

1 00:00:03:15 00:00:05:20
Good morning, everyone.
Good morning, Jim, as well.

2 00:00:07:14 00:00:10:18
So, as Mike said, to make the most
of this section and to make it interactive,

3 00:00:10:20 00:00:12:20
it would be really great
to get your questions through

4 00:00:14:14 00:00:18:00
and to pose some really good questions
to Jim.

5 00:00:18:02 00:00:22:14
I've got some to start with,
but as Mike said, the tab is on your screen,

6 00:00:22:16 00:00:23:15
make use of it.

7 00:00:24:18 00:00:26:01
We've got half an hour.

8 00:00:26:20 00:00:29:00
I'm going to start Jim,
so I'm going to jump in with a question

9 00:00:29:02 00:00:30:05
to kick off

10 00:00:30:07 00:00:34:07
and it's really a few questions
rolled into one.

11 00:00:34:09 00:00:38:08
We've seen some really strong data
coming out of the US

12 00:00:38:19 00:00:41:14
over the past few months,
and in the last few weeks obviously.

13 00:00:42:16 00:00:47:20
And in response, bond markets are pricing
in several rate hikes,

14 00:00:48:11 00:00:50:06
but on the flip of that,

15 00:00:50:08 00:00:54:13
you've got the Fed
actually painting a far more dovish picture,

16 00:00:55:05 00:00:58:22
saying they won't hike rates anytime soon.

17 00:00:59:04 00:01:02:02
So just to kick off,
what are your thoughts at the moment

18 00:01:02:04 00:01:03:21
on how the recovery is proceeding

19 00:01:03:23 00:01:06:16
and what does this mean
for the bond markets?

20 00:01:07:18 00:01:08:21
Yeah, morning, Mark.

21 00:01:08:23 00:01:13:02
You cannot deny,
and I think there's no argument anywhere,

22 00:01:13:20 00:01:17:18
that 2021 is going to be
an incredibly strong year

23 00:01:17:20 00:01:18:20
for economic growth,

24 00:01:19:05 00:01:22:06
especially in the United States
and especially in the UK,

25 00:01:22:16 00:01:28:02
where the vaccine rollout has been faster
than, for instance, in the Eurozone.

26 00:01:28:11 00:01:32:01
So a lot of the economic numbers
that we have coming through,

27 00:01:32:08 00:01:34:22
are comparing this year with last year

28 00:01:35:00 00:01:38:07
and obviously last year,
the global economy was closed down.

29 00:01:38:16 00:01:41:17
And so if you look at the inflation numbers,
for instance,

30 00:01:41:19 00:01:45:05
from April this year to April last year,

31 00:01:45:07 00:01:49:03
well, the oil price was negative a year ago,
if you remember,

32 00:01:49:05 00:01:51:16
it seems a long time ago

as we went into lockdown.

33 00:01:52:02 00:01:55:20
Oil prices went to negative \$20 a barrel.

34 00:01:55:22 00:01:58:11
And today they are up above \$60 a barrel.

35 00:01:58:22 00:02:03:13
So your comparison points for every piece
of economic data you're looking at

36 00:02:03:15 00:02:07:16
compared to a year ago is going to be
gangbusters effectively.

37 00:02:07:22 00:02:10:22
So don't be surprised
over the course of this year,

38 00:02:11:00 00:02:14:17
if we get relentlessly strong economic data.

39 00:02:15:00 00:02:17:15
The question for the central banks
that you mentioned,

40 00:02:17:17 00:02:20:02
like the Fed and the Bank of England is,

41 00:02:20:04 00:02:22:20
are we just getting back to normal

42 00:02:23:06 00:02:26:04
or are things going to be stronger
than they would have done

43 00:02:26:06 00:02:27:20
had we not had Coronavirus?

44 00:02:28:05 00:02:30:23
And there are some
good arguments to suggest

45 00:02:31:01 00:02:34:10
that things aren't just going to go
back to normal,

46 00:02:34:12 00:02:35:22
but they're going to be supercharged.

47 00:02:36:10 00:02:38:23
And if you think
about why that might be the case,

48 00:02:39:01 00:02:43:14
well, obviously, interest rates got cut down
to zero or negative

49 00:02:43:16 00:02:45:05
pretty much everywhere in the world.

50 00:02:45:17 00:02:49:20
We had huge amounts of quantitative
easing, pumping money into the economy,

51 00:02:50:04 00:02:54:22
bringing down bond yields for companies,
as well as for the governments involved,

52 00:02:56:00 00:02:58:21
and you, of course, had fiscal spending.

53 00:02:58:23 00:03:01:13
And if you think back
to the global financial crisis

54 00:03:01:15 00:03:03:05
that was the bit that was missing then.

55 00:03:03:12 00:03:07:12
So back in the GFC in 2008/2009,

56 00:03:07:14 00:03:09:20
again we cut interest rates down to zero,

57 00:03:10:01 00:03:11:17
again we had quantitative easing,

58 00:03:11:22 00:03:13:23
but we also had austerity.

59 00:03:14:01 00:03:17:21
And so governments around the world
were cutting the amount of money

60 00:03:17:23 00:03:18:19
that they were spending,

61 00:03:18:21 00:03:21:07
thinking that they were worried
about size of the debt,

62 00:03:21:15 00:03:24:03
and all of that has gone out
of the window this time round.

63 00:03:24:05 00:03:26:23
That might cause problems for us
further down the line

64 00:03:27:01 00:03:29:23
because there is so much debt
in the economy.

65 00:03:30:01 00:03:31:11

People look at the UK...

66 00:03:32:04 00:03:34:22
and compare it to us coming out
of World War Two

67 00:03:35:00 00:03:36:10
in terms of how much debt we have.

68 00:03:36:21 00:03:39:03
But for the time being,
that fiscal stimulus means

69 00:03:39:05 00:03:44:14
that as well as very cheap money,
people have got stimulus cheques,

70 00:03:45:02 00:03:49:14
extra unemployment benefits,
furlough payments in their pocket to spend,

71 00:03:49:21 00:03:51:09
they've got pent up demand

72 00:03:51:11 00:03:54:13
from not having anything to spend it on
for a year,

73 00:03:54:15 00:03:56:18
haircuts have come back into fashion,

74 00:03:56:22 00:04:00:03
I ate out in a pub last night.

75 00:04:00:10 00:04:03:08
You just want to spend some money,
go on holiday...

76 00:04:03:16 00:04:07:11
And so the fiscal stimulus,
higher minimum wages as well in the US...

77 00:04:07:19 00:04:12:04
I think it's inevitable that this year, Mark,
is going to be hugely strong

78 00:04:12:06 00:04:13:06
for economic growth.

79 00:04:13:16 00:04:14:23
And there are some early signs

80 00:04:15:01 00:04:18:13
that maybe the Eurozone is starting
to catch up

81 00:04:18:18 00:04:20:10
with its vaccination programme, as well.

82 00:04:20:12 00:04:21:15
So people had thought

83 00:04:21:17 00:04:23:22
that the Anglo-Saxon economies
would be strong

84 00:04:24:03 00:04:25:09
but Europe would be weak.

85 00:04:25:20 00:04:28:03
Now, it feels like
it's going to be a bit more strong.

86 00:04:28:09 00:04:31:01
Of course, the fly in the ointment
of all of this is

87 00:04:31:03 00:04:35:20
the potential for the Indian variant
or another variant

88 00:04:36:08 00:04:38:05
to start slowing things down again.

89 00:04:38:07 00:04:41:12
And so far I think that,
while we're very worried about that,

90 00:04:41:21 00:04:46:08
the evidence is that vaccines work
against the Indian variant,

91 00:04:46:16 00:04:50:02
and while this may be a slight slowing,
it's going to be a strong year.

92 00:04:50:04 00:04:53:18
And so, the Fed is going to be nervous

93 00:04:53:20 00:04:57:07
but will for the time being
let the economy rip.

94 00:04:57:16 00:05:00:21
And that's really the objective
of all central banks.

95 00:05:00:23 00:05:03:20
There are still 15 million people in the US

96 00:05:04:10 00:05:07:12
who haven't gone back into the workforce
post-Coronavirus.

97 00:05:07:21 00:05:10:11
We need them to be coming back

into the workforce

98 00:05:10:17 00:05:13:11
at the rate of a million a month or so.

99 00:05:14:11 00:05:16:09
And remember last month,

100 00:05:16:11 00:05:19:17
we had a very disappointing
unemployment number out of the US

101 00:05:19:19 00:05:21:05
compared to expectations.

102 00:05:21:20 00:05:23:08
Some people had thought
we were going to get

103 00:05:23:14 00:05:26:04
two million people re-joining the workforce.

104 00:05:26:11 00:05:28:23
We only got 266,000 people.

105 00:05:29:06 00:05:31:20
So this isn't going to be a straight line,

106 00:05:32:03 00:05:33:07
everything going right.

107 00:05:33:09 00:05:35:18
The data is going to be volatile

108 00:05:35:23 00:05:40:17
simply because of how much disturbance
has gone on in the global economy.

109 00:05:40:19 00:05:42:16
But I think the trajectory is good,

110 00:05:42:18 00:05:46:09
and that means
that not this year but maybe next year,

111 00:05:46:11 00:05:49:20
the Fed and the Bank of England and others
do start thinking

112 00:05:49:22 00:05:51:15
about hiking interest rates.

113 00:05:52:21 00:05:56:08
So, the natural question for me, Jim,
following on from that,

114 00:05:56:10 00:05:58:11
and I know it's a question

that Parit has mentioned

115 00:05:58:13 00:05:59:12
in the earlier session,

116 00:05:59:23 00:06:03:00
and one that when I'm talking to advisers

117 00:06:03:02 00:06:07:04
is a big theme

118 00:06:07:12 00:06:08:19
is inflation..

119 00:06:08:22 00:06:13:04
Core inflation has been below target

120 00:06:13:13 00:06:16:06
for a good number of years now.

121 00:06:16:12 00:06:19:11
And we are now seeing a spike in inflation

122 00:06:19:13 00:06:21:20
for some of the reasons
you've mentioned already.

123 00:06:22:03 00:06:27:22
But what's your view on inflation
in developed markets going forward?

124 00:06:28:19 00:06:31:19
Yeah, I mean the word you're going to hear
all the time

125 00:06:31:21 00:06:34:17
for the remainder of the year is transitory.

126 00:06:34:19 00:06:37:01
Every single speech

127 00:06:37:03 00:06:41:14
that the Federal Reserve Governors make,
"transitory", "transitory", "transitory".

128 00:06:41:16 00:06:43:04
And what they're saying is that

129 00:06:43:18 00:06:47:08
these are one off price shocks

130 00:06:47:10 00:06:49:18
to do with reopening of the economy,

131 00:06:49:20 00:06:53:17
to do with oil moving
from negative to positive numbers.

132 00:06:54:00 00:06:58:18
And we look at some of
the inflation numbers

133 00:06:58:20 00:07:00:10
that came through the United States...

134 00:07:00:14 00:07:03:12
We saw headline inflation numbers,

135 00:07:03:20 00:07:08:19
headline or core heading up
in the threes, even 4% year-on-year.

136 00:07:09:13 00:07:14:09
Remember that a lot of that is
due to one off effects

137 00:07:14:11 00:07:17:10
and all things to do with Coronavirus.

138 00:07:17:12 00:07:21:18
So, for instance, if you stripped out
the price of used cars

139 00:07:21:20 00:07:23:20
out of the US inflation data...

140 00:07:25:10 00:07:27:06
The number would be far more moderate

141 00:07:27:08 00:07:31:13
because used cars went up by 10%
in the month in price.

142 00:07:31:15 00:07:34:01
They are up about 20% year-to-date.

143 00:07:34:14 00:07:37:05
But the idea of transitory means that...

144 00:07:39:04 00:07:43:18
you have to expect that to happen
next month, next month, and the month after

145 00:07:44:05 00:07:47:04
in order just to keep
the rate of inflation steady.

146 00:07:47:11 00:07:48:21
And I don't think people expect that.

147 00:07:48:23 00:07:52:00
There are good reasons why
used car prices have gone up a lot.

148 00:07:52:02 00:07:53:18
And here are the main two:

149 00:07:54:00 00:07:57:15
One, people have got money
in their pockets

150 00:07:57:17 00:08:01:06
and not everyone did well
out of the pandemic,

151 00:08:01:08 00:08:02:19
but lots of people saved some money.

152 00:08:03:02 00:08:04:16
They want to go and buy a car,

153 00:08:04:18 00:08:08:09
they're perhaps afraid of public transport
still because of the virus.

154 00:08:09:16 00:08:11:12
They want to buy a new car, ideally,

155 00:08:11:18 00:08:13:00
but as you know,

156 00:08:13:06 00:08:16:11
the second reason, computer chips
have run out all around the world,

157 00:08:16:19 00:08:21:04
thanks to things like Bitcoin miners
and supply chain disruption.

158 00:08:21:06 00:08:25:10
There are 150 computer chips
in a modern car,

159 00:08:25:12 00:08:27:18
and that means that companies like Ford

160 00:08:28:00 00:08:31:19
have had to reduce their shipments
of new cars by 50%,

161 00:08:31:21 00:08:33:22
so people are buying second-hand cars.

162 00:08:34:10 00:08:37:06
And that effect is going to tail off
over time.

163 00:08:37:08 00:08:39:20
People will have got a car,

164 00:08:40:01 00:08:43:05
public transport will become more
comfortable for people to take.

165 00:08:43:17 00:08:48:01
And you do not expect used car prices
to go up by 10% every month.

166 00:08:48:09 00:08:52:16
You don't expect the oil price to move
from negative to positive every year.

167 00:08:52:18 00:08:56:08
So what inflation is
that would worry a central bank

168 00:08:56:17 00:08:58:17
is persistent inflation,

169 00:08:58:19 00:09:00:15
rather than these one off shocks

170 00:09:00:17 00:09:03:12
that are to do with where
we were a year ago,

171 00:09:03:14 00:09:05:20
or to do with a trade disruption,

172 00:09:06:05 00:09:10:00
or to do with Coronavirus re-opening effects

173 00:09:10:02 00:09:13:00
on hospitality and restaurants and so forth.

174 00:09:13:10 00:09:17:23
So what you need to see is that
these things are repeated and repeated,

175 00:09:18:05 00:09:20:04
and the only way that can happen really...

176 00:09:20:23 00:09:23:06
is if it starts feeding through into wages.

177 00:09:23:18 00:09:27:08
And I've been trading bond markets
for 30 years,

178 00:09:27:10 00:09:30:12
and really the big long-term factors

179 00:09:30:14 00:09:33:10
that are keeping inflation low remain
in place,

180 00:09:33:12 00:09:36:22
and that's ageing populations
want to buy government bonds

181 00:09:37:00 00:09:38:20
for income and safety.

182 00:09:39:05 00:09:41:17
We have technological factors.

183 00:09:42:02 00:09:44:12
Amazon enables us to buy cheap goods,

184 00:09:44:23 00:09:50:02
Uber allows us to not pay black taxi rates,

185 00:09:50:04 00:09:53:01
we pay cheaper fares
by having an app on our phone,

186 00:09:53:08 00:09:55:08
companies can use these things as well.

187 00:09:55:20 00:09:57:22
And globalisation, of course, means that

188 00:09:58:15 00:10:01:13
the movement of people
and goods around the world...

189 00:10:01:17 00:10:03:06
we end up with cheaper things.

190 00:10:03:16 00:10:05:15
And these all remain in place,

191 00:10:05:17 00:10:10:07
but I think for the first time in 30 years,
we are seeing some signs

192 00:10:10:09 00:10:13:03
that perhaps workers

193 00:10:13:14 00:10:17:04
who have done very badly out of capitalism
for the past 30 years

194 00:10:17:15 00:10:21:14
might be taking back some control in a way

195 00:10:21:16 00:10:24:05
of the price of wages.

196 00:10:24:15 00:10:26:09
And we see this from Biden.

197 00:10:26:11 00:10:31:23
Biden's talking about a \$15 an hour
minimum wage in the United States,

198 00:10:32:01 00:10:35:19
and at the moment it's \$7.25.

199 00:10:36:05 00:10:39:01

So wages are going up slightly in the US,

200 00:10:39:03 00:10:42:09
or dramatically
for some of the lowest paid workers,

201 00:10:42:18 00:10:44:19
so that kind of thing is going on,

202 00:10:44:21 00:10:47:07
and then we're also seeing
the rise of populism as well.

203 00:10:47:09 00:10:51:12
And you see this with the rise
of the far-right in France,

204 00:10:51:14 00:10:53:17
you see this with perhaps Brexit,

205 00:10:54:00 00:10:56:20
even things like the European Super League
in football,

206 00:10:57:05 00:11:00:15
fan power, people power can change things.

207 00:11:00:17 00:11:04:16
And maybe people who have done badly
out of capitalism for 30 years

208 00:11:05:01 00:11:07:21
are starting to realise
that they have some power

209 00:11:07:23 00:11:09:09
to demand higher wages.

210 00:11:09:11 00:11:13:03
So, for me, the one thing I look at
as a bond investor that I worry about...

211 00:11:13:19 00:11:16:19
I think it's fair.
I'm not saying it's a bad thing.

212 00:11:16:21 00:11:19:11
But the thing as a bond investor
I would worry about

213 00:11:19:20 00:11:23:10
is if wage inflation starts to go up and up

214 00:11:23:16 00:11:25:02
and that will be what the Federal Reserve

215 00:11:25:04 00:11:27:08
and the Bank of England

will be worried about as well.

216 00:11:27:13 00:11:31:03
If wages start outstripping inflation,

217 00:11:32:00 00:11:34:17
then you start worrying about
the same environment

218 00:11:34:19 00:11:37:11
that we saw in the early 80s or 70s

219 00:11:37:17 00:11:42:02
where wage inflation led to price inflation,
and we have this spiral upwards.

220 00:11:43:09 00:11:45:13
So we've had a question come in...

221 00:11:47:00 00:11:49:15
It's following on
from what you've been talking about

222 00:11:49:17 00:11:50:15
and obviously inflation,

223 00:11:50:20 00:11:54:05
and it's around how safe
are fixed income investments

224 00:11:54:07 00:11:57:17
in the current environment,
and what are the biggest threats?

225 00:11:58:20 00:12:01:13
And where are the opportunities
for investors to make money

226 00:12:01:22 00:12:03:06
by investing in fixed income?

227 00:12:04:01 00:12:07:02
Fixed income investors, as I say,

228 00:12:07:04 00:12:11:18
have had 30 years
of government bond yields falling.

229 00:12:11:20 00:12:13:18
And if you've been a bond investor
over that time,

230 00:12:13:20 00:12:17:15
as you know, as bond yields fall,
the prices of bonds go up,

231 00:12:17:19 00:12:22:01
so on average returns have been

spectacular for fixed income investors

232 00:12:22:03 00:12:26:12
whether that's been in government bonds,
investment grade corporate bonds,

233 00:12:26:14 00:12:28:15
emerging market, high yield.

234 00:12:28:20 00:12:30:14
Everything has done well.

235 00:12:30:23 00:12:34:06
And actually the same thing is true
for other asset classes as well,

236 00:12:34:08 00:12:37:21
because what we see,
as government bond yields fall,

237 00:12:38:12 00:12:42:00
that makes equities look
more attractive as well

238 00:12:42:02 00:12:45:08
because equity dividends have a yield

239 00:12:45:10 00:12:47:09
that suddenly looks really high

240 00:12:47:11 00:12:49:04
and interesting to investors.

241 00:12:49:15 00:12:54:22
So I think the biggest worry for markets
in general is if we see

242 00:12:55:06 00:12:59:14
the long-dated US Treasury bond yields
start rising dramatically from here...

243 00:12:59:16 00:13:01:02
And at the moment, looking at my screen,

244 00:13:01:04 00:13:04:20
it's about 2.5% or a bit under 2.5%.

245 00:13:05:00 00:13:07:21
If that went up to three, four, five percent

246 00:13:08:12 00:13:12:06
then you'd probably see
all bond asset classes reprice lower.

247 00:13:12:13 00:13:15:20
You'd see lower falling capital values
in bonds.

248 00:13:15:22 00:13:21:18
But you would also see falling capital values
in equities and other assets too.

249 00:13:21:20 00:13:25:00
So I think there are risks for bond investors
at the moment,

250 00:13:25:02 00:13:29:09
and that means that it's really important
when you think about your bond allocations

251 00:13:29:11 00:13:33:06
to think, how can I protect a bond portfolio

252 00:13:33:08 00:13:35:18
against rising levels of inflation?

253 00:13:35:20 00:13:37:16
And there are things that you can do.

254 00:13:37:23 00:13:42:12
And so I'd say inflation-linked bonds
will offer you some protection.

255 00:13:42:18 00:13:45:10
Inflation-linked bonds,
you have a gilt market

256 00:13:45:12 00:13:51:04
that has linkers
where the coupon adjusts higher

257 00:13:51:06 00:13:52:12
if inflation goes up.

258 00:13:52:22 00:13:54:21
You have floating rate bonds

259 00:13:55:03 00:13:58:02
where the coupon goes up
if interest rates go up.

260 00:13:58:04 00:14:03:15
And that's a really good protection
against central banks hiking interest rates.

261 00:14:03:17 00:14:07:12
For instance, M&G has
a floating rate high yield fund

262 00:14:07:14 00:14:10:17
where the coupons will go up
if interest rates go up.

263 00:14:11:05 00:14:12:11
Then there are other things you can do.

264 00:14:12:13 00:14:14:01
You could invest in currencies

265 00:14:14:19 00:14:19:10
that might do well if interest rates change
or if inflation comes back,

266 00:14:19:20 00:14:21:09
you can invest in the type of companies

267 00:14:21:11 00:14:24:16
that do well in an inflationary environment,

268 00:14:24:22 00:14:27:22
perhaps linked to commodities,
or supermarkets

269 00:14:28:00 00:14:30:10
or other companies
that can adjust their prices,

270 00:14:30:18 00:14:33:21
and then you could look at things
like emerging market bonds

271 00:14:33:23 00:14:39:03
where the kind of big structural things
going on there might be different

272 00:14:39:05 00:14:43:20
than in developed older markets
like the Eurozone or the UK.

273 00:14:44:07 00:14:48:13
And if you look at ten year gilt yields
at the moment in the United Kingdom,

274 00:14:48:15 00:14:49:20
they're below 1%.

275 00:14:50:03 00:14:55:23
But if you were to look at ten year yields
in Mexico, or in Russia or in parts of Asia,

276 00:14:56:01 00:14:59:04
then those yields are obviously
three or four times higher

277 00:14:59:06 00:15:00:07
than you can get in the UK,

278 00:15:00:09 00:15:02:08
and that gives you some protection

279 00:15:02:10 00:15:05:03
against inflation
or higher interest rates too.

280 00:15:05:13 00:15:08:11
So the good thing about bond markets,

281 00:15:08:13 00:15:12:03
bond markets are way bigger
than equity markets.

282 00:15:12:11 00:15:15:02
There are lots
of different types of bonds out there,

283 00:15:15:10 00:15:18:04
and you can always find different
types of bonds,

284 00:15:18:06 00:15:19:14
different categories of bonds,

285 00:15:19:23 00:15:22:14
that behave differently
in different scenarios.

286 00:15:22:18 00:15:24:21
So if you believe that deflation is coming,

287 00:15:24:23 00:15:28:13
and actually when we get out of 2021,

288 00:15:28:15 00:15:32:15
this looks more like the Great Depression
than the roaring 20s,

289 00:15:32:17 00:15:35:19
and that's the great debate at the moment...

290 00:15:35:21 00:15:38:08
If you believe in depression and deflation,

291 00:15:38:10 00:15:41:17
then you buy long-dated gilts
and they'll do very well in that environment.

292 00:15:42:03 00:15:43:15
If you believe the opposite,

293 00:15:43:17 00:15:45:01
then you might want to own

294 00:15:45:03 00:15:48:01
inflation-linked bonds, emerging markets
and high yield,

295 00:15:48:07 00:15:49:22
so plenty of flexibility.

296 00:15:50:00 00:15:54:22
I think a lot of the M&G range, and indeed
Parit's team and what they can do,

297 00:15:55:14 00:15:58:04
having the asset allocation ability to move

298 00:15:58:13 00:16:03:12
out of different sensitivities to inflation
is going to be a key differentiator

299 00:16:03:14 00:16:06:05
for us at M&G compared to our competitors

300 00:16:06:07 00:16:09:16
in what we're able to do
if inflation does make a comeback.

301 00:16:10:19 00:16:13:08
And so...

302 00:16:15:18 00:16:19:02
There is an opportunity you're saying
to find real yields out there

303 00:16:19:04 00:16:21:18
in the bond market across Asia

304 00:16:21:20 00:16:26:14
and there are plenty of opportunities
to tilt towards those real yields

305 00:16:27:06 00:16:29:02
rather than just relying on something

306 00:16:29:04 00:16:32:01
that obviously isn't giving you
the reward at the moment?

307 00:16:32:21 00:16:33:21
Yes.

308 00:16:35:00 00:16:39:08
Emerging market bonds have got
the highest real yields in in the world.

309 00:16:39:20 00:16:42:09
Real yield is the inflation-adjusted yield.

310 00:16:42:11 00:16:46:11
The underlying yield on emerging market
bonds are way higher than you can get

311 00:16:46:13 00:16:49:18
on investment grade corporate bonds
or high yield bonds,

312 00:16:49:20 00:16:51:13
let alone government bonds.

313 00:16:52:01 00:16:54:16

Obviously, there are
some good reasons for that.

314 00:16:54:19 00:16:58:20
If you look at what has gone on in Russia
with sanctions

315 00:16:58:22 00:17:02:13
around the political instability there
and corruption,

316 00:17:03:01 00:17:06:03
or you look at Brazil

317 00:17:06:05 00:17:11:05
and Bolsonaro's terrible response
to Coronavirus

318 00:17:11:07 00:17:15:06
and they're still having 2000 deaths a day
in Brazil,

319 00:17:15:08 00:17:18:08
and that has a big impact
on the economics and political stability.

320 00:17:19:09 00:17:23:08
You look at other areas of the world,
India, similar situation.

321 00:17:23:20 00:17:27:19
So there are good reasons
around both political risk,

322 00:17:27:21 00:17:33:17
the risk of military coups, or sanctions,
or corruption and those sorts of things,

323 00:17:34:01 00:17:35:02
and economic risk,

324 00:17:35:04 00:17:40:02
perhaps some of those countries have
high reliance on commodity prices...

325 00:17:40:04 00:17:42:04
And at the moment,
commodity prices are doing well,

326 00:17:42:06 00:17:43:17
so they are doing well,

327 00:17:43:19 00:17:48:06
but go back a year
and people didn't want copper and oil

328 00:17:48:12 00:17:49:12
in the same way.

329 00:17:49:18 00:17:54:02
So there are different factors
when you think about emerging markets

330 00:17:54:21 00:17:56:02
on the negative side

331 00:17:56:12 00:17:59:00
that make you fearful
about investing in them.

332 00:17:59:16 00:18:02:12
But when you take a step back from that
and say,

333 00:18:02:14 00:18:05:23
"Yeah, it's right to be fearful
about investing in emerging market bonds,

334 00:18:06:01 00:18:07:23
or indeed emerging market equities,

335 00:18:08:16 00:18:11:18
but you do get paid for that volatility".

336 00:18:11:20 00:18:13:07
And there are some positives too.

337 00:18:13:09 00:18:16:07
If you went back 20 or 30 years ago,

338 00:18:17:02 00:18:23:04
the rule of law in emerging market countries
was way weaker than it is today,

339 00:18:23:06 00:18:25:03
the strength of their institutions...

340 00:18:25:13 00:18:29:02
Did they care about inflation?
Did they have independent central banks?

341 00:18:29:21 00:18:33:00
All of these things were way weaker
20 years ago.

342 00:18:33:02 00:18:36:15
Today, you look at inflation trends
in emerging markets,

343 00:18:36:17 00:18:40:13
inflation is converging
towards developed market levels

344 00:18:40:15 00:18:42:18
because that was always the thing
that people worried about.

345 00:18:43:03 00:18:47:21
They associated emerging markets
with hyperinflation.

346 00:18:47:23 00:18:49:19
And that's obviously true of Argentina.

347 00:18:50:01 00:18:54:06
If you read the papers today,
Argentina has banned exports of beef

348 00:18:54:17 00:18:59:07
because it has hyperinflation
again domestically

349 00:18:59:14 00:19:03:20
and it wants to drive down the price of beef
for consumers in Argentina.

350 00:19:03:22 00:19:05:20
So, these things are always going
to be with us,

351 00:19:05:22 00:19:11:03
but, generally, emerging market economies
have a lot less government debt than we do.

352 00:19:11:06 00:19:15:07
Our debt to GDP ratio in the UK is 100%.

353 00:19:15:09 00:19:18:08
We have as much debt
as the size of our economy,

354 00:19:18:19 00:19:20:22
whereas if you go
to an emerging market country now

355 00:19:21:00 00:19:22:11
it's something like 60%,

356 00:19:22:17 00:19:28:08
so almost half as much debt as we have,
yet their credit ratings are much lower.

357 00:19:28:20 00:19:30:23
As I said,
their inflation rates are coming down,

358 00:19:31:06 00:19:33:06
they also have better demographics
than we do.

359 00:19:33:09 00:19:37:02
A lot of people on this call will, like me,
have grey hair,

360 00:19:37:04 00:19:40:16
and the average age in the UK
is creeping up and up,

361 00:19:40:18 00:19:43:04
as it is in Europe and the United States.

362 00:19:43:06 00:19:48:04
The average age in Africa, or Asia,
or Latin America might be

363 00:19:48:06 00:19:51:19
20 years younger
than it is in the Western world.

364 00:19:51:21 00:19:56:09
And that means their potential to grow
and be dynamically growing

365 00:19:56:18 00:19:58:01
is way higher than we have.

366 00:19:58:03 00:20:01:06
And so lots of good things to say
about emerging markets.

367 00:20:01:13 00:20:04:14
But every now and then,
one of them will default.

368 00:20:04:16 00:20:07:06
And we have issues in Colombia
at the moment.

369 00:20:07:08 00:20:09:19
Colombia got downgraded to junk last night

370 00:20:10:06 00:20:14:08
because of political unrest
around a new tax regime there.

371 00:20:14:19 00:20:17:09
And so you've got to be aware
that all these things are out there,

372 00:20:17:15 00:20:19:22
which means you need to be
super diversified

373 00:20:20:07 00:20:23:16
and super aware of the dynamics.

374 00:20:23:18 00:20:27:19
Our head of Emerging Market Debt
at M&G is called Claudia Calich.

375 00:20:28:01 00:20:31:05
I hope that one of these days...

Get her along to one of these calls.

376 00:20:31:07 00:20:33:17
I think she's one of the most
highly-respected

377 00:20:33:21 00:20:36:09
emerging market fund managers
in the world.

378 00:20:37:04 00:20:39:14
It's a real centre of excellence at M&G...

379 00:20:40:06 00:20:42:02
that we're really very proud of.

380 00:20:42:12 00:20:45:15
And that will help us get through
these situations

381 00:20:45:17 00:20:48:01
but allow us to have some higher yields

382 00:20:48:03 00:20:49:20
than perhaps some of our peers do.

383 00:20:50:02 00:20:52:01
And again, I don't know if Parit talked
about this,

384 00:20:52:03 00:20:54:13
but Claudia runs

385 00:20:54:15 00:20:58:22
the emerging market portion of the funds

386 00:20:59:00 00:21:00:20
that you guys will be invested in.

387 00:21:01:04 00:21:03:06
Yeah, that's absolutely true.

388 00:21:03:14 00:21:06:05
Jim, just following on
because I'm conscious of time,

389 00:21:06:21 00:21:10:02
can we just do a quick run through
of some of the main areas

390 00:21:10:04 00:21:13:08
that our clients and advisers
that are listening to this

391 00:21:13:10 00:21:15:06
will be invested in already.

392 00:21:15:14 00:21:17:18

So, investment grade bonds...

393 00:21:18:00 00:21:21:06
Typically, historically,
rising rates can bring challenges

394 00:21:21:08 00:21:23:10
for the investment grade
corporate bond market

395 00:21:24:09 00:21:26:20
because they've got
a slightly longer duration

396 00:21:26:22 00:21:30:01
within that asset class.

397 00:21:30:03 00:21:33:12
But we've seen negative returns in Q1...

398 00:21:34:23 00:21:39:20
but there's not been any real outflows
from the retail investment market.

399 00:21:40:14 00:21:44:03
What do you see for investment grade
corporates going forward

400 00:21:44:05 00:21:45:04
in the next 12 months?

401 00:21:46:07 00:21:49:10
I think the very good news,
two bits of good news:

402 00:21:49:12 00:21:53:14
One, we don't expect the Fed to be hiking
over the course of the rest of the year.

403 00:21:53:16 00:21:55:21
Bond market yields generally have gone up,

404 00:21:56:09 00:21:59:02
but to a level where there probably is
some value again.

405 00:21:59:04 00:22:01:18
They did get really expensive
at the end of last year,

406 00:22:01:20 00:22:06:12
and it's probably right that they sold off
somewhat at the start of 2021.

407 00:22:06:23 00:22:08:13
So that's probably the good news,

408 00:22:08:15 00:22:10:22

we don't think the Fed jumps the gun

409 00:22:11:00 00:22:13:18
and tries to put a break on this economy yet.

410 00:22:14:10 00:22:16:15
The second really good piece of news...

411 00:22:16:17 00:22:19:13
This is different
to the global financial crisis

412 00:22:19:21 00:22:21:10
in one significant way.

413 00:22:21:20 00:22:25:02
Go back to the GFC
and you'll all remember running around,

414 00:22:25:04 00:22:26:16
the banks were going bust,

415 00:22:27:02 00:22:28:12
companies were going bust.

416 00:22:29:11 00:22:31:20
This time round, nothing has gone bust.

417 00:22:31:22 00:22:34:15
The default rate is incredibly low.

418 00:22:35:09 00:22:37:21
If someone showed me...

419 00:22:39:11 00:22:43:12
out of nowhere,
the unemployment rate going up to 10%,

420 00:22:43:16 00:22:45:12
deflation,

421 00:22:45:14 00:22:51:06
the fact the UK economy is 8% smaller
than it was a year ago still,

422 00:22:51:12 00:22:53:14
and said, "what do I think the default rate
is going to be

423 00:22:53:16 00:22:55:05
in investment grade corporate bonds?"

424 00:22:55:13 00:22:59:06
You'd be thinking,
"Maybe two, three four, 5%".

425 00:22:59:08 00:23:03:08
In fact, it's pretty much zero,

and even in high yield, it's below 2%,

426 00:23:04:05 00:23:07:12
whereas you might have expected
that to be more like five to 10%.

427 00:23:07:21 00:23:10:21
So companies are not going bust,

428 00:23:10:23 00:23:13:18
and that's partly
because governments have stepped in

429 00:23:14:16 00:23:16:11
and offered them emergency loans.

430 00:23:16:17 00:23:20:13
The central banks have stepped in
and offered them cheap money,

431 00:23:20:15 00:23:22:13
free money, free loans,

432 00:23:22:18 00:23:24:03
they've bought their corporate bonds.

433 00:23:24:05 00:23:27:22
The corporate bond market in 2008, 2009,

434 00:23:28:06 00:23:30:15
took probably two years
to get back to normal

435 00:23:30:17 00:23:32:22
in terms of issuance coming through again.

436 00:23:33:10 00:23:36:01
This time round,
the corporate bond market was...

437 00:23:36:15 00:23:40:19
I left the office a year ago in March,

438 00:23:40:21 00:23:43:15
I think was my last day in the office
before lockdown.

439 00:23:44:01 00:23:46:16
The corporate bond market closed down
for about a week.

440 00:23:46:18 00:23:50:07
It was already reopened
before we went back into lockdown

441 00:23:50:09 00:23:52:12
because the Bank of England had said,

442 00:23:52:21 00:23:57:13
"We're re-opening our bond buying
programme for corporate bonds".

443 00:23:57:15 00:24:03:19
And all these schemes and so forth
made it OK for companies.

444 00:24:03:21 00:24:06:13
So I think those two things
are really important.

445 00:24:07:00 00:24:09:04
Rates aren't going to go up dramatically

446 00:24:09:06 00:24:11:21
unless we do have
this huge inflation breakout

447 00:24:11:23 00:24:14:23
which I think is a possibility, but unlikely.

448 00:24:15:10 00:24:19:05
If rates do go up dramatically
that will be bad news for corporate bonds,

449 00:24:19:08 00:24:21:19
but I think that's still a tail risk
at this point.

450 00:24:22:08 00:24:24:20
And then I don't think governments
are going to unwind

451 00:24:24:22 00:24:28:06
all these support mechanisms
for corporates.

452 00:24:28:15 00:24:31:11
And remember growth is incredibly strong
as well at the moment,

453 00:24:31:13 00:24:34:11
thanks to this rebound
and the unlocking of the economy.

454 00:24:34:18 00:24:37:07
So I think Ryanair did
a bond issue yesterday

455 00:24:37:09 00:24:43:10
because it knows that in a month or so,
things are going to be supercharged,

456 00:24:43:12 00:24:45:16
people are wanting to go abroad again,

457 00:24:45:18 00:24:50:03

so I think this is a different environment
to 2008, 2009.

458 00:24:50:05 00:24:52:20

And as a result of that,
you shouldn't really...

459 00:24:53:09 00:24:58:00

It's unlikely that we'll see the sell offs
in corporate bonds that we saw back then.

460 00:24:58:02 00:25:00:23

We saw them this time round,
but it only lasted about a month

461 00:25:01:04 00:25:02:22

and then things got back to normal.

462 00:25:03:22 00:25:06:09

Great. And just quickly,

463 00:25:06:19 00:25:09:03

the high yield market has been awash
with liquidity

464 00:25:09:10 00:25:15:06

and you're saying
that you don't expect defaults,

465 00:25:15:08 00:25:17:02

is that the same within the high yield market

466 00:25:17:04 00:25:19:10

and are there opportunities in high yield
at the moment?

467 00:25:20:09 00:25:23:23

I mean, I don't like high yield particularly,
but I've been wrong.

468 00:25:24:04 00:25:27:15

High yield has continued to perform strongly

469 00:25:28:16 00:25:32:05

partly because, as we've talked about,
defaults are incredibly low.

470 00:25:32:15 00:25:34:21

So, again, it's one of these things.

471 00:25:34:23 00:25:36:02

I don't expect a panic,

472 00:25:36:04 00:25:40:03

but I also don't think I'm getting paid
enough yield

473 00:25:40:05 00:25:42:15

to be invested in high yield bonds
at the moment,

474 00:25:42:17 00:25:45:23
so I'm not expecting defaults
to go up dramatically,

475 00:25:46:07 00:25:49:11
but remember when you buy
either a corporate bond or a high yield bond,

476 00:25:49:22 00:25:53:09
the extra yield you get is
not just about default risk.

477 00:25:53:11 00:25:55:05
It's also about liquidity risk.

478 00:25:55:13 00:25:59:18
And I think that high yield bonds
are so tightly priced at the moment

479 00:25:59:20 00:26:04:11
that I'm probably getting paid enough
to compensate me for likely defaults,

480 00:26:04:17 00:26:06:04
but I don't think I'm getting paid enough

481 00:26:06:15 00:26:11:16
for the fact that if liquidity disappears,
these things will underperform.

482 00:26:11:22 00:26:13:08
And so, for that reason,

483 00:26:13:10 00:26:15:00
I'm a bit underweight
in the high yield market.

484 00:26:15:16 00:26:17:10
OK. One very last question

485 00:26:17:12 00:26:21:16
and then I'm going to move on
to quickly ask you about ESG.

486 00:26:22:23 00:26:27:09
Do you feel developed market
government bonds sovereigns still provide

487 00:26:27:11 00:26:30:04
risk diversification, given where they are?

488 00:26:32:00 00:26:36:17
A little bit, but less than most people
on this call will be used to.

489 00:26:36:19 00:26:38:13
If you went back a few years ago,

490 00:26:40:00 00:26:42:11
the so called 60/40 portfolio

491 00:26:42:13 00:26:47:00
where you've got equities in one bucket
and bonds in the other bucket,

492 00:26:48:04 00:26:50:10
depending on how old your clients are,
etcetera,

493 00:26:51:21 00:26:54:20
what you would expect is,
if equities were doing really well,

494 00:26:55:02 00:26:57:15
bonds would be doing badly and vice versa.

495 00:26:57:17 00:26:59:12
There was a kind of balancing mechanism,

496 00:26:59:14 00:27:02:09
a diversification
between bonds and equities.

497 00:27:02:19 00:27:06:14
What we've seen over the past two years
or so and maybe longer actually,

498 00:27:07:00 00:27:10:11
is that that diversification is
no longer so powerful

499 00:27:10:13 00:27:14:14
because as central banks
have started intervening in bond markets,

500 00:27:15:01 00:27:17:17
it's almost the case that if bonds do well

501 00:27:18:03 00:27:20:18
that means that central banks
are being aggressive

502 00:27:20:20 00:27:25:10
and that gives equity investors confidence
that they are going to do OK, as well.

503 00:27:25:16 00:27:26:15
And remember we also talked

504 00:27:26:17 00:27:31:00
about equity returns being linked
to the long-term bond yield as well

505 00:27:31:07 00:27:35:01
because they are priced
using long-term bond yields.

506 00:27:35:03 00:27:36:21
And so what we've seen
over the past two years is

507 00:27:36:23 00:27:41:06
that actually bonds and equities have been
relatively well correlated.

508 00:27:41:15 00:27:46:05
And so when bonds have done badly,
equities have underperformed,

509 00:27:46:07 00:27:49:16
and when bonds have done well,
equities have done well as well,

510 00:27:49:18 00:27:52:01
so I'd be a bit cautious nowadays

511 00:27:52:03 00:27:56:16
about putting too much weight
on the negative correlation

512 00:27:56:18 00:28:00:23
because if the Fed were to hike
by 2% tomorrow,

513 00:28:01:10 00:28:02:10
bonds would sell off,

514 00:28:02:17 00:28:04:07
equities will also sell off.

515 00:28:05:02 00:28:07:16
So that's the kind of world
we're in at the moment.

516 00:28:07:18 00:28:11:18
The correlations are no longer
as useful to us

517 00:28:11:23 00:28:14:02
as they might be in our heads.

518 00:28:14:19 00:28:18:06
OK. I'm going to get told off by Mike
for running over for a couple of minutes,

519 00:28:18:08 00:28:21:02
but I'm going to ask this question and
we've got a couple of minutes to answer.

520 00:28:22:15 00:28:27:03
Can you just outline how important

incorporating ESG considerations is

521 00:28:27:05 00:28:30:08
into the way that your teams manage
the bond funds?

522 00:28:31:06 00:28:33:05
Yeah, we are fully integrated now

523 00:28:33:07 00:28:36:08
in how we think about ESG
into all our portfolios.

524 00:28:36:17 00:28:40:09
We published our sustainability report
this week.

525 00:28:41:12 00:28:42:23
We have goals around...

526 00:28:44:15 00:28:49:15
net zero around coal and so forth
as an asset owner as well as for our clients.

527 00:28:49:20 00:28:54:06
Some of our clients are already demanding
higher standards and exclusions,

528 00:28:54:13 00:28:59:10
for instance, sin industries
and thermal coal and so forth.

529 00:28:59:22 00:29:02:12
Other clients want us to deliver returns...

530 00:29:03:22 00:29:08:10
in a way where the assets
that we own have a higher ESG score

531 00:29:08:19 00:29:11:10
than the benchmark or than our competitors.

532 00:29:11:12 00:29:12:22
So we're fully integrated.

533 00:29:13:00 00:29:16:04
Our Credit team
under Rob Marshall and Mike Posnansky

534 00:29:16:16 00:29:20:11
are writing school cards for every company
that we invest in.

535 00:29:20:13 00:29:25:04
I think we're about 80% there
for European credit at the moment

536 00:29:25:06 00:29:27:07

and having an ESG score for it.

537 00:29:27:09 00:29:31:13
So we're not finalised, what we've got,
but I think it's best in class.

538 00:29:31:15 00:29:35:14
I doubt any of our competitors have got
anything as good,

539 00:29:35:16 00:29:37:23
anywhere near as good, even half as good,

540 00:29:38:07 00:29:41:22
as what Rob Marshall and the Credit team
have done in terms of ESG.

541 00:29:42:00 00:29:44:07
So something to be proud of at M&G.

542 00:29:44:09 00:29:47:12
And for all of you guys and girls
on the call today,

543 00:29:48:06 00:29:52:02
I think we're the best out there
when it comes to ESG in doing it properly,

544 00:29:52:10 00:29:54:10
not just giving it lip service

545 00:29:54:12 00:29:57:15
and being superficial about it.

546 00:29:57:17 00:30:00:21
We're really doing the work
and we're engaging with companies

547 00:30:00:23 00:30:04:00
to make them change for the better
when they make mistakes.

548 00:30:05:06 00:30:07:13
Jim, that's a really positive note
to finish on.

549 00:30:07:15 00:30:09:13
Thank you for your time today.

550 00:30:09:15 00:30:11:21
And what I'd like to do is...

551 00:30:11:23 00:30:14:06
if there were any questions
we didn't get to, apologies,

552 00:30:14:08 00:30:18:08
we will come back to you about those

after we finish today's event.

553 00:30:19:03 00:30:21:10
Thanks, Jim, for your time.

554 00:30:21:18 00:30:25:02
Hopefully that's given lots of people
food for thought

555 00:30:25:04 00:30:26:23
around what they're doing
within fixed income.