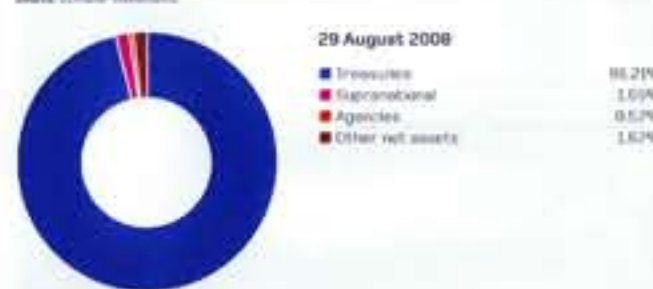
'In September, investors were left reeling by the worsening credit crisis,' says Schroders. 'Governments have proposed massive rescue plans to help the collapsed financial system. However, given the deterioration in the banking sector and the dismal growth outlook for the broader economy, the argument for a cut in UK interest rates (and other major economies, such as the US and eurozone) is strengthening. This action should be supportive for government bonds.'

'The fund invests predominantly in UK government bonds and aims to deliver a reliable income, coupled with capital growth in excess of bank and building society deposit accounts over an interest rate cycle. The fund could be ideal for an investor requiring a regular income or steady capital growth generated with low levels of risk.'

'Although abnormal market conditions have resulted in price fluctuations in gilt markets, these assets tend to be very stable and we are confident that this characteristic will re-establish itself over the medium to long term.'

SCHRODER GILT AND FIXED INTEREST

Source: Schroder Investments



What the advisers say:

Andrew Merricks
Head of Investments
Skerritt Consultants

As an asset class, gilts have had a perfect backdrop, with security of capital more to the forefront of investors' concerns than return. It is disappointing that this fund's performance in comparison to its peers is not inspiring over the past 12 months.

The fact that the annual management charge is charged to capital will allow a higher distributable income to be provided to unit holders. But the total return from the fund is still slightly behind its rivals; 27% of the fund is invested in just two individual gilts, while there are no more than 20 holdings in the portfolio. The portfolio is 96% invested in UK bonds, whereas competing funds take advantage by investing in overseas bonds.

If you were looking to invest in the gilt sector with new money, this fund would not necessarily be rated a buy compared with others in the sector. But assuming that security is still the number one priority for those investing in gilts today, this fund would rate a **hold**.

Mike Deverell
Investment manager
Applewood Asset Management

This fund has performed well below the sector over one, three and five years. Recently we have used it on some platforms where there is a limited choice of gilt funds and have been disappointed with performance. It has a relatively low annual charge at 0.5%, which usually aids performance, but not in this instance.

Yield is relatively high 5% at the end of August. This may partly reflect the poor capital performance of its holdings compared with other funds in the sector.

Schroders appears to have invested the majority of the fund in longer-dated gilts. This may have contributed to underperformance as investors have sought the safety of short-dated gilts.

The portfolio has a large turnover rate of 216%, which is significant when you compare it with M&G's turnover rate of 78.1%. The impact of dealing costs may have hindered performance.

Schroders has an excellent reputation as an equity manager but its skills in this area are not quite as impressive. This is a **fold**.

Nicola Downs
Director
Trentham Invest

The fund aims to achieve a high level of income with the potential for capital growth. Investments include British and other government securities, corporate obligations, eurobonds and local authority loans.

Performance against the average index is lower by 1.7% over three years, 1% in five years and 3.1% in 10 years. The volatility of the fund is commensurate with the M&G fund, but the performance is significantly and consistently lower.

Maturity of the gilts range from 2011 (13% of the fund) to 2055 (4.7%). So performance is below average.

M&G has outperformed Schroders over all time periods except 10 years, where Schroders has outperformed M&G by 1%.

The top performer in this sector is the L&G All Stocks Gilt Index Trust. Buy this instead, until one of the gilt managers has proved he can outperform his index consistently.

This fund is positioned 22nd out of 27 over two and three years and is a **fold**.



The portfolio has a large turnover rate of 216%. The impact of dealing costs may have hindered performance.

Mike Deverell

New Model Adviser[®] verdict

M&G Gilt & Fixed Interest Income

M&G's established position and expertise makes this a **hold**.

HOLD

Schroder Gilt & Fixed Interest

Underperformance gets this one a thumbs down from two out of three advisers.

FOLD

Twist...

HSBC Gilt & Fixed Interest has delivered consistently good returns over the shorter and medium terms.

