SEAMARK Innovates Low Volatility Bond Strategy

On the strength of our success in launching our Low Vol Equity mandate three years ago, we are pleased to announce that SEAMARK is now introducing a Low Volatility Bond mandate. In combination with Low Vol Equities, we can now offer clients Low Vol Balanced portfolios. This mandate has already been endorsed by a Foundation that recently hired SEAMARK.

When we introduced Low Vol Equities, it was as an alternative to the traditional response of institutions and individual investors that had had enough of equity volatility. Normally the response would have been to sell equities in favour of increasing bond weights, but in 2010 10 year Canadas yielded a paltry 2.75%. So we thought of purchasing low volatility companies with a yield bias as a hybrid of the characteristics of stocks and bonds.

Now, we look ahead to an environment of rising yields. Ironically, bond investors who have fled equities because of their volatility are signing on to bonds with a much higher volatility than is expected.

"This is my safe money, I would like to keep it in bonds" investors say to us. That is why it is warranted to explain the changing market dynamics, as the "safe haven" status for bonds has to be questioned. As the Chart below shows, interest rates have been declining for the last 30 years. This means, investors' money has been "safe" by enjoying capital gains while gradually sacrificing yields. However declining yields did not matter to the investors as long as their portfolios showed the positive return, and at a minimum they were preserving their principal. In the last crisis, when there was a shortage of safe havens, bonds became the life saver once more especially due to the suppression of the rates by the central banks by rounds of quantitative easing.

Quantitative Easing has been the fancy name for the last three rounds of expansionary monetary policy pursued by the Federal Reserve. In May 2013, the Fed hinted of reducing the bond purchases (i.e. tapering) which had kept the long-end of the yield curve under pressure since the crisis. The market reacted to the news of tapering with a jump in 10-year yields by 130 bps in the U.S. and 110 bps in Canada. Bond returns over the summer reflected the sharp sell-off in the market, where there was a 5% decline in the IG Composite in the U.S. and 2.4% decline in DEX Universe Index in Canada.

The reaction was significant enough that the Fed re-thought its decision at the September meeting by holding off on tapering. Rates recovered by approximately 40 bps in both countries, but not all the way back to previous levels. That was a sign for the Fed to be gentle with the reduction, so that the tapering would not choke the mortgage market and other lending activities.

In December, the Fed announced the US$ 10 billion reduction in bond purchases starting in January 2014. The market reaction brought the 10 year yields to 3.00% (+50 bps) in the U.S. and to 2.8% (+35 bps) in Canada, ending the year at a high water mark.

At SEAMARK, we have been rebalancing our clients' portfolios accordingly. Our long term view is that sooner or later, interest rates are going to be higher than current levels. The gradual improvement in global economic data is confirming the start of the trend where central banks will reduce stimulus sooner, rather than later. This sets the stage for us recommending a solution against the volatility of the bond market with our Low Volatility Bond Mandate.

Traditionally, bonds used to be purchased for safety and yield. Today, they offer little of either. The near historic lows in yields will dictate negative rates of return if interest rates rise just to normalized levels.

The SEAMARK Low Volatility offering accepts that interest rates are artificially low, and must rise over time. The mandate seeks to protect capital, aiming to achieve an absolute return on each investment, independent of the experience of the DEX Universe Bond Index.

We believe that many investors are striving to smooth their returns, and for them, a combination of our Low Vol Equities and Low Vol Bonds will address their volatility concerns. As our industry continues to evolve in the categorization and management of risk, we believe these Low Vol efforts will be attractive for risk-averse investors.

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