

Managers can't ignore the elephant in the room

It is at their own peril that managers do nothing about the current flurry of LBOs in the UK

It seems as though everything is up for grabs in the UK – British Airports Authority is no longer British; Sainsbury's is currently in the bidding arena; everywhere you look, businesses large and small seem to be falling prey to private equity deals and leveraged buyouts.

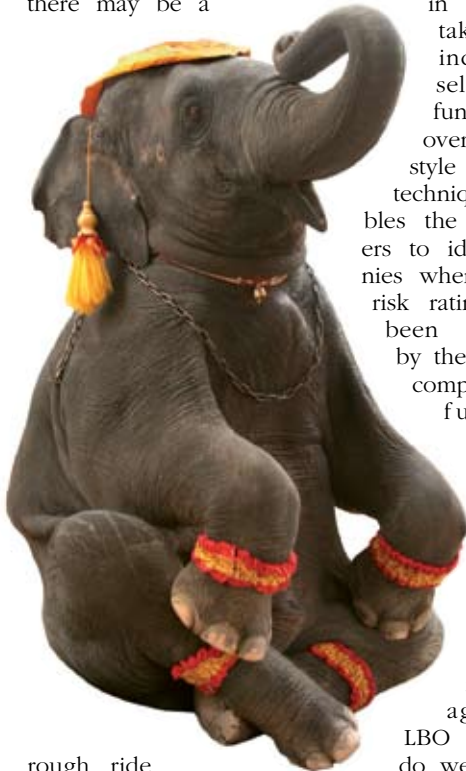
This is good news for the value equity fund manager who just happens to have these previously overlooked stocks in their portfolio. But the scenario is not so comfortable for the fixed income manager whose portfolio of debt includes industrials and asset-rich companies that are the preferred targets of LBOs. In such circumstances, owning bonds that have no provision for 'change of ownership' could be problematic.

■ That big grey thing

Ignoring the possibility that some of the best-known names in your portfolio may change hands, leaving you saddled with a whole lot of debt, is like ignoring the elephant in the room.

So what is to be done about it? After all, surely the investor has the right to consider the fixed income element of their portfolio as sacrosanct? It is the safe and steady performer where no risk is

expected. Yet the combination of leveraged buyouts in the investment grade segment of the market and the chase for every ounce of yield from the CCC area at the lower-quality end of the market, suggest that there may be a



rough ride ahead for portfolio managers who do not demonstrate prudence.

■ No more default risk

At Danish asset managers Sparinvest, 'prudence' is the watchword. This means that the two bond

funds the company offers to UK investors (through its Luxembourg-based Sparinvest Sicav) both have portfolios that are constructed to avoid as much default risk as possible.

What is more, in an innovative take on fixed income debt selection, both funds employ an overlay of equity-style value analysis techniques. This enables the fund managers to identify companies where the default risk rating may have been overestimated by the market when compared with the fundamental strength of their balance sheets.

Wealth managers who want to achieve fixed income exposure that is protected against the LBO threat would do well to consider Sparinvest's newly launched Investment Grade Value Bond Fund where the focus is firmly on avoiding takeover candidates, with a strong top-down sector emphasis on financials.

Meanwhile, the average credit rating in the

Sparinvest High Yield Value Bond Fund is BB. The exposure to CCC credits is very underweight and very selective (at 6%, compared with a market average of 20%). This is because the fund managers do not believe the credit premiums from the lower quality end of the market are currently offering investors adequate compensation for the risks involved with investment.

■ No dinosaur

"We always prefer to err on the side of caution," comments Frits Carlsen, Sparinvest's head of business development. "It is deeply ingrained in our investment philosophy and style. It is similar to when we ignored the hype about the dotcoms on the equity side and everyone laughed at us, calling us 'dinosaurs'."

"We believe that at present there are some serious threats abroad in the fixed income market and those charged with looking after this element of an investor's portfolio should really remember what is expected of them." *Details of Sparinvest's two value bond funds are available from www.sparinvest.co.uk. Alternatively, you can contact your usual financial consultant or Frits Carlsen at Sparinvest on +352 2627 4728.*



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Frits Carlsen, head of business development, Sparinvest