

# Pensions & Investments

The International Newspaper of Money Management

February 19, 2007

## SPECIAL REPORT: Top-performing managers

# Familiar strategies

**Fixed income:** Top spot goes to currency strategy, but high yield dominates list

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**H**igh-yield bond strategies dominated the fixed-income portion of the Morningstar Separate Account Monitor for the year ended Dec. 31, with portfolio managers citing bottom-up credit picking as a key to topping the performance rankings.

A specialty offering — the global currency program run by New York-based FX Concepts Inc. — led the top-10 list with a 12-month return of 19.80%.

FX Concepts President Philip Simotas said the ability of his firm's computer-driven model to capture a fourth-quarter "directional play," focused on a sharp weakening of the U.S. dollar, helped bolster the global currency program's full-year results. Over the first three quarters of 2006, most of the strategy's gains had come from forward positions in emerging markets currencies.

High-yield strategies took the next three spots, with Loomis Sayles & Co., Boston, delivering gains of 14.03%; Delaware Investments, Philadelphia, 13.45%; and Hyperion Brookfield Capital Management Inc., New York, 13.13%.

Cleveland-based First Fiduciary Investment Counsel Inc.'s multisector bond strategy took fifth place with a 13.10% return.

High-yield strategies filled out the

remainder of the top 10, with Western Asset Management Co., Pasadena, Calif., delivering a 12.90% return, followed by Babson Capital Management LLC, Boston, with 12.59%; Janus Capital Management, Denver, with 12.3%; BlackRock Inc., New York, with 12.13%; and Hartford Investment Management Co., Hartford, Conn., with 12.02%.

For the year ended Dec. 31, the domestic Credit Suisse High Yield index returned 11.93%, up sharply from 7.8% for the 12 months through Sept. 30. The Lehman Brothers U.S. Government/Credit index rose 3.78% for the year through December, improving upon that benchmark's gain of 3.33% for the 12 months through Sept. 30.

### Flexibility is key

Kathleen Gaffney, a manager of Loomis Sayles' high-yield full-discretion strategy, said her team has the flexibility to hold non-U.S. paper in markets such as Mexico and Brazil, which helped Loomis beat the benchmark for the year ended Dec. 31.

Ms. Gaffney called the latest year a tricky one. "With spreads so tight, you have to get your credits right," she noted. The strong performance of names such as El Paso Corp. and AES Corp., which

Loomis Sayles added in 2002, when liquidity was being squeezed, helped drive the strategy's market-beating gains for 2006, she said.

The strategy's holdings in the auto sector, a more recent addition to the portfolio over the past 18 months, also helped, with General Motors Corp. in particular "executing very well in its turnaround," Ms. Gaffney said.

Other performance leaders in Morningstar's fixed-income database cited the auto sector as well. High-yield portfolio managers had faced a dilemma in 2005, when a downgrading of bonds issued by General Motors and Ford Motor Co. found the sector suddenly accounting for well above 10% of the high-yield market.

Even with high-yield managers considerably underweighting the sector in 2006, strong performance by the paper of GM and its affiliates was a big reason the latest year exceeded most people's expectations, said Tim Rabe, a senior vice president and head of the high yield team at Delaware, whose high-yield fixed-income strategy snared the fourth-highest return in the Morningstar rankings.

In addition to autos, Mr. Rabe said the ability of his team of 16 credit analysts and three traders to focus on debt coming to market in recent years as a

result of sizable leveraged buyouts, such as Neiman Marcus Inc. and Sungard Data Systems Inc., helped drive his strategy's results. Several of those LBOs were so hefty their paper had to be priced at a discount to ensure the market absorbed it all, yielding "bigger than expected coupons," he said.

Elsewhere, some of the technology and telecom names that had detracted from Delaware's performance in the third quarter recovered during the final three months of the year. Among the bottom-up picks that worked for the strategy was its holdings of Adelphia Communications Corp.'s Century Communications bond, which Mr. Rabe added to the portfolio when its price was trading at a discount in the mid-90 cents on the dollar and which rebounded to roughly \$1.20.

### Individual issues

James W. Hirschmann, CEO of Western Asset Management, also pointed to individual issue selections in sectors such as autos and bank loans as a prime factor allowing Western Asset's U.S. high-yield strategy to beat its benchmark in what he termed a "tricky year" in the credit area.

Mr. Hirschmann and other top-performing managers said the outlook for the coming year, while challenging, doesn't look bearish for now.

"This year is going to be trickier than last year, with credit spreads as tight as they've ever been and nothing that really jumps out at you at the moment as a real opportunity," said Mr. Hirschmann. Still, with the economy "moving along nicely" and with inflation under control, the possibility that the Federal Reserve could begin easing interest rates later this year leaves Western in "the mildly positive camp," he said.

Mr. Hirschmann said the auto sector should remain interesting in 2007. Other promising sectors include paper, housing and energy.

With Loomis Sayles' overseas exposure, Ms. Gaffney said one of her perpetual concerns is "when is the carry trade" — where investors can pick up healthy gains by borrowing in low-yield currencies such as the yen or Swiss

franc and invest in higher yielding markets such as the U.S. — "going to unwind." But with ample liquidity and huge amounts of savings in Asia being recycled, together with the deflationary impact of Chinese manufactured goods, the music doesn't seem likely to end abruptly anytime soon, she said.

### 'Relatively benign'

Portfolio managers said they realize there's always some shock waiting out in left field to worry about, such as the potential for a sharp correction in high-flying equity markets. But for now, "the characteristics that dominated the market for most of 2006 should continue to hold ... making for a relatively benign environment," said Mr. Rabe. Returns for the broad high-yield market for 2007 could be below 8%, with 8% to 9% likely to count as a "great year," he said.

The top fixed-income strategy for the five years through Dec. 31 was Hyperion Brookfield's high-yield CMBS strategy — recently reclassified by Morningstar from specialty real estate — with a return of 14.27%. All returns for periods of more

than one year are compound annualized figures. Loomis Sayles' high-yield full-discretion strategy was next with a 13.11% return, followed by Delaware's high-yield offering at 12.82%; New York-based MacKay Shields LLC's high-yield strategy with 12.5%; and Babson's high-yield strategy at 12.37%.

High-yield strategies swept the top five commingled fixed-income spots for the year ended Dec. 31, led by White Plains, N.Y.-based Diversified Investment Advisors Inc., with a gain of 12.64%. Filling out the ranks were Pyramis Global Advisors, Boston, with a 12% return; New York-based Financial Management Advisors LLC, 11.69%; TCW Group, Los Angeles, 10.44%; and Newark, N.J.-based Prudential Investment Management, 8.61%.

For the five years through Dec. 31, Financial Management's high-yield strategy led the pack with a annualized gain of 10.56%, followed by Pyramis, with a 10.33% return; TCW, 9.88%; Prudential, 9.18%; and New York-based Muzinich & Co., whose high-yield bond strategy delivered a return of 8.43%. ■

### Composite U.S. taxable bond

#### TOP 10 MANAGERS – 1 YEAR

FX Concepts Glo. Currency Prog.	19.80%
Loomis Sayles High Yld Full Disc.	14.03%
Delaware High Yld	13.45%
Hyperion High Yld CMBS	13.13%
First Fiduciary Balanced	13.10%
Western Asset High Yld	12.90%
Babson High Yld	12.59%
Janus Capital Mgt High Yld	12.30%
BlackRock High Yld	12.13%
Hartford Broad High Yld	12.02%

#### TOP 10 MANAGERS – 5 YEARS

Hyperion High Yld CMBS	14.27%
Loomis Sayles High Yld Full Disc.	13.11%
Delaware High Yld	12.82%
MacKay Shields High Yld	12.50%
Babson High Yield	12.37%
FX Concepts Glo. Currency Prog.	12.23%
RiverSource High Yield	11.99%
Loomis Sayles Med. Gd. Full Disc.	11.96%
PENN Capital Core Def. High Yld	11.39%
BlackRock High Yld	11.37%

### Composite U.S. limited duration

#### TOP 10 MANAGERS – 1 YEAR

FX Concepts Glo. Currency Prog.	19.80%
Brandes Interm.	6.84%
Sage High Yld	6.78%
Phoenix Core Plus	6.56%
Steinberg Glo. Taxable	6.31%
Metropolitan West	6.12%
Western Asset Enhanced Cash	6.01%
NB 1-3 Year	5.88%
Fischer Francis Mortgage	5.88%
Smith Breeden Enhanced Cash	5.64%

#### TOP 10 MANAGERS – 5 YEARS

FX Concepts Glo. Currency Prog.	12.23%
Sage High Yld	8.30%
Brandes Interm.	6.95%
Phoenix Core Plus	6.77%
MFC Glo. Inv. Grade	5.80%
FX Concepts Dev. Mkts Currency	5.77%
Steinberg Glo. Taxable	5.45%
TCW Mortgage-Backed	5.28%
Loomis Sayles Interm. Total Ret.	5.16%
Taplin, Canida Inter.	5.06%