Institutional Investors Symposium 2017

A Conversation with Liew Tzu Mi, Chief Investment Officer, Fixed Income and Managing Director, GIC

A combination of active management and the selection of high quality emerging market paper is the solution to achieving an acceptable level of risk-adjusted bond returns in the current low yield environment, says Liew Tzu Mi, chief investment officer for GIC's fixed income arm.

While fixed income returns have been buoyed by a three decade-long bond bull market, low interest rates and large amounts of leverage in the global financial system means that institutional investors need to move away from a benchmark focused investment style, according to Liew.

The CIO was speaking at the DBS Institutional Investor Symposium, held in Singapore on June 22. She said it was difficult to perceive that interest rates would return to the low double digits that were seen when GIC was established in 1981.

"For the last 35 years fixed income returns have been driven by a beta tailwind. Now we are in a trading environment where there are negative returns in a number of leading economies, making returns becomes challenging across the whole asset class.

We all know that the starting yield is the best predictor for returns, particularly over a longer duration, so if large proportions of fixed income are at low or negative levels, how can you deliver a meaningful return?"

According to Liew, one part of the answer is to accept that beta returns will not do the heavy lifting anymore, and as a result, investors must take a more benchmark agnostic approach.

Even without factoring a potential interest rate rise - which would reduce the value of fixed income portfolios because bond prices move inversely to yields - the low starting point means total returns will be slight.

Added to which the general equivalence of global interest rates today means that even in a balanced portfolio, the hedge provided by diversification is greatly diminished.

"This is a very challenging environment for fixed income investors to operate in, but there is a lot that can be done by opting for an active management approach. This will also enable investors to take advantage of a frankly once-in-a-lifetime opportunity to profit from inefficient benchmarks."

The post-crisis overhaul of the global banking regulations has required lenders to hold significantly higher amounts of capital against their fixed income portfolios. The result of which is that banks, the traditional fixed income market makers, have been forced to slash their inventories.

According to Liew, this means that even when large asset owners, such as GIC, want to invest on a counter-cyclical basis it isn't always possible to source the requisite instruments.

“Even when there is a sell-off and we try to buy bonds at a cheaper price there isn't any inventory on the street. We can't get anything in meaningful volumes and as a result a counter-cyclical investment style is difficult to execute.

This is particularly true given the rich valuations in the fixed income market, due to the large volumes of central bank-instigated liquidity, and the already high levels of corporate leverage.”

Given the unpalatable risk: return characteristics in the fixed income market, Liew said that GIC has opted to utilise the long term corporate relationships it has acquired as a large scale investor.

She said that GIC had been required to discard what she termed, “the old mindset of desktop investing”. Liew characterised this approach as waiting for new issues, or announcements to emerge, putting in an order, and then waiting to see what allocation was received.

Instead GIC opted to utilise its long-term investment time horizons and its global footprint across a broad swathe of asset classes.

“The way GIC is organised, is that when we go to a company we are able to provide them with a range of financial solutions, from loans to bonds, to hybrids, or to equities. GIC is also capable of offering either a private or public solution.

The end result of this approach is we find out exactly what their financing needs are. GIC provides them with advice and in return it gets bigger allocations.”

Liew conceded that a bespoke investment approach of this type is resource intensive, and required a greater level of involvement. However, she said the upside at this part of the credit cycle was a risk: return profile that is much more attractive than simply relying on beta returns.

Liew also said that the closer relationship with counterparties that resulted meant that GIC was able to better understand corporates’ ability to deal with shocks or stresses.

The other way to look for yield is investing in emerging market fixed income, according to Liew. However, she was at pains to point out that this is not a heterogeneous asset class, contrasting A-rated Asia sovereigns, with non-investment grade counties such as Venezuela and Argentina.

Liew did not directly say to avoid the latter group, but did point out that given the general low rate environment, GIC was not looking for double digit returns. She said instead it looked for countries with visible positive long term prospects.

“The idea is to be able to look for idiosyncratic situations and understand which are the countries that over a long period of time have the prospects of converging with developed markets.

The good news is that many of these so-called ‘convergence countries’ are here in Asia.”

In line with a number of speakers at the event, Liew singled out China as an important prospect for fixed income investors. Liew highlighted there were still a number of areas of the Chinese fixed income market that needed to develop, such as treatment of restructurings, but that overall it is a market that can't be ignored.

“China’s capital markets are developing fast. The onshore bond market is already the third largest globally but foreign ownership is currently next-to-nothing. GIC has been watching the Chinese market develop for a while and it was lucky enough to be able to invest a few years ago.

The logic for the investment is simple. Put away the cyclical considerations and understand that in the longer run, China will be a mainstream market. At the same time the Chinese Yuan has a good prospect of becoming a global reserve currency, and this is an area of strategic importance for GIC.”