

“WE BELIEVE FIXED INCOME PORTFOLIOS SHOULD ADD VALUE WHILE ALSO BALANCING THE EQUITY AND LIQUIDITY RISK OF THE TOTAL INVESTMENT PROGRAM.”



**BLAINE S. PHO, CFA**

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*Blaine Pho is chief investment officer, fixed income, with Greystone Managed Investments Inc. He is also a member of the asset strategy team. Benefits Canada asked him about the role of active fixed income portfolios and how investors can increase yield in today's low interest rate environment.*

**In your view, what is the role of active fixed income portfolios, and has this changed in recent years?**

Active bonds play an important role in both adding value and anchoring risk. Good fixed income managers have shown a persistent ability to add value over benchmarks through time. In many cases, fixed income is a large allocation for investors, so every bit of value-add can have an impact on total portfolio returns. This is arguably more important in today's low interest rate environment than in the past. The risk management side of the equation is increasingly important, as factors such as credit and liquidity risk are increasing within passive exposures.

Since our inception, we've worked with clients to manage not only core bond mandates but also custom and liability-matching portfolios. In recent years, we've noted a stronger orientation toward aligning fixed income portfolios with long-term objectives and liabilities. We've also seen a greater appetite to include fixed income investments that may be found outside of benchmarks and traditional public markets, in order to add additional value.

**What sets you apart from others in managing fixed income?**

We believe fixed income portfolios should add value while also balancing the equity and liquidity risk of the total investment program. This has guided us to an approach that looks to be defensive with corporate bond risk at later stages of economic cycles.

Our research suggests that, at these later stages, and through subsequent recessions, corporate bonds exhibit downside risk similar to equities. We've also noted that liquidity for corporate

bonds can be fleeting at times of market stress, so we attempt to build defensive positions in advance of downturns. This approach also allows us to harvest higher yields in corporate bonds that are often available following periods of market stress.

The other side of the coin to our approach is developing capabilities for anticipating interest rates, which can add value when the portfolio is defensive with corporate bond exposures. We'll take meaningful positions with respect to the benchmark if we think the market hasn't accurately reflected future interest rates into bond prices.

**How do you set your expectations for the economy, interest rates, and corporate bond returns?**

As bond investors, we think it's important to understand the economic, interest rate, and credit cycles in order to set our bias for interest rate and corporate bond positioning. What we add is an acknowledgement that bond prices can, at times, reflect our view and, at other times, differ from our view.

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We spend a great deal of time studying how interest rates and corporate bonds have behaved historically. While the future may be different, we like to use history as a guide for what generally occurs. We also seek to understand to what extent our view has been priced into bonds. When bond pricing dislocates from our fundamental view, we'll scale into our highest conviction positions.

**What are the main risks you see for bond investors in today's low-yield environment?**

The primary risk is that low interest rates make it increasingly difficult to meet their total return objectives. This can drive investors toward riskier parts of the bond market in search of higher yields and expected returns. Often, this results in greater equity-like risk for the bond portfolio.

The other challenge is that the premium earned in most credit sectors is lower today than it has been at any other period since the financial crisis, indicating a lower return relative to long-term credit risk.

Compounding the issues around credit risk are structural changes in the bond market, which can challenge the liquidity in periods of market stress. We think there's a good chance that the credit risk held going into the next recession will stay on the books through the entire period. As a result, we believe that high-quality, shorter-term credit exposures are likely the most prudent.

**What is your best idea for increasing yield in this low interest rate environment?**

Our highest recommendation to clients is to integrate high-quality private

debt investments into their bond portfolios. In private markets, the investor underwrites a loan directly with an underlying borrower. Often, the investor is rewarded with a premium for the additional governance and capital scarcity, and the fact that private debt is often not traded in the market.

Through prudent underwriting, the credit risk can be similar to investment grade bonds. Unlike corporate, global, and high-yield bonds, the premiums available in certain segments of the private debt market are also attractive, relative to their history. For long-term bond investors, we think this is an attractive premium to harvest.



**HOW DO YOU SPEND YOUR TIME AWAY FROM WORK?**

*Saskatchewan is home to many beautiful lakes, and what's great about our Regina location is that we're 45 minutes (door to door) from our cottage. For my family and me, it's really our favourite place to be. It's where we spend a large portion of our summer—on and off the lake—and I see it as an important investment in my family. A lot of great quality moments have come from there.*



**HOW DOES WORK/LIFE BALANCE DIFFER IN REGINA?**

*I view working in a different time zone than the rest of the financial world as an advantage, because it allows me the flexibility to be around more. I'm up and at work early and home before most. This balance allows me to be there for my family, to be active in my two kids' lives and in their extracurricular activities, and to hit the gym a few times a week.*



**ARE THERE ANY VOLUNTEER INITIATIVES YOU'RE CURRENTLY INVOLVED IN?**

*At Greystone, we believe in giving back to the communities in which we work and play. Every person at our firm is encouraged to give back in one form or another—be it through monetary donations or through volunteering time, for example. I'm active in my church's initiatives, and I've also had the good fortune to coach some of my kids' sports teams. It's rewarding to be with an organization that has such a strong commitment to community involvement.*