With investors searching for yield and simultaneously facing the potential threat of rising interest rates, many have begun to question how best to manage their fixed income exposure. Investors could be well served by employing actively-managed strategies with the flexibility to invest in different parts of the fixed income market.

Fixed income yields are low compared to historical levels
- Central bank policies have driven interest rates to historical lows, and some government debt even into negative yields. This environment is particularly difficult for income-seekers looking to protect capital, as volatility can increase. This was a lesson learned in April and May of 2015, which saw many of the euro area government bonds that had negative yields swing back into positive territory.
- This makes it challenging for investors, especially those more adverse to risk—such as the elderly or retired—to generate investment income, while also leaving them vulnerable to the threat of rising rates.
- Now more than ever, investors will need to look beyond traditional “safe” fixed income sectors and adopt a more flexible approach to bond investing to address these concerns.

Search across sectors and borders for additional yield and returns
- Although yields on high-quality fixed income are extremely low, there are still areas of the bond market where investors can pick up yield.
- Investing in lower-quality credits entails risk, but the reward is a higher yield, and many issuing companies are flush with cash, which should help to keep default risk contained.
- Investors may also find opportunities in the sovereign and corporate debt of other countries, particularly emerging markets, where credit quality has improved and yields are relatively attractive.

Don’t ignore the threat of rising interest rates
- It is important for investors to remember that when yields rise, bond prices fall.
- Different areas of the bond market react differently to rising interest rates. A 1% rise in interest rates will have a much larger impact on the price of longer-maturity government bonds compared to shorter-maturity bonds, for example. Furthermore, on a total return basis, the larger coupon available on high-yield bonds provides some protection from rising interest rates.
- The duration of an investor’s overall fixed income exposure is an important consideration. Focusing on this measure of interest rate sensitivity should help investors to position their portfolios for a rising-rate environment.
Investment implications

• With interest rates at record lows and much uncertainty remaining, it is more important than ever for investors to employ a flexible approach to fixed income investing.

• When economic and monetary policy forces affect fixed income returns, active managers have the ability to flexibly adjust allocations and exposure to rising rates.