AJBell Investcentre

Fundamentals with Russ Mould

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Hello, I'm Russ Mould, AJ Bell's Investment Director, and welcome to the latest edition of Fund-amentals, where I'll be looking at the third-best selling fund on the AJ Bell Investcentre platform at the moment, namely BlackRock Corporate Bond 1-10 Year.

[CAPTION]

BlackRock Corporate Bond 1-10 Year Fund D (Acc) ISIN - GB00B84DT147 SEDOL – B84DT14

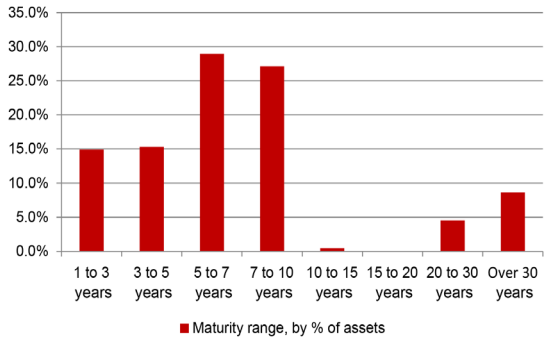
The £887 million fund seeks to provide a total return via a combination of capital growth and income by investing in fixed-income securities – bonds – issued by corporations.

It seeks to do this by closely tracking the performance of a composite benchmark, itself the product of two indices. The first is the Bank of America Merrill Lynch Sterling Corporate Securities 1-5 Year Index and the second the Bank of America Merrill Lynch Sterling Corporate Securities 5-10 Year Index.

The portfolio of bonds is a wide one. The fund has 401 holdings and the top 10 positions represent barely 8% of the assets under management – and they include debt issued by Barclays, Imperial Brands and Lloyds Banks as well as global brewer Anheuser Busch and US Bank Wells Fargo.

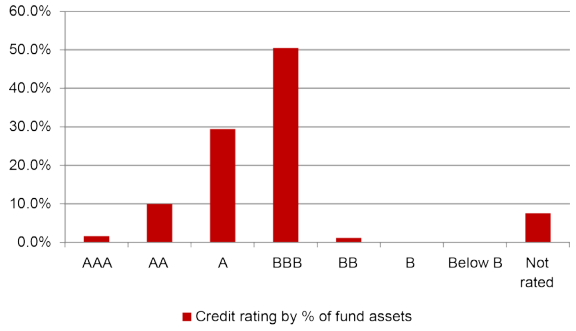
The yield is around the 3.4% mark As the name suggests the fund is designed to have a relatively short duration – as I sit here the effective duration is 4.7 years and the effective maturity 9.9 years.

The chart here shows the maturity range of the holdings, ranked by year.



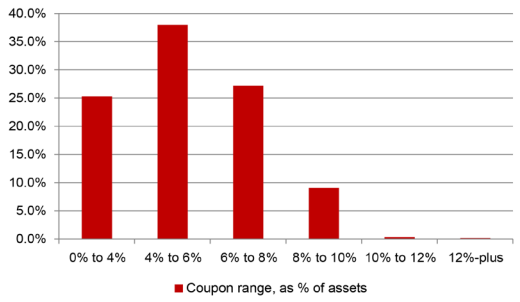
Source: BlackRock fact sheet

The next graphic shows the mix of credit quality through the portfolio. It's not surprising that there is very little AAA-rated paper here, as there are so few companies who now have that coveted top rating. However, the bulk are rated between A and BBB – in other words investment grade – with barely 9% of the holdings assessed as sub-investment grade (or high-yield or 'junk) or unrated.



Source: BlackRock fact sheet

This credit quality mix is reflected in the coupon profile across the fund, with the vast bulk offering between zero and 6%:



Source: BlackRock fact sheet

This version of the fund comes with Accumulation units so the income generated is reinvested on a semi-annual basis and the ongoing charge figure is a pleasingly low 0.17%.

So, those are the mechanics. The question is why advisers and clients are buying right now and I think there are four possible explanations:

- First, that yield of 3.4% will be more than satisfactory to some income-hunters.
- Second, interest rates on cash remain anchored at rock-bottom levels and yields on sovereign or government paper are heading deeper into negative territory in many cases. Negative interest rate policies – NIRP for short – are in many ways forcing advisers and clients toward corporate bonds whether they like it or not, if they are looking for yield but do not wish to embrace equities too wholeheartedly.
- Third, the short duration of the fund may appeal to some, given it leaves investors in the collective less exposed to capital loss, in the event interest rates start to go up at some stage. Duration measures how much a bond's price will change relative to a 1% change in interest rates and in general long-duration or high-yield bonds are the most sensitive instruments to rate changes and short-duration and low-yield bonds the least.
- Fourth, the European Central Bank has started buying corporate debt as part of its Quantitative Easing scheme, so this is creating some positive price momentum as a seemingly price insensitive buyer gets involved in the market.

This is not to say the fund will be immune to any wobbles if the Federal Reserve or any other central banks get round to hiking headline borrowing costs any time soon (or if the ECB ever turns seller). But it may offer a little more protection than those funds which have heavy weightings toward paper that has a lifespan of 10-years or more.

Some advisers and clients may just take the view that bonds are little more than return-free risk, given the yield compression we have seen in a world where low interest rates and Quantitative Easing dominate. If so they'll avoid this fixed-income collective as they will any other, but judging by fund flows some are taking the view that some exposure is still desirable and this collective may be one way of managing interest rate risk while seeking out some income.

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