



Fixed Income: Is your portfolio a leaky home?

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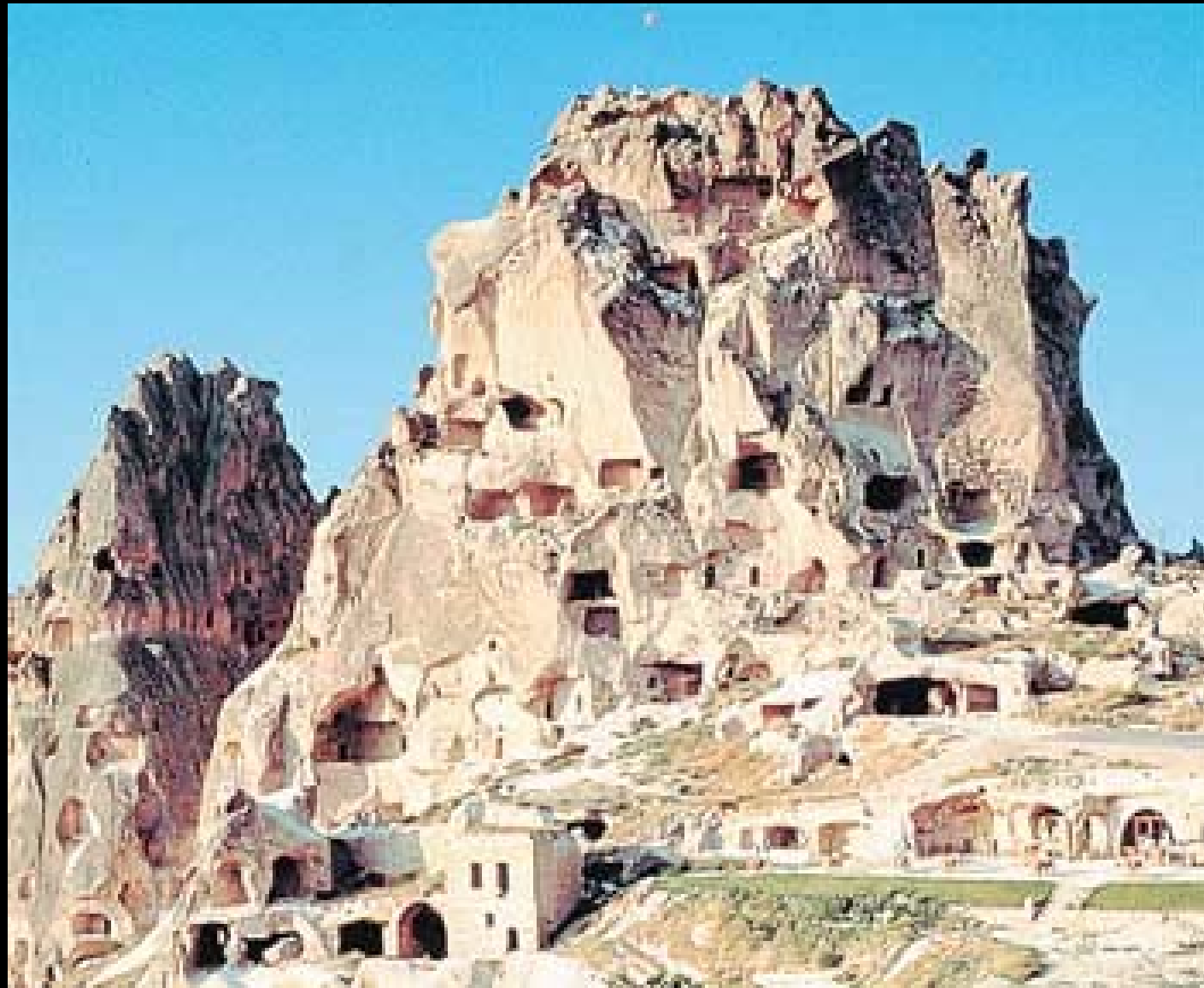
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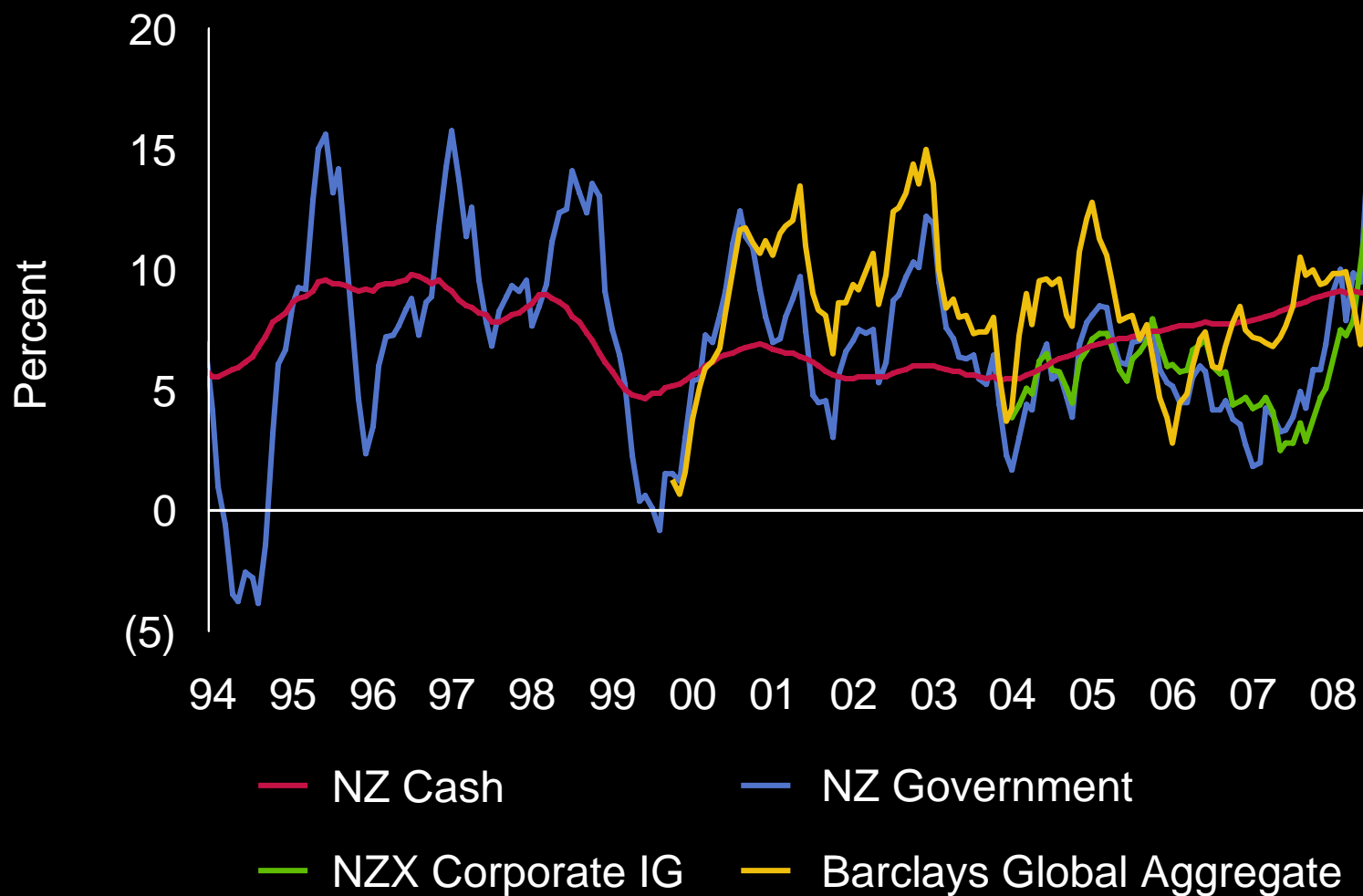
Nice...



Very Nice...



Returns in NZ Fixed Income



Source: NZX Data from May 1994 to February 2009. Returns are for rolling 12 month periods. Barclays Global Aggregate data from March 1999.

The Credit Market Minefield

- Finance Companies—concentrated lending, subordinate position, liquidity squeeze
- CDO's—Poorly priced, complex, opaque, leveraged, subordinate, illiquid.
- Mortgage Funds—structural liquidity management issues

Financial/Economic stress hit these products pretty quickly.

Outcomes

- Income Losses
- Capital Losses
- Illiquidity (lock-ups, frozen funds)
- Underperformance

What Mistakes Do We See?

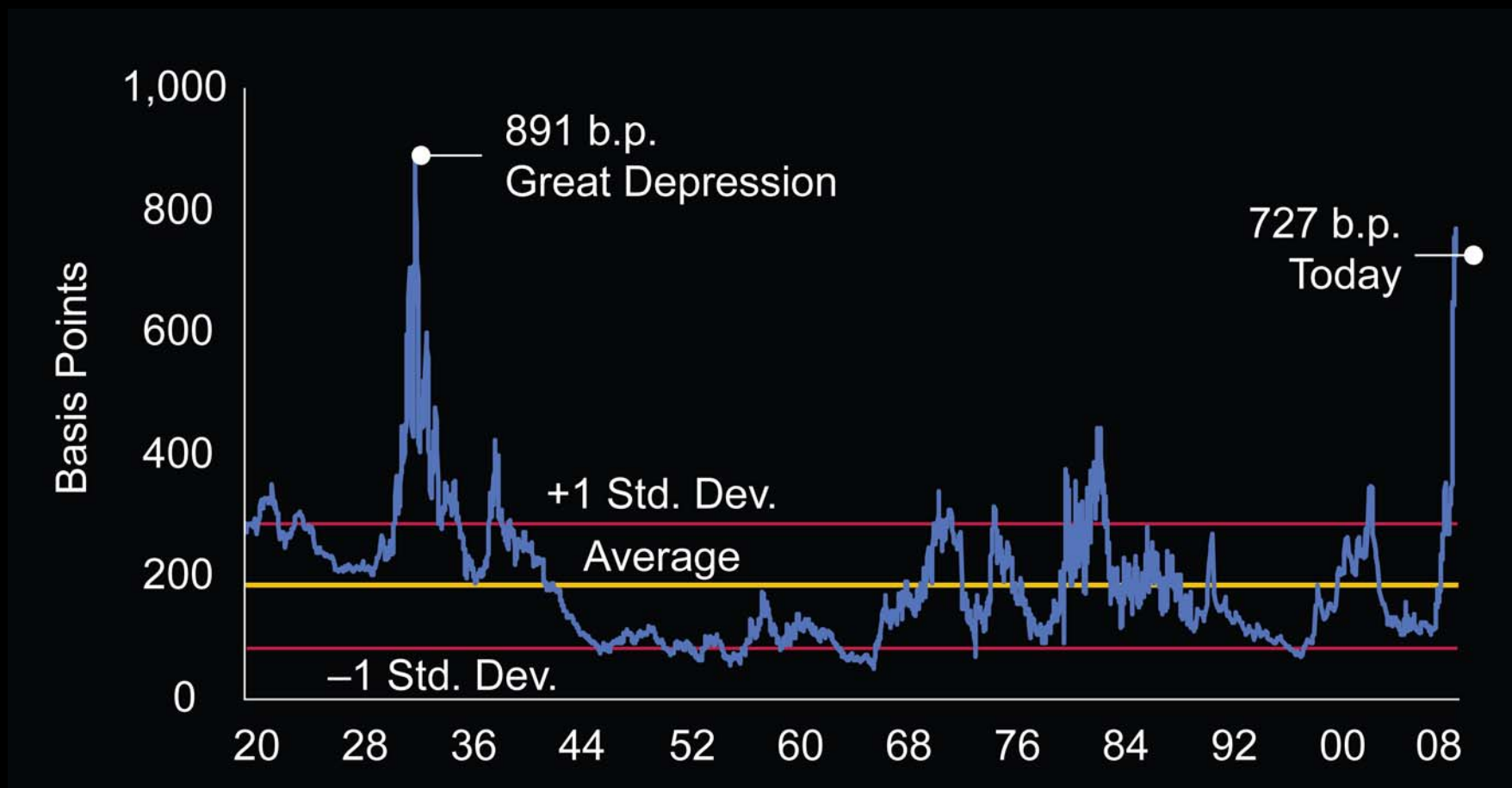
- DIY mentality—Do domestic brokers or fund managers really have the resources to research the sectors, issuers, securities and then construct a risk-aware portfolio?
- Complacency as a result of a decade of low economic and financial volatility
- Too little diversification
- Poor understanding of risk management
- Liquidity has been undervalued
- Chasing yield even when spreads became unfeasibly narrow
- Brokerage brings wrong incentives

Credit: The Challenges for a New Zealand Fixed Income Investor

- Poor credit diversification—Only 32 issuers in the NZX Composite Index
- Common practice is to hold large exposures to single issuers and ‘pick’ winning high yield securities.
- High concentration in sectors such as banks, financials
- Liquidity evaporates when news is bad
- Opportunity set is limited

The Opportunity: Once-in-a-Lifetime Valuations in Credit

US BBB Corporate Spreads



Through December 31, 2008

Source: Barclays Capital, Global Financial Data, Moody's and AllianceBernstein; see Disclosures & Important Information

Best Thinking

- Dynamic risk-taking
- Diversify
- Security research
- Respect seniority
- Brokerage belongs to the client

Fixed Income: It's how you invest that matters

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