Navigating the current fixed income market with Bill Eigen

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Strategic Income Opportunities Fund is an absolute return oriented fixed income fund. We do not use leverage, for instance, to accomplish our goals. It's not a traditional hedge fund, for instance, it is a mutual fund. It does have long positions, short positions, and relative value positions in it, as it should. If you're targeting absolute return, you have to use different types of strategies to accomplish that goal. And again, our goal over market cycle is to provide absolute returns regardless of the direction of single factors in the fixed income marketplace, including the direction of interest rates or for instance of the direction of credit spreads.

The current positioning of the fund is relatively defensive right now. And you have to remember that could change over the next three, six, nine months. It all depends on how the opportunity set is changing. Like for instance, when credit spreads tend to get on the wide side, most people tend not to like them because it's generating losses for them, but that's when they become attractive. And that's typically when I'll become attracted to them.

The current environment is one characterized by very, very tight risk premiums across most fixed income sectors. Very, very low rates, which are rising now because those low rates were driven by unprecedented central bank intervention. And that's on the decline now, that's actually reversing now. So again I want to be relatively defensive, so how do I do that? Well, I'm holding a larger than the normal position in cash. I'm holding a significant allocation toward floating rate securities, which actually can benefit from rising rates. And I've cut my allocation toward more aggressive sectors of the market, including high yield. And I've actually targeted short positions in areas of the market they think are vulnerable to rising rates including emerging market debt.

Cash is the ultimate liquidity hedge. Right it means I always have liquidity available to buy things that other people are trying to get rid of, and that typically can result in downward price discovery which means I can find bargains in the marketplace. Now this has only come in fits and starts over the last couple of years. Late 2015 was the last real good opportunity I had to find, for instance, lower rated credit and bring it into the portfolio. But I think we're going to have volatility episodes going forward. And it's taking advantage of those volatility episodes that's extremely important to the fund, and always has been since the inception the fund nearly 10 years ago.

The cash position in this fund has been as low as 10% historically as high as 80%, believe it or not. Cash is a function of the opportunity set. So the lower the opportunity set threshold goes, in other words, the less attractive the opportunity set is, the higher my cash position is typically going to go. Because I'm going to wait until I'm getting paid enough to put money into those asset classes to make it worthwhile for my investors to be invested in them. That time is not now.

You're just exiting a period of unprecedented central bank intervention which brought interest rates to record low levels, artificially, I might add. And now you're on the back side of that. So obviously interest rate risk is not something I want to take. Credit spreads are extremely tight as a result of that central bank intervention. So I don't really want to take much in the way of credit risk so where am I going?

Well cash is the ultimate floating rate asset, so that's a nice place to be. Floating rate securities, including both high yield and investment grade, but really targeting investment grade floating rate securities. Nice place to be as interest rates continue to move up. And I'm also targeting areas of the market that I think are vulnerable on the short side. For instance, rising rates and a rising dollar is not good for emerging market debt. So that's been one of my key short positions that has benefited the fund over the short term for instance.
And the only other thing I'll say is that on the long side, really not targeting much in the way of longs right now. There's just not a great opportunity set there. I still do have some remaining high yield positions I still think can collect their coupon, but outside of that it's not really an area I want to focus on.

My single biggest concern going forward, particularly over the next 6 to 18 months, is interest rate risk. I don't think it's adequately priced in currently, given what the Federal Reserve is doing. I think the thing people forget about is most areas of the market are tied to interest rates, whether it's investment rate corporate bonds, mortgage backed securities, asset backed securities, higher rated high yield securities. They all react negatively to rising interest rates the correlation is very, very high. I want to avoid that correlation and continue generating uncorrelated returns like we're doing this year.

The next 10 years in fixing, I think is not going to be characterized by what the previous 10 years have brought us. The previous 10 years were characterized by financial crisis after financial crisis. The eurozone having real problems. Middle Eastern strife. Oil prices collapsing. All these horrible things that not only brought unprecedented and the central bank intervention that we've never seen before, but also brought interest rates to record low levels which generated great returns for traditional fixing them funds.

The next 10 years in my mind are not going to be characterized by that. I mean sure you're going to plenty of volatility episodes. But interest rates coming off a level of near zero right, obviously have room to move up and they are starting to move up as a result of the central bank normalizing policy which they're continuing to do right now. That's going to result in difficult returns for traditional fixed income funds and investors.

And the whole purpose of Strategic Income Opportunities Fund is to avoid that single factor risk. To diversify more and to most importantly, take advantage of volatility episodes. And that's what I look forward to over the next 10 years. Right now not a lot of stuff to do. I'm not going to force money into areas of the market that don't deserve it. That's not what I do.

What I will do though, is if when we do get volatility episodes, that's when I put my cash to work that's when the opportunity set opens up, and that's when you can find securities with very attractive return characteristics which are few and far between right now.

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