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UOB Fund Return Beats Peers With Perpetual Debt: Southeast Asia

By David Yong - Aug 31, 2012 12:01 AM GMT+0800

UOB Asset Management Ltd.'s Singapore dollar debt fund is beating most peers by buying perpetual bonds and investing 70 percent of its money overseas as rates on bank deposits and sovereign yields approach zero.

The S$435 million ($347 million) United SGD Fund managed by the unit of United Overseas Bank Ltd. (UOB) counts seven perpetual bonds among about 50 securities in its portfolio as of June 30, including Westpac Banking Corp.'s debt, according to the fund's semi-annual report. The manager also bought floating-rate notes sold by Standard Chartered Plc and Korea First Bank maturing in 2018 and 2034, respectively.

Commercial buildings, including the United Overseas Bank Plaza towers, stand in the central business district of Singapore. Photographer: Munshi Ahmed/Bloomberg

"We want to diversify across countries, sectors and structures, and perpetual bonds are an added spice to dish," said Joyce Tan, co-head of Asian fixed-income investment at UOB Asset Management, which manages $15.5 billion. "It's still a short-term bond fund," she said in an interview yesterday.

The picks helped the plan return 5.1 percent this year through Aug. 29, topping 76 percent of rivals including investment vehicles managed by Fullerton Fund Management Co. and Nikko Asset Management Ltd., data compiled by Bloomberg show. That outpaced the city's 4.9 percent average inflation this year and compares with the 0.26 percent bid-rate on the six-month Singapore interbank offered rate and 0.5 percent on one-year bank deposits.

Falling bond yields are prompting money managers to buy riskier debt with no set maturities to boost returns as inflation erodes the value of fixed-income assets. Singapore government bonds, rated AAA, yielded 1.35 percent on Aug. 29, versus 1.83 percent average in 2011 and were as high as 3.47 percent before the onset of 2008 global financial crisis.

Corporate Debt

Investors in Singapore local-currency corporate bonds earned 4.1 percent this year, according to HSBC Holdings Plc, compared with 3 percent on local government securities. U.S. investment-grade company debt rose 7.7 percent, according to Bank of America Corp.

Central banks in the U.S., Japan and Europe have cut benchmark policy rates to near zero to spur lending and economic growth. Two-year government bonds yielded 0.22 percent in Singapore, 0.27 percent in the U.S., 0.1 percent in Japan and below-zero in Germany.

Perpetual notes pay more than securities with a fixed maturity to compensate investors for the risk they won't be called. They're generally senior to equity and subordinated to other types of debt. Issuers typically retain the right to call the bonds after a set period.

Top Holdings

Tan, 38, who joined UOB in 2007 after a stint at ING Investment Management, said her fund started buying the debt in 2009 and invests in those that are callable within three years. The fund's current average duration is two years, she said.

She invested 35 percent of the fund's assets in debt sold by Singapore-based companies as of the end of July, the largest portion by geography. The holdings include the 8.5 percent bond due in 2013 sold by Noble Group Ltd., Asia's biggest commodity supplier, and the 3.83 percent bond maturing in 2014 issued by property developer Savu Investments Ltd.

The United SGD Fund (OUBGPCI) was ranked the top local-currency bond fund in 2010 and 2011 by Lipper Inc. based on three- and five- year performance. Its single largest holding is Westpac's (WBC) perpetual debt, which may be called at par on Sept. 30, 2013.

The securities were sold with a 5.819 percent coupon in August 2003, or a spread of 155 basis points more than similar- maturity U.S. Treasuries. The bond yielded 5.733 percent yesterday, while the bank's 1.85 percent bond due December 2013 yielded 0.99 percent, data compiled by Bloomberg show.

'Compelling Valuations'

Tan oversees a team of 20 credit analysts and scours the region for 70 percent of investment denominated in foreign- currency bonds. Those assets are fully hedged, covering investors against currency risk, she said.

"The euro-dollar market offers better risk-adjusted return in terms of better liquidity, wider choices and compelling valuations," Tan said. "The bonds are commonly rated and the issuers have longer track records."

The S$859 million Short-term Interest Rate Fund managed by Fullerton Fund Management earned 4.5 percent this year, while the S$233 million Nikko AM Short Term Bond fund run at Nikko Asset Management returned 3.5 percent, according to data compiled by Bloomberg. Both are Singapore dollar funds that invest in securities due within three years.

Fund managers may be saddling investors with too much risk by loading money-market and bond funds with securities that may be hard to sell in times of market volatility, said Benedict Koh, a finance professor at Lee Kong Chian School of Business at the Singapore Management University.

Higher Risk

“Given the low interest-rate environment and poor prospects of financial markets, many money-market and bond funds are pressured to earn a decent return,” he said in an e-mailed reply to questions on Aug. 30. “This pressure to perform may explain partially their interest in perpetual bonds. They need to ask whether the risk-return tradeoff is justifiable.”

Koh said perpetual bonds are riskier than fixed-term bonds or money-market instruments as there is no repayment of capital unless they called. Volatility to interest-rate swings is “very high,” especially when rates are projected to rise in the long run, he said.

Still, the securities are helping money managers to keep pace with inflation. Consumer prices in the city-state increased by an average 4.9 percent in the first seven months this year, compared with 5.2 percent in 2011. Inflation averaged 1.7 percent in the previous two years.

Popular Debt

Demand for perpetual bonds is spurring a record pace of issuances in Singapore. Companies including casino operator Genting Singapore Plc (GENS), Mapletree Logistics Trust (MLT) Ltd. and Singapore Post Ltd. (SPOST) have raised S$5.3 billion this year, compared with $1.9 billion in all of last year, according to data compiled by Bloomberg.

“The popularity of this instrument is due to the record- low and negative yields that investors are exposed to after adjusting for inflation,” said Grace Lim, a bond strategist in Singapore at ABN Amro Private Bank. “Bond prices are relatively resilient and private banks’ clients are also unwilling to stomach more risk and volatility in the equity market.”