

Introducing Alliance Trust Monthly Income Bond Fund – Video Transcript

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Fund Manager Video – Gareth Quantrill

Gareth Quantrill, Co-manager of the Fund, has 19 years' experience in managing fixed income products while specialising in credit analysis and corporate bond management. Here he gives an insight into the team's investment process.

What are the key features of your investment process?

There are three key elements for us. The first is the interest rate decision. So whether or not we want to be hedged or to take exposure to interest rates. The second will be asset allocation between investment grade credit, government bonds and high yield. The third would be the credit selection. So the individual issuers that we take exposure to and also the actual bonds within their complex of issuance that we want to take exposure to.

What is your initial asset allocation?

So the initial asset allocation of the Fund will be heavily invested in corporate bonds. Approximately 95% investment grade because we think we're at a point in the cycle where we're going to see the best returns from investment grade corporates, as profitability continues to improve, but also management of companies are still cautious and are eschewing measures of acquisition activity in keeping leverage at relatively low levels.

How do you select the holdings in the Fund?

We have a number of filters that we use to select the holdings that we take in the portfolio. Initially we use a liquidity filter to make sure that we're buying issues that are sufficiently large for us to be able to get into and out of the position and at a reasonable price. We then have a look at trying to buy the cheapest bond. So where we find an acceptable credit, the next piece of work is to essentially look at all of the bonds issued by that credit, whether they be in Sterling, Euros or indeed in Dollars; and then select the bond that has the best return potential given its position in the capital structure of the issuer.

Who does the credit research? Where do you source your ideas?

All members of the team carry out research and due diligence on the holdings that we have, with Stuart Steven and myself predominantly looking at the credit analysis and Stuart McMaster and Rod Davidson looking at interest rate exposures and asset allocation. The ideas for the Fund and the holdings in the Fund, can often be sparked from anything, whether it be a company report, a piece of analysis by one of our colleagues on the equity side, maybe something even from the research centre within Alliance Trust. Then it's a question of digging into that stimulus or that catalyst and seeing whether it's actually creating opportunity for us to invest.

How many bonds/issues will you hold in the Fund?

Typically, we are going to hold somewhere between 60-100 holdings within the portfolio. We think at that level, we get a good diversification, because clearly in a corporate bond portfolio you want to ensure that you don't have too large exposure to any individual issue, but at the same time, having sufficient focus that we're actually going to benefit from the research we conduct in choosing the cheapest bond of the name selected. In terms of how we actually select issues, it really comes down to liquidity filters, where we're looking at the issue size, also looking at the level of offers in the street and whether a bond is frequently traded and age of issue as well. Unfortunately, it's typical of the market that the older the bond the more likely it is to be tucked away in a life company or pension fund and less likely to be traded, which makes it much more illiquid.

What are the main sources of risk in the Fund and how do you manage them?

There are three main categories of risk within the portfolio. The first is corporate credit risk. So there's a potential that the companies who we lend money to, don't pay us back. We deal with this one in a couple of ways. One from being very conservative in our selection of companies; so on average we will have a portfolio of investment grade and Single-A companies, which means they're very robust and likely to repay us, but over and above that, we don't just rely on the Rating Agencies opinion, but we carry out our own due diligence as well, to ensure that companies have sufficient cash on hand and also are sufficiently profitable through the cycle to be able to repay us both interest and capital through time. The second risk that we run is one of credit spread volatility, where the market maybe trades off and so the spreads widen. This is one where we are looking to actually make money through asset allocation and trying to spot positions, where we think there is going to be a turn in valuation. So what becomes a risk is actually a source of our performance for us; and similarly with the third risk that we run in the portfolio, which is interest rate risk. We have the ability to hedge completely all of our interest rate risk, which will protect the capital of the portfolio in moments where we expect gilt yields to rise, but conversely we can actually remove those hedges in moments where we think we're going to see significant returns from falling gilt yields. It's worth saying though, at the inception of the Fund, we're expecting to have a substantial hedge on, because we think gilt yields will rise over the medium term.

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