AJBell Investcentre

Fundamentals with Russ Mould

December 2016

Hello, I'm Russ Mould, AJ Bell's Investment Director, and welcome to Fundamentals, where I'm going to look at one of most popular Exchange-Traded Funds on the AJ Bell Investcentre platform right now, namely iShares Global High Yield Corporate Bond ETF.

[CAPTION - IShares Global High Yield Corporate Bond UCITS ETF USD (Dist) (GBP) EPIC code - IGHY SEDOL – B81BLN7]

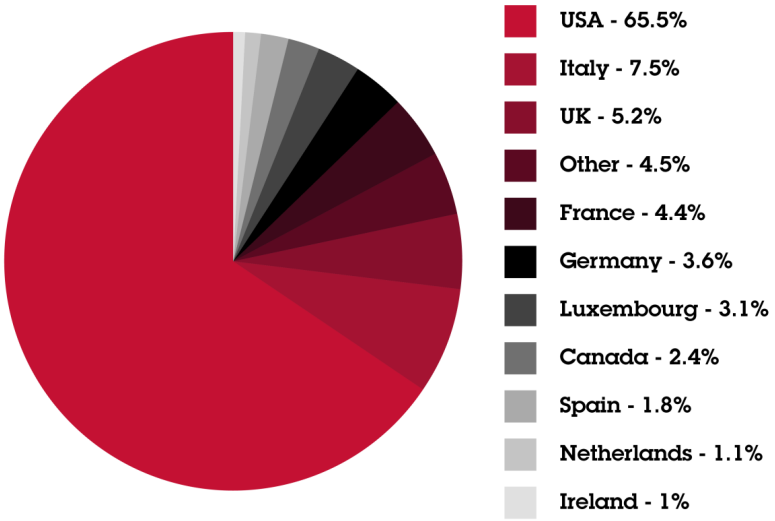
An ETF is designed to track the performance of the underlying assets and deliver that performance, minus any running costs.

In this case, iShares Global High Yield Corporate Bond uses physical – or direct – replication to provide performance.

It tracks the Markit iBoxx Global Developed High Yield Capped index, which consists of a basket of high-yield corporate bonds, ranked BB+ (or Ba1) or lower – in other words sub-investment grade. In plain English these tradeable loans have been issued by companies that have less than pristine balance sheets and probably spotty profit track records for good measure.

The ETF has over eleven hundred underlying holdings and the biggest positions are bonds issued by American data storage firm Western Digital and US telecoms firms Sprint and Frontier.

America overall represents two-thirds of the assets under management, with Italy and the UK the next largest geographic exposures, as we can see here:



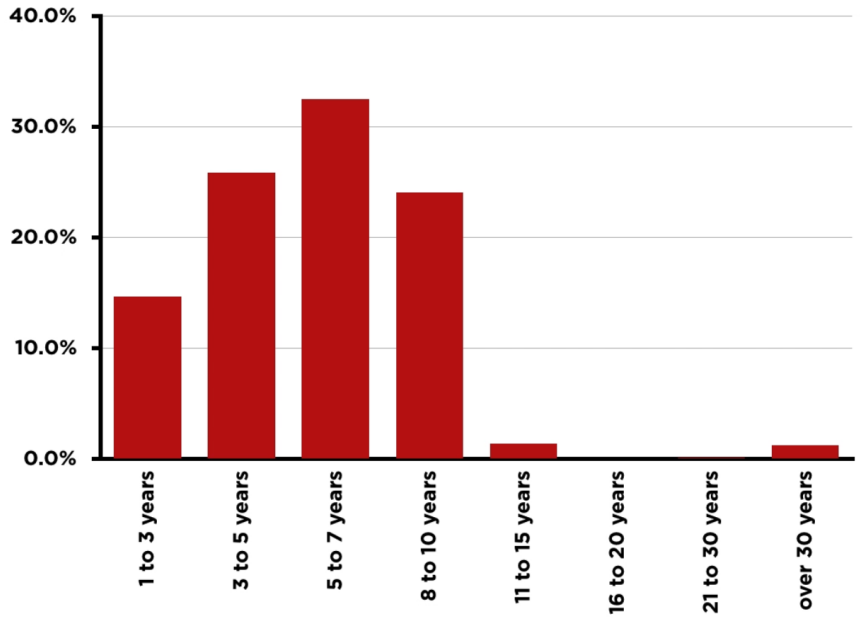
Source: Morningstar, iShares factsheet

Total assets under management come to around $530 million, or £420 million. The ETF comes with a competitive total expense ratio 0.55% and a 12-month yield of around 5%. For those who put faith in such things, it has a three-star Morningstar ranking. Do note that the ETF units trade at the moment at around £78 apiece.

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

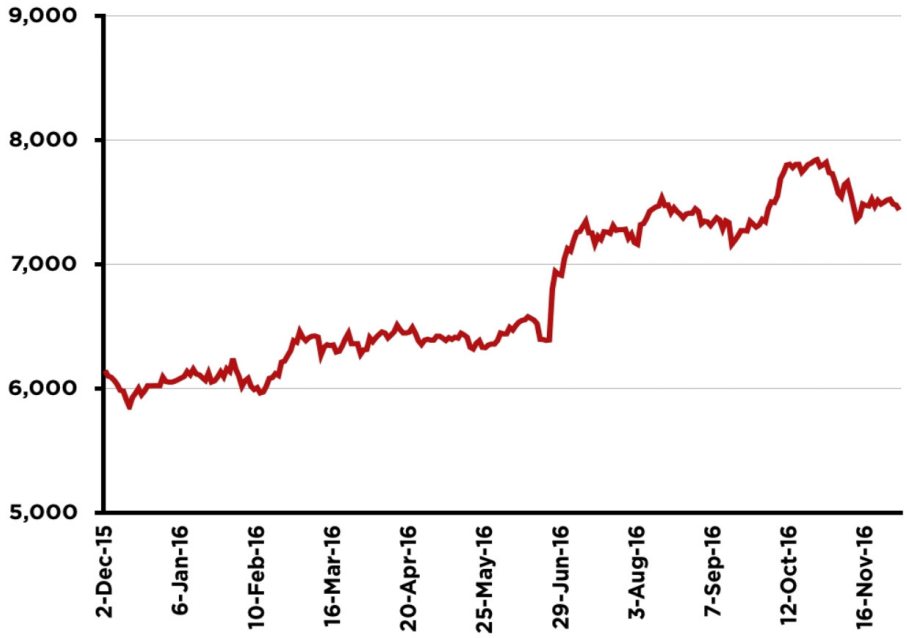
Well, I think there may be three possible reasons:

- The first is that 5% yield. Even if interest rates start to rise and Government bond yields keep rising it will take them a fair while to get anywhere near that level.
- Second, this chart shows the maturity range of the portfolio. The effective duration of the ETF's portfolio is just 3.91 years, which is relatively short and may offer some degree of capital protection in the event interest rates do start to rise.



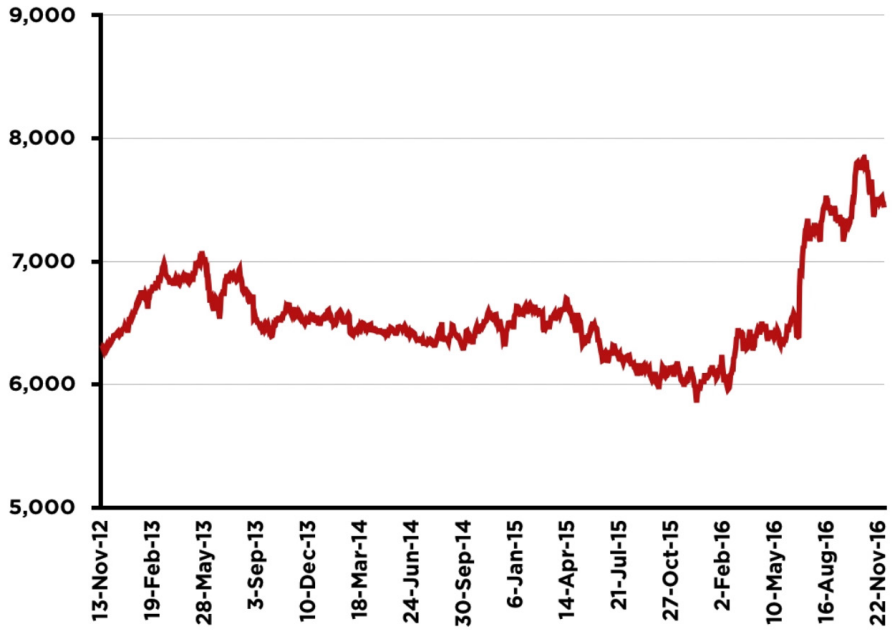
Source: Morningstar, iShares factsheet

- Third, following the election of Donald Trump as US President, growth and inflation expectations have started to rise. This is potentially good news for the high-yield – or junk – bond asset class, which can trade a lot like equities. As we can see from this chart, the ETF has put on a bit of a spurt since the autumn, although it's been a pretty solid performer anyway, helped by low interest rates, historically low default rates and that 5% yield.



Source: Morningstar, iShares factsheet

There are risks however, as the ETF's performance since launch makes clear. The last year looks good but it had been harder work previously.



Source: Morningstar, iShares factsheet

During 2013-15 the prevailing theme had been fear of recession, even deflation and that is a doomsday situation for high yield, as both scenarios make it harder for issuers to service and ultimately repay their debts. If the market loses faith in the Trump reflation trade then high yield as an asset class could take a hit, inflicting capital losses upon advisers and clients that more than outweigh the yield received.

Also note that high yield as an asset class is not necessarily that easy to trade, or liquid – yet the ETF offers liquidity and the ability to trade whenever. We have yet to see any sort of market stress but it will be a key test of the ETF mechanism if lots of advisers want to buy or sell it all at once and the underlying assets are trickier to move along at a sensible price.

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.

AJBIC/RM/T/20161214