

## TAM INTERNATIONAL INVESTMENT NOTE



## Bill Gross “Kings of bonds”

*“Begin at the beginning,” the King said, very gravely, “and go on till you come to the end: then stop.”*  
Lewis Carroll, Alice in Wonderland

In 1992, President Clinton’s adviser, James Carville, said that he wanted to be reincarnated as the bond market. Using more colourful language than we can publish here, he was expressing his view that in the earliest months of his Presidency, Clinton appeared to think bond markets were more important than taxes and even the Pope. But to many investors Bill Gross “the king of bonds” WAS the living embodiment of the bond market for four decades.

When he set up a small bond fund, not long after co-founding PIMCO in 1971, few would’ve believed that he was first on the scene at the beginning of one of the most extraordinary bull markets of all time. His firm amassed \$2 trillion of global funds running one of the best performing funds in its class and was the most influential bond manager in the world.

From its peak in 1981, the 10-year US Treasury bond yield fell steadily from over 15% to just 2.38% with the wider market giving an annualised total return of 10% over 30 years. In addition to this, his foresight in creating liquid bond funds for the retail market gave rise to a \$40 trillion market we know today.

However, since 2008, bonds have been a complicated, perplexing and fickle market. Bill Gross's fund performance has struggled since and in the last year has languished in the bottom quartile with significant outflows. The problem has been that he has been calling time on bond markets for some time. In 2010 he declared that the UK's bond market was like a bed of nitroglycerin, ready to go off the moment the Bank of England was forced to raise rates. He reiterated his bearish stance again in 2013, since which time, unfortunately, and thanks to central bank intervention in the US and UK, bonds have moved higher still. One can imagine the difficulty of maintaining such a bearish stance as \$70 billion worth of investors voted with their feet.

Against this backdrop, his resignation from PIMCO last Friday did not come as a complete surprise to everyone as there had evidently been some acrimonious disputes behind the scenes. This was even before his No.2, Mohamed El-Erian, abruptly quit the firm in January citing personal reasons. Indeed, the Wall Street Journal reported that PIMCO was preparing to fire him at the weekend, but were beaten to it by his sudden resignation announced in well-prepared media statement.

What did surprise markets was that Bill Gross is moving to another California-based competitor, Janus Capital, where he starts promptly this week to run their unconstrained bond funds. Shares in Janus, headed by former PIMCO MD, Dick Weil, rose 40% on the news as it is expected that some of the funds will inevitably follow.

Whilst TAM clients are not invested in PIMCO's funds, we, along with the markets and the regulators will be watching carefully to see if this might provide a liquidity event given the potential for large sales from PIMCO's \$220 billion fund. We have already heard of many large fund allocators redeeming from the fund and reports suggest that \$23.5 billion (over 10%) has already left the fund last month alone.

However, the fund has in excess of 6,000 holdings and well over half is in highly liquid investments that can take billions of dollars worth of trades every day – something deliberately built into a fund of that size. It's hard to imagine selling in this part of the portfolio moving the needle at all. Having said that, the fund is a global one and so the liquidity issue, if there is one, is not restricted to US bonds alone. PIMCO is among the largest holders of Brazilian debt, for example, holding \$14 billion of the local market.

In the last few trading days, despite some fast money trying to get ahead of certain positions, bond markets have been relatively calm, although both bonds and equities are undoubtedly more preoccupied with the police crackdown on protesters in Hong Kong with the threat of troubles spreading to the Chinese mainland, the start of renewed military action in Iraq, and the threat of Ebola. Markets are also bracing themselves ahead of some important events later this week. In the US, the keenly awaited non-farm payrolls figure will provide insight into the health of the US economy and a pointer for future interest rates – important for bonds. In Europe, we've just seen another set of weaker inflation figures for the eurozone, rising just 0.3% year on year in September, down from 0.4% a month earlier. We will also see what the ECB decides to do about it when they flesh out details of their asset-buying plan today as the lower than expected figure will heap additional pressure on ECB President, Mario Draghi.

**So this week could be one to watch, starting as it did with the abdication of the 'King of the bonds' and ending, potentially, with a little more insight into the future direction of global debt markets.**

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