FINANCIAL REVIEW

There's never been a better time to own bonds

Sarah Turner *Reporter*

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As a bond investor, Vimal Gor naturally leans to a more pessimistic view of the world. But he is downright enthusiastic about some of the opportunities he sees in the bond market if interest rates continue to head lower in developed markets.

"I am very bullish on bonds, even at these levels, very bullish. Probably the most bullish I have been in my entire life," says Gor.

With a career spanning 25 years to date in the UK and Australian financial markets, Gor now manages about $17 billion in bond, income and defensive strategies for Australian investment management giant Pendal.

Vimal Gor at Pendal says he's more excited about bond markets than at any time in his career. **Louie Douvis**

"It's really easy right now, you just want to be long bonds. And long bonds at the front end. That's because I believe the US economy is weaker than the consensus thinks, there's a number of things happening at the Federal Reserve, and the global economy is also much weaker than consensus," Gor says. Front end in bond market terms refers to short-term bonds that typically mature within five years.

He is not alone in his positive view on the bond market. Investors have been flocking to fixed income across the globe, including pushing the Australian 10-year government bond yield briefly below 1.5 per cent last week and below the official cash rate.

That widespread investor preference for government bonds has evolved as interest rate expectations have turned down while central banks fret about the economic outlook. The New Zealand central bank cut its cash rate in May, citing global growth concerns, and the US Federal Reserve has taken a markedly dovish turn this year.

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— Vimal Gor

There are gathering expectations for an interest rate cut in Australia as soon as Tuesday, with the Australian cash rate is widely expected to fall to 1.25 per cent when the Reserve Bank of Australia meets. A new record low would represent the first adjustment to the cash rate since the last cut in August 2016.

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At the same time, an intense debate is taking place about whether the central bank should be easing, in part due to the fact that employment remains robust. The Reserve Bank has indicated that the employment picture is at the centre of its interest rate deliberations.

Reluctant to ease

In Gor's view, if the Reserve Bank does ease on Tuesday, the central bank would be lowering interest rates reluctantly. "The RBA is reticent to cut for good reasons. Ultimately, by pulling down the interest rate, it impacts on savers and that's a negative, so there is a strong argument not to cut," he says.

The other consideration for the Reserve Bank is whether lowering the cash rate by 50 basis points – as 2019 market pricing suggests – will have much impact on the economy. "Probably not," says Gor.

Still, Gor says that while the Reserve Bank may not find the domestic arguments to lower interest rates "that compelling" that's not a reason to hold steady on rates if other central banks are easing.

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For the fund manager, the strongest reason for the Reserve Bank to cut is that other central banks are easing. "If you don't cut rates, then your currency goes up and that slows your domestic economy," he says.

Given the global backdrop, "I think that [the case to cut] is quite compelling in Australia – it's about the global environment and the relative movements in your own currency.

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"You certainly wouldn't want the Australian dollar to strengthen. You would like it to weaken and probably weaken materially," he says.

Unlike the Reserve Bank, Gor believes that the US Federal Reserve and Reserve Bank of New Zealand are willing, and able, to cut rates, and that informs his very positive view on US and Kiwi bonds.

"The front end of New Zealand and the US are the two clearest trades I can see across the world. That trade continues until US rates hit zero, which could be some time next year," he says.

Gor says that with such high debt levels around the world, and the power of monetary policy dwindling as interest rates get progressively lower, the focus will eventually firmly turn to fiscal policy.

"The handover comes when interest rates have done all the work they can do. US rates are at 2.5 per cent. In the US, a normal rate cutting cycle is over 500 basis points. So they don't have enough room. So when interest rates come towards zero and they realise that growth is still slowing, that's when you get a fiscal response.

However, such fiscal responses will likely unsettle markets with their promise of higher inflation. Gor sees an eventual progression from deflation, to low inflation and eventually higher inflation.

Real asset winners

While bonds tend to work well for investors when interest rates are falling, bonds perform terribly in times of high inflation, as do equities. Such a world would be one where investors would want to be long real assets, he says.

"But that's really the end game and being there right now probably isn't the right place because you're going to go through recession first."

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"I think that the whole environment is changing," the fund manager says, noting that financial models developed over the past 40 years may become obsolete. Gor is trying to make sure that his investment processes and the way he generates ideas and interacts with his team are primed for change in this new era.

For his part, Gor is unconvinced that financial markets are as attractive a career option as technology companies for clever young people entering the job market. The next five years are likely to be incredibly interesting, he says, but in the long run there's likely to be more government control over industry if fiscal stimulus eventuates.

"I don't know what jobs are going to be around in the next 20 years as it's so fluid right now. I think that the thing that I am trying to instil in my children is the ability to think laterally."

Brexit shambles

Gor moved to Australia from the UK about 10 years ago and says he has no regrets about the move given the country's ongoing and painful divorce from the European Union that started almost three years ago.

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>
> — Vimal Gor

"I look at it now, the complete shambles that is Brexit. The UK has destroyed itself," the British-born and raised Gor says.

"Even if they were to roll back Brexit tomorrow, the whole of the UK exists on the top end of London, which sponsors the arts, and all the money that goes through to culture, and that's why people live there.

"A lot of that top end is now leaving. Therefore you will find that cultural scene beginning to die and the whole of the UK will change over the next 10 to 20 years to a worse place. It's like seeing the decline of Rome, seeing it slowly ebb away."

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