AJBell Investcentre

Fundamentals with Russ Mould

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Hello, I'm Russ Mould, AJ Bell's Investment Director, and welcome to Fundamentals, where I'm going to look at the single most popular Exchange-Traded Fund on the AJ Bell Investcentre platform right now, namely iShares UK Gilts 0-5 year UCITS.

[CAPTION - iShares UK Gilts 0-5 year UCITS ETF (GBP)EPIC code - IGLS SEDOL – B4WXJK7]

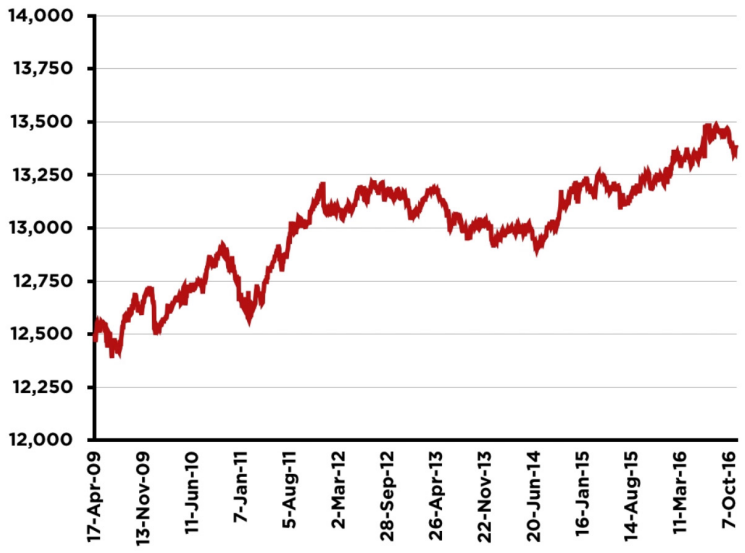
An ETF is designed to track, or mirror, the performance of the underlying assets and deliver that performance, minus any running costs.

In this case, iShares UK Gilts 0-5 year UCITS ETF uses physical – or direct – replication to provide performance, minus the product's running costs. It tracks a FTSE bond benchmark - the FTSE UK Conventional Gilts - Up To 5 Years Index, which contains sterling-denominated UK government bonds that are quoted on the London Stock Exchange and have no more than five years to maturity. Only conventional Gilts are included, so this rules out index-linkers, for example.

The ETF comes with a competitive total expense ratio of 0.2% and a 12-month yield of 0.9%. Do note that the ETF units trade at the moment at around £134 apiece.

iShares UK Gilts 0-5 year UCITS has £1 billion under management, and for those who put faith in such things it has a one-star Morningstar ranking.

This graphic here shows how the ETF has performed since launch in April 2009:



Source: Thomson Reuters Datastream

So, those are the mechanics. The question to address next is why would advisers and clients be buying right now?

Well, there are three possible reasons:

- The first is that this tracker is in some ways as close as you can get to being in cash without being actually in cash. As such, it's a convenient place to park money, eke out a bit of a yield (even after expenses) and plan what you want to do next.
- Second, October ushered in a 'risk-off' period for markets, which are now digesting the US presidential election result and still have to confront both the Italian constitutional reform referendum on 4 December and the ongoing debate in the UK over Article 50, and how and when it will be implemented and triggered.
- Third, inflation expectations have started to rise, especially in the UK, owing to the fall in the pound and the rally in oil from its below-$30 low. As a result, Governor Mark Carney declared after the Bank of England's November policy meeting that the next move in interest rates could be up or down – and not just down as he had hinted before. This tracker follows short-duration bonds and so could provide some capital protection against any rise in interest rates while still allowing clients to seek income.

In this case the ETF's portfolio has an effective duration of just 2.7 years, something which may appeal to clients who want a little income, some shelter from market volatility and flexibility to act by parking cash in an instrument that should be pretty liquid in normal market conditions.

The tracker won't appeal to everyone, not least as the yield is low and if inflation fizzles or central banks decide to do nothing then long-duration bonds could confound the doubters for a third or fourth year in a row. Advisers and clients will therefore need to ensure the ETF does fit with their overall strategy, target returns, appetite for risk and time horizon before they put any capital to work.

Thank you for watching and I look forward to seeing you next time.

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