

GLOBAL FIXED INCOME



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TIME IS NOW FOR GLOBAL FIXED INCOME OPPORTUNITIES

Canadian plan sponsors are increasingly turning to innovative new products in the global fixed income space to generate alpha within their portfolios.

Gone are the days when fixed income strategies served only as a relatively reliable hedge against risk. Today, fixed income strategies use the increasing sophistication of the marketplace to capitalize on myriad innovative opportunities for creating alpha. Yet certain investors still seem averse to the global fixed income landscape. While products in the fixed income space can indeed involve a high degree of complexity versus other types of investments, they create unique opportunities to be capitalized upon by investors who have access to robust portfolio management and research.

“The fixed income investment marketplace has evolved a great deal over the last decade,” explains Christopher Molumphy, Chief Investment Officer for the San Mateo, California-based Franklin Templeton Fixed Income Group. “Even as recently as five years ago, while global equity investing was universally accepted, there were still questions about the validity of fixed income on a global basis in terms of providing diversification and added value.

“That has changed dramatically in the recent past,” he says. “If plan sponsors aren’t open to evaluating new opportunities in the financial markets, then they are limiting their potential for strong risk-adjusted returns over the long-term.”

But despite recent performance that clearly demonstrates the efficacy of global fixed income investing as a method by which to add value to a portfolio, some Canadian sponsors

still possess a home-country bias, relying on domestic fixed income strategies for diversification and amelioration of risk while ignoring the proliferation of global fixed income products. That’s a missed opportunity, according to Duane Green, Senior Vice-President, Institutional Investment Services at Franklin Templeton Investments Corp.¹

“Over the past several years, Canadian plans have become far more global with regard to their equity investment universe,” he says, “and most now have a variety of global or EAFE equity strategies representing a significant portion of their asset allocation.”

Within the fixed income sphere, Green notes, there will likely always be a substantial allocation to Canadian bonds for Canadian institutional investors, but in the current environment a strong case can be made that the Canadian market alone may not provide the depth or diversification required to build an ideal risk-adjusted strategy, let alone produce alpha opportunities, especially in the high-yield markets.

“I think there is an ideal opportunity for Canadian plans to diversify by building in a global fixed income component within their portfolio,” he adds. “The hunt for alpha has traditionally been within equities – but our message is that, as a part of an overall portfolio composition, global fixed income can diversify the plan *and* contribute to strong returns.”

¹ Franklin Templeton Investments’ Canadian subsidiary.



Chris Molumphy,
CIO, Fixed Income Group



Michael Reed,
VP, Portfolio Specialist, FTFIG



Duane Green,
SVP, Institutional Investment Services

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MEET THE FRANKLIN TEMPLETON FIXED INCOME GROUP

With four decades of diverse experience in the fixed income arena, the Franklin Templeton Fixed Income Group (FTFIG) is well positioned to help Canadian plan sponsors take advantage of these emerging opportunities.

With roughly US\$184 billion* in fixed income assets under management, FTFIG is the largest division of Franklin Templeton Investments, which includes Templeton, Franklin Global Advisors, Franklin Templeton Real Estate Advisors, Mutual Series, Bissett², Franklin Templeton Managed Investment Solutions and Darby Private Equity. Collectively, the firm's AUM tops US\$482 billion*.

The breadth and depth of Franklin Templeton's history in fixed income investing has solidified their position as leading innovators in the marketplace. The team's high yield and bank loan investment strategies predate their respective benchmarks, and its core global bond strategy is one of the longest-running on record. In the early 1980s, the firm launched one of the first Ginnie-Mae-only funds (the U.S. Government National Mortgage Association), created in response to investors who clamoured for a product that provided the same credit quality as treasury bills, but with higher income and with a limited corresponding increase in risk. There was also the first investment manager to offer a double-tax free municipal bond fund, and at one time the

Franklin U.S. Government Securities Fund had the distinction of being the largest mutual fund in the world.

With a significant global footprint, FTFIG's operations involve more than 100 seasoned investment professionals worldwide. Their multinational and multi-regional approaches to global fixed income investing uniquely harness the experience and knowledge of their local asset management shops whose core business is investing in local assets for local investors – which represents a significant departure from the industry standard of transplanting U.S. or Canadian staff to foreign branch offices.

“We have local investment specialists around the world. Our global footprint and size in the market allows us to work with issuers to help guide issuance structure and overall policy,” says Michael Reed, Vice President and Portfolio Specialist for Franklin Templeton Fixed Income Group. “It's a real core advantage of Franklin Templeton Fixed Income Group. The local asset management offices not only provide investment ideas that are used across our global and multi-sector products – they also run their own businesses, investing in assets for local investors. When they innovate within their own portfolios, they keep us informed and sometimes we're able to leverage their ideas.”

*As of July 31, 2009. ² Bissett Investment Management is an operating division of Franklin Templeton Investments Corp.

Franklin Templeton Fixed Income Group—Global Investment Professional Presence



The Franklin Templeton Fixed Income Group consists of more than 100 investment professionals providing comprehensive coverage of potential alpha opportunities across sectors and around the world. (Professionals include portfolio managers, analysts, and traders. As of 7.31.09)

THE FTFIG INVESTMENT PROCESS

FTFIG prides itself on a long history of being a bottom-up, research-intensive operation rooted in fundamentals and employing large, specialized teams within each of the main sectors that comprise the firm’s overall fixed income strategy.

“When it comes to fixed income investing, FTFIG is certainly a pioneer,” says Michael Reed. “The firm cut its teeth on fixed income, focusing on the sectors that produce alpha, so we have deep experience and a rich history in this area. Other companies built their strengths in traditional core asset classes that make up traditional fixed income – such as U.S. treasuries – and only added ancillary alpha generation as they saw a need. We try to look to where the market is going to innovate, not where it has been.”

The worldwide FTFIG team follows stringent and systematic processes designed to consistently add alpha to their institutional clients’ portfolios through multi- and single-sector strategies, across many market cycles. The investment process – representing a true bottom-up, research-driven approach – involves three interdependent key activities, each informing and influencing the others.

From a top-down point of view, the Fixed Income Policy Committee (FIPC), comprised of senior team members and heads of research from across the firm’s corporate credit, global sovereign and emerging market debt, mortgages, bank loans, municipals and local asset management teams gather via audio and video conferencing in weekly meetings. Here, global macroeconomic issues affecting the world economy and the fixed income market are discussed, and sector-specific opportunities are identified.

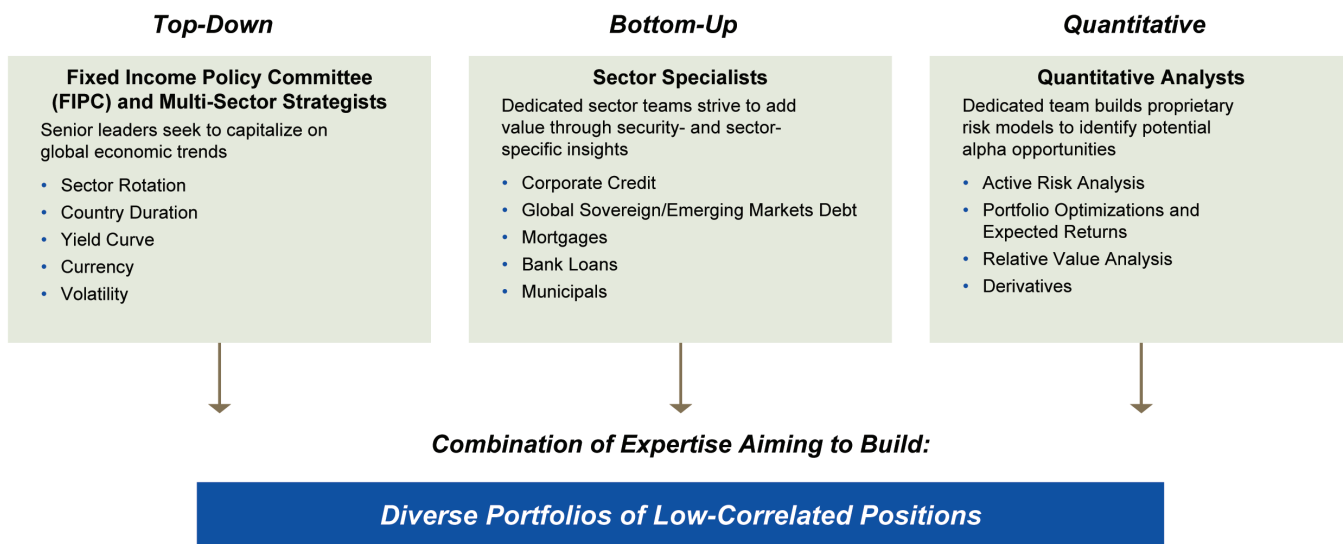
The core of the research process, the bottom-up research, is conducted by sector teams and analysts on a daily basis. These

deep research teams are responsible for developing security-specific investment ideas within each sector, building portfolios according to client needs and providing bottom-up feedback to the FIPC. Bolstering all these efforts is a dedicated group that provides daily portfolio risk analysis to identify potential alpha opportunities, while monitoring exposures and performance attribution to ensure consistency across like portfolios.

A focus on uniformity and continuity in the management process across sector teams also means that senior FTFIG members are directly involved in managing the portfolios, unlike many investment firms where execution of the larger vision is delegated to team members far removed in the corporate structure from core decision makers.

This commitment has required a significant investment in a small army of personnel with diverse backgrounds and specialties, a tactical response to the trend toward increased sophistication and specialization that have accelerated in the fixed income market over the last decade. From MBAs working as analysts in investment-grade and high-yield corporate bonds, to PhDs with backgrounds in international economics focusing on global bonds and professionals with advanced degrees in quantitative areas, such as mathematics and statistics, who delve into mortgage- and asset-backed securities, the FTFIG team is at the top of its game. Add to this a collegial, empowering corporate culture that emphasizes a team approach, and the result is a staff as notable for the breadth of their experience as they are for the longevity of their service with the company – global and multi-sector senior staff members have been with the firm for an average of 14-plus years.

Franklin Templeton Fixed Income Group Overview



FTFIG STRATEGIES & PERFORMANCE

The FTFIG global team stewards a proud legacy of performance in the fixed income arena, managing a breadth of products designed to exploit established and emerging opportunities in the marketplace. With an emphasis on higher alpha generating, value-added asset classes, such as corporate issuances and global government debt, FTFIG has long distinguished itself from the traditional core asset approach many investors take to the fixed income market.

KEY FIXED INCOME STRATEGIES

Global Bond – This high alpha-seeking and benchmark-agnostic strategy looks to capitalize on global interest rates, currency and sovereign credit trends. Government and related issuance allocations in both developed and emerging markets are the focus of bottom-up research that looks at where a country is headed in terms of growth, inflation rates and currency. Looking at a diverse opportunity set, while isolating specific risk exposures to optimize portfolio composition, means that the portfolio management team is able to find value in any market scenario.

Emerging Market Debt – Within this discipline, the team invests in sovereign and sub-sovereign debt securities, including issuances by local authorities, government-owned or -controlled agencies, corporations and supranationals in the emerging world. With a benchmark-agnostic approach to investing in opportunities much of the financial world ignores, a strong performance track record is expected to continue across cycles. The FTFIG team believes that current asset prices may already reflect improvements and optimism in the global economy, and will look to less benchmark-oriented securities going forward.

U.S. High Yield and Global High Yield – Both of these strategies are designed to provide superior high-yield returns by exploiting inefficiencies within high-yield markets. Rigorous bottom-up research looking at a company's financial structure, cash flow, market share, earnings prospects and other factors identifies return opportunities that can add value over a three- to five-year period. Weak economic outlooks in the equity and financial markets for the balance of 2009 suggest the high-yield sector could see some volatility ahead, but longer-term value prospects remain attractive. Still, the FTFIG team believes that individual security selection is the key to generating alpha in the corporate space and has built resources to help in this effort.

Global Credit – FTFIG's global credit strategy invests in government, securitized and corporate sectors seeking alpha through selection, country and duration positioning and currency allocation. Currently, the team favours the risk-return proposition for investment-grade credit over the near-term.

Global Aggregate – This strategy focuses on corporate bonds with tactical investments in the global fixed income marketplace, looking at a broad opportunity set to drive value. Positive performance over the first two quarters of 2009 can be attributed to fiscal and monetary actions taken by governments worldwide to stem the effects of the economic

crisis. In the near-term, as prospects for global economic activity and growth appear weak, FTFIG's approach will be to seek opportunities by selectively adding exposure in key spread sectors.

AN ASSET CLASS WITH WORLDWIDE OPPORTUNITIES

Across the board, U.S. plan sponsors have been showing increased interest in global fixed income and corporate credit strategies, with the latter being more popular than ever within the institutional space. Luckily, global fixed income and corporate debt are two areas of FTFIG's expertise.

All told, according to Molumphy, FTFIG's approach has historically achieved alpha over time by focusing on diligent collateral analysis combined with a top-down process, all steeped in a rich tradition.

"We take a great deal of pride in the results we have achieved across our fixed income strategies," he says. "As markets have become more competitive, it seems a large segment of investors has shortened their time horizons. Our focus has always been over the longer-term, and we are also fortunate to have always applied a global approach to fixed income. As these trends have gained momentum, they have played to what we consider our core strengths."

"NOW IS CERTAINLY THE TIME TO BE EVALUATING ONE'S APPROACH AND EXPOSURE TO FIXED INCOME."

Plan sponsors who have yet to embrace a global fixed approach have to look no further than some key sector returns for 2009 as dramatic evidence that fixed income can generate significant alpha, Molumphy notes. "High-yield corporate bonds have posted 40% gains, while commercial mortgage-backed securities, emerging market debt, investment-grade corporates and leveraged bank loans are up 20% to 30% year-to-date."

"Looking forward, there are a number of forecasters who envision a somewhat slower-than-normal growth environment which may persist for a number of years," Molumphy explains. "If in fact that is the environment, we see a number of fixed income sectors and strategies appear on a risk-adjusted basis to look even more attractive than they have in the past. Now is certainly the time to be evaluating one's approach and exposure to fixed income."

While Canadian institutional investors may look at global fixed income investing as a relatively new concept for their plan, they can be confident that the approach is far more than a fad, according to Duane Green.

"This asset class is very new to Canadian plans, and sponsors may not be aware of the depth and breadth of the opportunities in the world," he says. "For us, it's not just a trend – we are able to bring expertise via a proven global team into the Canadian marketplace. We've been in this space for a long time, and we have proven results."⁴

³ Barclays Capital Live, July 31, 2009.

⁴ As of June 30, 2009. First quartile 1-, 2-, 3-, 5 year. Mercer Investment Consulting Pooled Fund Survey.

For more information on the Franklin Templeton Fixed Income Group, please contact Duane Green at 416.957.6165 or email dgreen2@franklintempleton.ca.

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