FINANCIAL TIMES

June 3, 2013 7:44 pm

US funds left bruised by heavy bond losses

By Dan McCrum in New York

Every one of the most popular class of US mutual funds investing in bonds lost money in May, highlighting the risks for investors as interest rates rise.

Bond yields around the world soared from some of the lowest levels in decades last month as investors anticipated an end to the extraordinary measures the Federal Reserve has used to stimulate the US economy.

US funds that invest in higher-rated bonds with average maturities of under 10 years lost an average 1.8 per cent in May, marking their worst performance since the depths of the financial crisis in October 2008, according to Lipper, a research group.

Such a broad decline has been rare for these funds. With more than $900bn in assets, these investment vehicles have attracted the lion's share of inflows from savers in search of regular income and low risk since the crisis.

Bill Gross, who runs the world's largest bond fund, Pimco's $293bn Total Return Fund, has this year bulked up on US Treasuries, saying they are the safest holding in a world in which "almost all asset markets are bubbles and mispriced."

However, Treasury prices fell as yields on US 10-year government bonds rose from 1.6 per cent at the start of May to 2.1 per cent on Friday. The Total Return Fund lost 2.2 per cent, making it one of the worst performers last month, Lipper said. This year, the Pimco portfolio is down 0.5 per cent, the same as the average fund.

Arvin Soh, portfolio manager for GAM, a $48bn alternative asset manager, said moves in the bond market reflected the activity of longer-term investors. "Very little of this has actually come from the hedge fund world," he said.

Mr Soh said few hedge funds had taken a strong view on the direction of US interest rates. "Where you are seeing a lot of this is on the long-only side, for instance where you saw outflows from high-yield bonds for the first time in three weeks."

Ben Bernanke, Fed chairman, last month said that bond purchases designed to hold down interest rates could slow in coming months as the US recovers, a shift that could have far-reaching consequences for US debt markets, perhaps signalling a turning point in the 30-year bull market for bonds.

However bond funds continued to attract inflows in May: investors put $136bn into taxable bond mutual funds in the first five months of the year, according to Lipper, only slightly less than the $145bn of inflows during the same period in 2012, and ahead of flows in 2011.

Eric Jacobson, senior analyst for Morningstar, a research group, said that one month of losses may not be enough to change behaviour. “The fact that it’s such a short period cuts both ways. It has the potential to spook people, but to really drive investors away from this market we do need to see deeper losses.”