

What goes around comes around

Overview

Amid much talk of a 'great rotation' **Pauline Skypala** finds bonds have not been forgotten in the move to equities

The "great rotation" sounds like a dance craze; sadly it describes a more mundane movement – investors forsaking fixed income in favour of equities. There is much talk of this phenomenon, but less evidence it is really happening.

Fund flow data show money coming out of money market funds and going into both equity and bond funds, but do not support the thesis of a mass desertion of bonds. According to data provider EPFR, in the third week of February US money market funds saw their biggest outflows since the third quarter of 2011, with \$25.8bn withdrawn (\$32.1bn globally). Equity funds saw the highest net inflows, of \$8.6bn globally, but investors also ploughed \$3.5bn into bond funds.

Fund managers are cautious of dismissing the great rotation completely, but suggest that, to the extent it is happening, it is mainly a function of the search for yield.

"Last year we saw huge flows out of cash and into fixed income. This year it is more balanced – out of cash and into fixed income and equities," says Michael Krautzberger, head of euro fixed income at BlackRock. He says the latter movement is "more healthy", and in line with the aims of central banks. The zero-rate policy and bond-buying programmes the banks have pursued are designed in part to "increase the pain of holding cash" and persuade people to move up the risk spectrum, raising asset prices as they do so.

Simon Pilcher, chief executive of fixed income at M&G, says retail investors are putting money into both high income equities and bonds, but institutional investors have "an ongoing appetite for fixed income because pension funds are still de-risking".

Towers Watson, a consultancy, confirms pension funds are unlikely to re-risk by shifting assets to equities. "Some might re-risk but we have not heard of anyone discussing it," says Robert Brown, chairman of Towers Watson's global investment committee.

Tower's clients are moving money into alternative investments rather than equities, he adds, pointing to a 70 per cent increase in allocations to hedge funds and private markets over the two years to the end of 2012.

Perhaps the real question is whether the great rotation is waiting for its cue rather than taking centre stage now. The cue would be the expectation, or actual

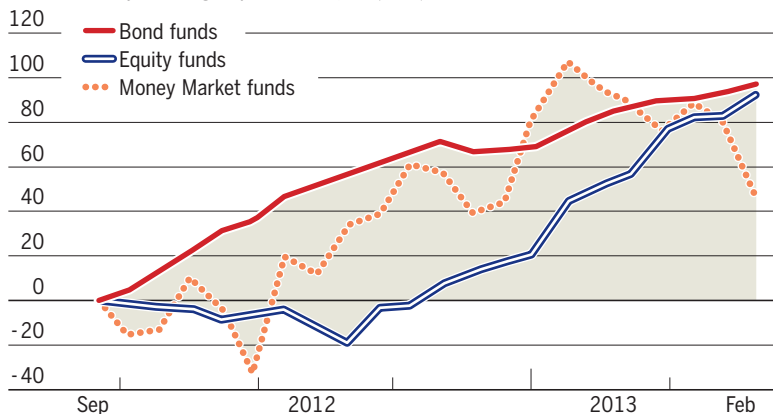


Getting around to it: the 'great rotation', to the extent that it is happening, is mainly a function of the search for yield

Dreamstime

Where the money goes

Flows into major fund groups since 4Q12 (\$bn)



Source: EPFR Global

arrival, of rising bond yields (and falling bond prices) and a sustained rise in share prices, as economic growth revives and central banks move away from the ultra loose monetary policies they have employed to fight deflation.

Equity markets rallied in the first weeks of the year, relieved that the US found a way to avoid the automatic tax increases and spending cuts dubbed the fiscal cliff. But it is not clear the rally

will be sustained.

Markets wobbled last month when it appeared Federal Reserve officials were divided over the wisdom of maintaining the bank's bond-buying programme, with some warning of the risk of overheating credit markets. However, few expect central banks to wind down their bond-buying programmes in the near future.

Adrian Grey, head of fixed income at Insight Investment,

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levels. He also notes a "growing willingness to encompass a bit more upside on inflation".

Mr Grey also argues that if a recovery gathers pace and bond yields rise too quickly, central banks will intervene to push yields back down, as higher rates could choke off the upswing. In the US, for example, higher mortgage rates could stifle the housing recovery that appears to be under way.

Mr Krautzberger of BlackRock believes 2013 will be more of a transition year than a crisis year. "We expect the healing in the economy to continue, but only because the central banks will keep their pumps going." He expects net monetary loosening globally, given the direction of travel of central banks in Japan and the UK. In Europe, there is even talk of a possible cut in interest rates, he notes.

But the healing process will not go in a straight line, he warns.

M&G's Mr Pilcher similarly expects a "gradual and steady improvement in sentiment" interspersed with occasional panics, "because the world is still a pretty

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Investing in fixed income

Local currency funds come out of shadows

Emerging markets

Big international institutions are following the hedge funds, writes **Robin Wigglesworth**

In a memorable blog post last year, Michael Riddell, a fund manager at M&G Investments, observed that emerging market bonds are a "bit like Converse shoes; it seems almost everyone I speak to owns some".

The popularity is easily explained. While the developed world is struggling with huge debts and tepid economic growth, emerging market governments and companies are in robust health. Yet despite the better fundamentals, emerging market bonds offer higher yields than developed world counterparts.

Allocations to the asset class have climbed as a result and, aside from a brief interruption caused by the financial crisis, emerging market bonds have provided investors with blistering profits.

Over the past decade, the JPMorgan EMBI Global Diversified index has produced annualised returns of almost 11 per cent. Last year the asset class brought investors gains of more than 17 per cent, causing more money to gush into EM bond funds.

Many fund managers argue that investors are still not allocating enough, given the tilt of economic power towards the developing world.

"The shift into emerging markets is happening too slowly, not too quickly,"

argues Arvind Rajan, international chief investment officer for fixed income at Prudential in the US. "These countries account for over half of global GDP, but only a small part of asset allocations."

Nonetheless, some investors and analysts are becoming concerned that the great run enjoyed by emerging market debt is due for a pause or even a reversal – at least for "hard currency" bonds, international issues denominated in euros, yen and most of all the US dollar.

These bonds have proved particularly popular in recent years because of the volatility of local currencies in the developing world. Although JPMorgan's local currency Global Diversified index has delivered annualised returns of more than 12 per cent since 2002, occasional bouts of turbulence have spooked some investors.

A "currency quake" in the autumn of 2011 proved particularly worrisome, as most emerging market currencies took a tumble

When US Treasury yields climb, as they have done in recent months, hard currency bonds suffer

owing to fears over the deepening eurozone crisis.

As a result, hard currency-focused emerging market bond funds tracked by EPFR, a data provider, attracted twice the investor inflows of local currency-dedicated funds last year.

But hard currency bonds have a big vulnerability that is causing some investors to fret. They are overwhelmingly denominated in US dollars, the dominant international funding currency for emerging market countries and companies, and use US Treasuries as a pricing benchmark.

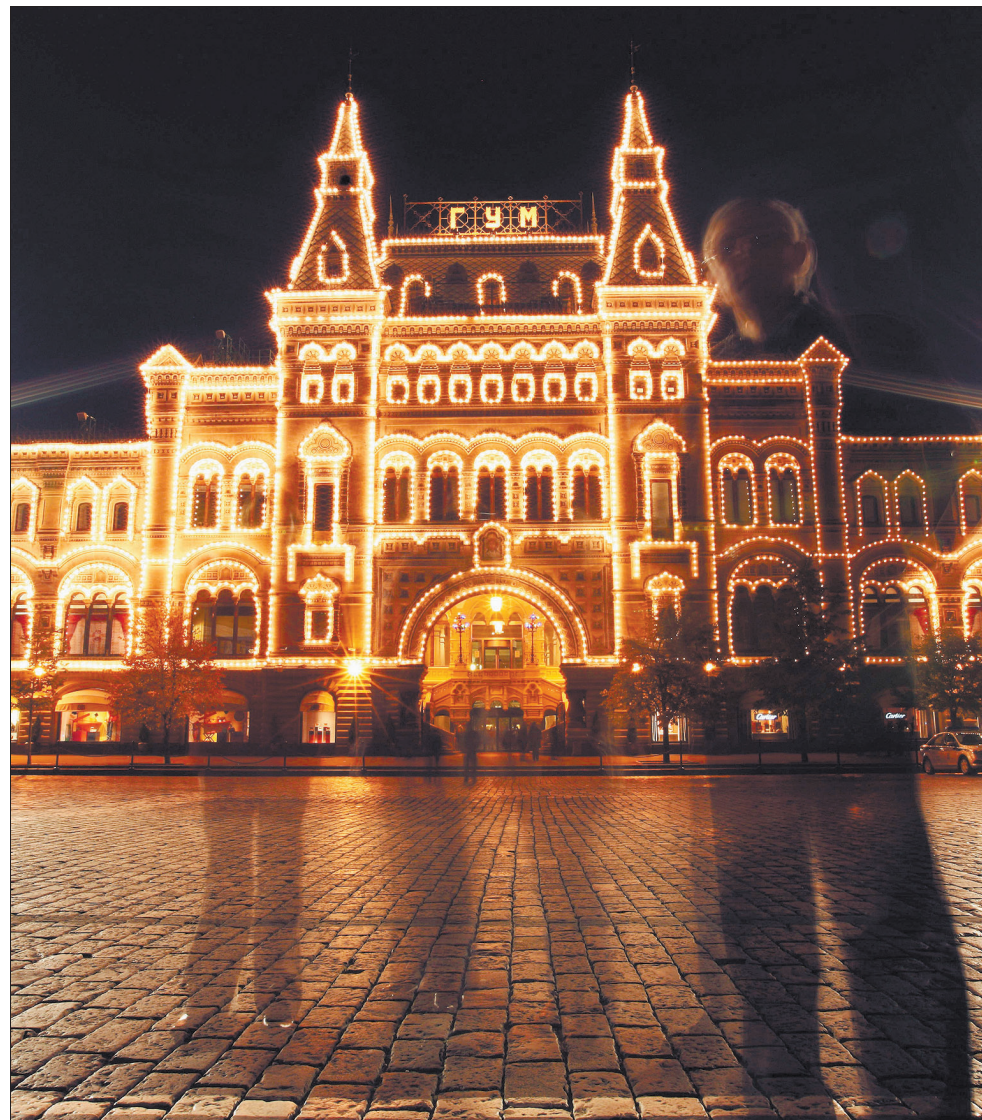
When US Treasury yields decline, as they have largely done for the past three decades, hard currency bonds benefit. When US Treasury yields climb, as they have done in recent months, hard currency bonds suffer.

The moderate back-up in the 10-year US Treasury yield to more than 2 per cent has triggered a loss of about 1.5 per cent for dollar-denominated emerging market bonds. In contrast, local currency bonds have returned more than 1 per cent so far this year, according to JPMorgan indices.

"Ultimately, the experience of January shows that it boils down to what the base rate does, and there's clearly a fear of higher rates," says one senior emerging market bond trader.

Few believe that Treasury yields are set to rise markedly any time soon, given the US Federal Reserve's dovish stance. But even slightly higher longer term rates would erode much of the gains of the safest emerging market bonds.

After a year of being overshadowed by their hard currency-focused counterparts, local currency bond funds have attracted markedly more investor cash in recent months. Traders say hedge funds were the first to shift their attention



Red square deal: Russia has been popular with international investors

Getty

towards local bond markets, but the big international institutional investors are now also following suit.

More international involvement in local bond markets is a boon to the developing world, which has been tripped up by foreign debts in the past but which often needs outside sources of capital to fund necessary investments.

Among international investors, Mexico and Russia have been two of the most popular markets – the former due to its robust economic outlook and expectations that the peso will appreciate; the latter prima-

rily because of reforms to its local bond market.

The \$100bn Russian rouble debt market late last year became connected to Euroclear, the pan-European post trade services system, which makes it far more attractive to international investors.

Barclays estimates that the market could see foreign inflows of \$30bn during the next few years.

"The Russian market becoming euroclearable was a big thing," says Peter Charles, a senior debt syndicate banker with Citigroup.

He adds: "There is a lot of

money looking for opportunities in emerging market debt these days."

Still, some investors are concerned that the party in emerging market debt may end with a painful hangover once the liquidity supplied by western central banks is withdrawn.

In his blog, Mr Riddell pointed out that, despite its cachet, Converse had to file for bankruptcy protection in 2001 and ended up being owned by Nike. Some fear that a smattering of emerging market countries – and their investors – might end up in a similar predicament in the future.

Investing in fixed income

Electronic trading route is a 'long journey'

US

Michael Mackenzie asks if telephones and personal relationships are on the way out

A shake-up beckons for corporate bond trading in the US, led by two pronounced trends that have investors, banks and technology vendors scrambling to implement solutions.

Tougher capital regulations have compelled banks to lower their inventory holdings of bonds sharply, reducing liquidity in the secondary market for bond investors and money managers, known collectively as the buy-side.

This comes as computerised trading is steadily growing across fixed income and has many in the market wondering if machines and new firms providing two-way prices for bonds and derivatives can help offset the recent drop in support from Wall Street banks.

While some university studies suggest the use of electronic trading can be the most cost-effective way to buy and sell bonds, a long journey of acceptance looms for an industry that has preferred the telephone and personal relationships with dealers for conducting business.

"We are on a journey, this won't happen overnight," says Richard Prager, head of global trading at BlackRock. "Nobody likes change, but the market will evolve."

Nearly a year has elapsed since a group of leading bond investors sat down with dealers at State Street's headquarters in Boston to discuss ways to improve trading liquidity. Not much has changed apart from the wide recognition that the market has a problem.

"There is a broad recognition that the liquidity model is broken for corporate bonds, as seen by the sharp drop in dealer inven-

ories in recent years," says Rick McVey, chief executive of MarketAxess, a leading electronic trading platform for corporate bonds. "It is alarming for investors to see the shift in dealer inventories."

The amount of bonds currently held by banks is less than a quarter of the \$235bn peak reached in 2007, according to Federal Reserve data. It means banks have fewer bonds in reserve to help facilitate a smooth market for large investors seeking to either buy or sell debt.

Working against the greater adoption of electronic trading is the fragmented and less liquid nature of corporate bonds, where each security has its own unique number, known as a Cusip. Unlike equities, where an individual stock is common to all investors, each bond issued by a company is distinct, with different coupons and prices. The lack of a generic bond works against a liquid market developing in this sector.

To date, electronic trading has mainly focused on small lots of bonds and niche areas of the market.

'Investors want a meaningful amount of anonymity when they trade on electronic systems'

Ashish Shah, head of global credit at AllianceBernstein, says the expansion of corporate-bond electronic trading will evolve in the future. "Most buy-side investors use electronic trading to manage small transactions, but that threshold will grow over time," he says.

MarketAxess has a market share of approximately 20 per cent for bond trades that are smaller than \$5m in size. That figure drops to about 5 per cent for trades of more than \$5m. This has many in the industry pushing for standardising of debt issues and creating a directory of Cusips that can facilitate electronic trading.

But much depends on companies and their corporate treasurers embracing such a change. Selling debt via standardised funding notes would sharply reduce the number of individual securities that characterise the current bond-trading environment.

Mr Prager says the real challenge is that the entire fixed income market needs to change in terms of investor behaviour, while companies should reassess

how they sell their debt. Dealers such as Goldman Sachs, Morgan Stanley and UBS have launched electronic initiatives in order to boost secondary liquidity. Meanwhile, BlackRock's alternative trading system, known as Aladdin, has also attracted attention as a venue for transacting bonds.

Working against single dealer platforms is the reluctance of large bond investors to reveal too much information. "Investors want a meaningful amount of anonymity when they trade on electronic systems," says Mr Shah.

A US-based money manager who attended last year's Boston meeting says electronic trading is not the

silver bullet, just part of the solution.

He says information leakage is the area of most concern for bond funds trying to buy or sell large amounts of bonds across electronic platforms.

"The most important thing is anonymity," he explains. "We are agnostic about the platform, you just don't want the system

being used against you."

Mr Prager envisions a market where investors provide bond prices for central limit order book electronic trading platforms and also rely on sending specific requests to other players for quotes.

"I'm optimistic that the major buy-side firms will move faster than some people think," he adds.

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Michael Krantzberger of BlackRock: bond yields more likely to go up than down

Search for yield grows more balanced

Continued from Page 15

broken place, pasted over by unorthodox monetary policy." Spain, for example, has fundamental problems that "no amount of monetary policy can solve. Yet we are in an environment where the European Central Bank has given comfort to markets that it won't allow anything uncomfortable to happen." This is a reference to the July pledge by Mario Draghi, ECB president, to do "whatever it takes" to protect the eurozone.

So are bonds a buy, a sell or a hold? Differentiation is needed at this point, although Mr Krantzberger takes issue with the view that fixed income is expensive across the board. "I'm not sure even that general remark is true," he says.

Two-year German Bunds were clearly expensive, but a recent correction sent yields 50 basis points higher, he says. "They're still not cheap, but not as expensive."

Pointing to indications from five-year forward rates, he says it is "not that

obvious" the European market is expensive further out.

"We can still find corporate bonds we like, and the covered bond area is quite interesting," he says.

The eurozone can offer interesting opportunities because it is no longer one market, as it was before the financial crisis, he adds.

Mr Pilcher says it is "hard to argue solvent government bonds are anything other than not great value", especially given central banks' aspirations to see higher inflation. "But they offer more than cash

and are likely to for some time."

Investment grade corporate bonds offer "reasonable value", but are a hold rather than a buy. In the junk bond arena there are "signs of froth", with some "OK deals and some where investors have begun to lose touch with the risks they are taking".

Investors should also consider whether yields could go down rather than up, as has happened for the past few years. "The nightmare scenario for bond bears is a replay of Japan, where even

though yields are low, it is a lot more than you get in cash," says Mr Grey at Insight. Uncertainty about such a possibility is a good argument for taking an absolute return approach to bond investing, rather than buying bond indices, he says.

Mr Krantzberger believes bond yields are more likely to go up than down.

So the bond bonanza is probably over, but leaving the relative safety of bonds for riskier equities is a step investors are still hesitant to take.



Rick McVey: inventory shift

Investing in fixed income

Demand exceeds supply in thriving sukuk market

Islamic bonds

Sharia compliant investment may be seen as a niche sector, but appetite is growing, writes **Chris Newlands**

Long before 2012 had finished, many were predicting a bumper year for the issuance of sharia-compliant bonds, or sukuk.

The assertion was that issuance of sharia-compliant paper would top the \$100bn mark before the year was through and, although that view proved to be correct, it also turned out to be significantly conservative.

According to numbers from Islamic investment research house KFH Research, total sukuk

issuance for 2012 came in at \$131bn – 54 per cent higher than the previous year. In December alone about \$8bn of sharia-compliant paper was brought to the market, which was a 61 per cent rise on 2011 figures.

Despite this jump, however, concern still lingers that the supply of sukuk, which is structured in such a way as to generate returns without infringing Islamic law, is woefully short of investor demand. Consultancy Ernst & Young says annual demand for Islamic bonds is expected to grow to \$900bn by 2017.

Jubin Jose, investment adviser to the Qatar Investment Fund, recognises this concern: “The appetite for sukuk has gone up substantially over the past four years. There is definitely a dearth of sukuk issuance versus demand.”

The exponential rise in demand is primarily a

result of the double-digit growth of the Islamic banking industry, and the increasing appetite for credible, sharia-compliant, liquid securities.

Demand comes from Islamic financial institutions, as well as fund managers and very wealthy individuals, say experts, who add that conventional institutions are also showing renewed interest in sukuk as a result of the eurozone debt crisis. The argument is that Islamic products are appealing because they are backed by real assets.

‘We have already seen General Electric, HSBC and Sime Darby tap the sukuk market’

Jason Kabel, head of fixed income at Bank of London and The Middle East, says: “It will likely be many years before supply catches up with demand. The cost associated with issuing a sukuk is holding back certain markets, especially corporates and countries outside Malaysia and the Gulf Co-operation Council.”

The costs Mr Kabel mentions include the availability of sharia-compliant assets as well as the legal and taxation frameworks in different jurisdictions. In some cases, such structures continue to render sukuk issuance uneconomical, as there is a widespread view that costs may be higher and/or structures are deemed too complex when launching sharia-compliant paper compared with mainstream bonds.

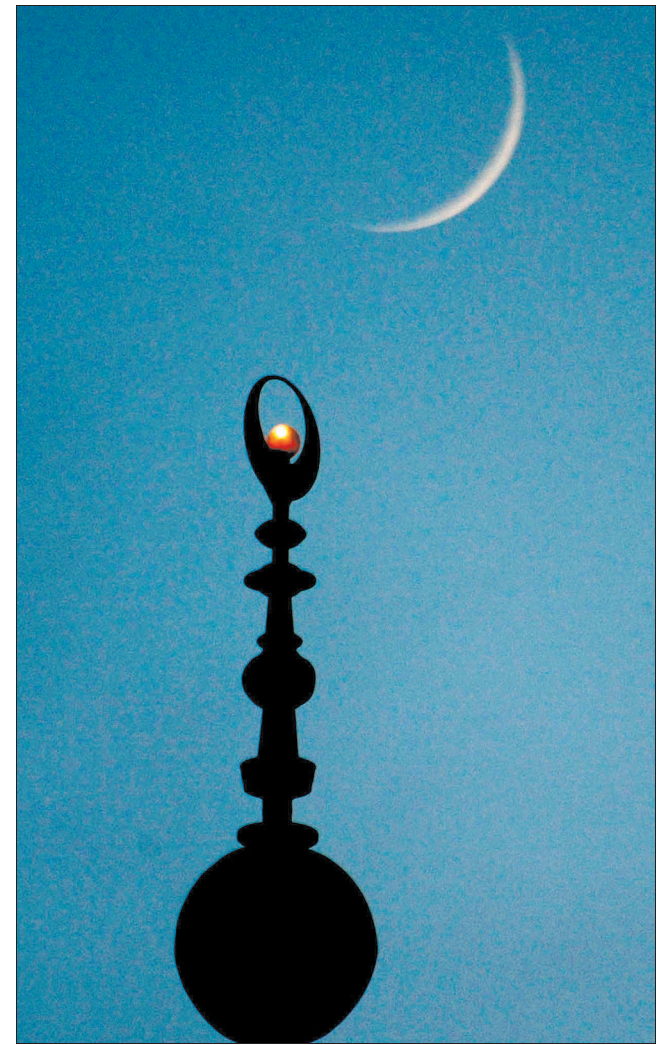
Jesse Liew, portfolio manager for global sukuk investments at BNP Paribas Investment Partners, who is based in Malaysia, is mindful of this: “In essence, the sukuk primary market is geographically skewed towards Asia and the Middle East. Other regions may have limited motivation in terms of issuing sukuk due to the infancy of the market and the limited [number of] government initiatives to encourage and promote sukuk as a funding source or investment.”

But Qatar Investment Fund’s Mr Jose disagrees. When asked if the sector was still considered too niche by issuers, he answers: “Not really.”

The spectrum of issuers and issuance is expanding, he explains. “We have already seen General Electric, HSBC and Sime Darby tap the sukuk market, and in the future we might see sovereigns such as the Republic of South Africa, Tunisia, Turkey and Morocco also looking at the sector,” he told FTfm.

Egypt is a case in point. It has outlined plans to raise as much as \$1bn before June from the sale of its first Islamic bonds, with the government completing a draft law to allow sukuk sales.

Mohammed Dawood, global head of sukuk financing at HSBC, says: “Five years ago there were two main centres, GCC and Malaysia. Today we’re seeing issuance from a multitude of markets, such as Turkey and Indonesia, and over time we expect others like Australia, Hong Kong, north Africa, Jordan, Oman and Singapore to follow



Crescent moon rising: The appetite for sukuk has gone up substantially over the past four years Reuters

suit.”

That said, figures for 2012 show that Malaysia accounted for more than 70 per cent of global sukuk issuance last year while Saudi Arabia grabbed second spot with a 7.5 per cent share of global issuance. The first sukuk were issued by Malaysia in 2000.

Mr Kabel recognises this concentration but is still optimistic: “The sector remains niche, but we believe that increasingly more market participants are awakening to the fact that sharia-compliant investment, and particularly sukuk, can offer significant benefits.”

Mr Dawood is equally hopeful and points out that sukuk issuance in US dollars, for instance, doubled from \$9.5bn in 2011 to \$18.4bn last year.

“We expect 2013 to be a record year, with GCC issuance alone accounting for as much as \$35bn. That’s

partly due to the fact we’re starting to see the traditional impediments, such as the lack of a legal framework, start to fall away.”

Dubai’s ambition to become the economic hub of the Islamic world will accelerate this process, he adds. “It will also help facilitate a standardisation of the sukuk process, including a greater consensus across Islamic boards and scholars. This will bring more efficiency to overall sukuk issuance.”

But Kate Hollis, director, fund research at S&P Capital IQ, which has assigned a fund grading to the Mashreq Al Islami Income fund, is not so sure. For her, the sukuk market has a long way to go before it captures the imagination of mainstream investors. “The wider investment community still considers sukuk to be a niche asset class,” she says. “It rarely buys them as liquidity can be poor.”

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Investing in fixed income

Asset managers fill the gap as banks retreat

Shadow banking

A growth opportunity for larger firms can also boost the real economy, writes David Oakley

One person's loss is another's gain.

This old proverb has certainly proved true in the world of finance since the crash of Lehman Brothers in 2008, with the big banks as the losers and the large asset managers as the gainers.

Since the financial crisis, many banks have scaled back their traditional lending programmes in direct loans, commercial mortgage lending, social housing, property and infrastructure because of capital constraints and regulations.

And as they have done so, the asset managers have started to fill the void in what has come to be known as the shadow banking sector, or non-banks doing the work of banks.

William Nicoll, head of non-bank lending operations at M&G Investments, says: "The withdrawal of the banks from lending has provided us with a great opportunity. This is a growing part of our business and should be very profitable for us."

Ashley Goldblatt, head of real estate lending at L&G Investment Management, adds: "We see this as a tremendous opportunity. We opened our business in lending a year ago to take advantage of this opportunity."

M&G prefers to call this type of lending bank replacement finance, which it adds is not only an opportunity but also should aid the economy as companies that need loans for expansion can in theory still find them.

M&G Investments raised just under £1.5bn in a couple of rounds for its UK Companies Financing Fund, from mainly third party UK pension schemes. The fund closed last summer having invested £930m of that money.

L&G also sees this as a plus not just for itself but for companies and the broader economy, too.

It has made new appointments and signed deals this year as its business is starting to flourish.

In January it announced a new £120m, 10 year debt facility to Bruntwood, the Manchester-based, family-owned commercial property company that owns and manages more than 100 UK office buildings, and has a number of other deals in the pipeline.

Other groups such as BlackRock, the world's biggest manager of money, and Allianz Global Investors have started to develop operations in the infrastructure debt market.

AllianzGI plans to launch debt funds for infrastructure projects in the UK and Europe in the coming weeks, which will go towards

the expansion of roads, the building of schools and hospital renovations.

Elsewhere, funds such as BlueBay Asset Management are pushing into corporate lending.

It plans to offer direct loans to small and medium sized enterprises in the UK and northern Europe.

However, it is not as simple as asset managers replacing banks.

As Mr Goldblatt says banks have traditional distribution and networks and years of experience in lending, while asset managers are new to the game, which means it will take time for many to build up their offices and networks.

Some asset managers do not have the skills and experience to assess companies, particularly smaller and more obscure corporates. Others say they are reluctant to offer big loans because of the risks to their balance sheet.

However, one sector that is growing fast and become increasingly popular for a raft of asset managers is commercial real estate.

BlackRock, Schroders, Axa, Allianz, M&G and L&G are all moving into the property space.

One sector becoming increasingly popular for a raft of asset managers is commercial real estate

The motivation for these managers is simple. Direct lending often offers high yields, or at least much higher than the historically low yields in the government bond markets, which have put pressure on pension deficits.

One asset manager at a big UK institution says the move into real estate is about value as well as diversification away from corporate bonds. A real estate loan can offer yields of up to 11 per cent, a very big pick-up over government bonds, which offer about 2 per cent or even investment grade corporate bonds that offer about 4 per cent.

Fees are also higher with a 3 per cent margin on a deal relatively common.

L&G moved into property lending last year. It provided Unite, the UK's largest developer and manager of student housing by units, with a £121m loan in April.

However, completing some deals is tricky as they can take time and due diligence and management can throw up problems.

It means that only the big asset managers are able to take advantage of the withdrawal of the banks. Shadow banking is not a market for the smaller players, meaning many companies are still struggling to get loans they once easily accessed from the banks.



Super Mario: ECB action reduced the risk that the eurozone would break up Reuters

Political instability tests strength of Draghi pledge

Eurozone

Worries over volatile states are triggering debate about the ECB's support programme, says Mary Watkins

It took a moment to sink in, but when it did, the impact was enormous. As governments in Spain and Italy saw their cost of borrowing driven to euro-era highs and with markets witnessing sharp swings, the president of the European Central Bank took to the stage at a conference in London last July.

Artfully placed within a candid speech on how the ECB viewed the crisis in Europe, Mario Draghi said: "But there is another message I want to tell you. Within our mandate, the ECB is ready to do whatever it takes to preserve the euro. And believe me, it will be enough."

A month later the ECB provided a further backstop to the euro, promising to buy the short-dated government debt of ailing eurozone nations via its outright monetary transactions (OMT) programme, subject to various conditions. ECB action provided the trigger for a months-long markets rally that continued into the start of this year.

What intervention from the ECB did was offer up the "unlimited ammunition" of a central bank's balance sheet, says Gianluca Salford, fixed-income strategist at JPMorgan.

Put simply, ECB action reduced the risk that the eurozone would break up. Yields fell, stock markets rallied and investors that had shunned the eurozone started to return.

A few months on and the tone is changing.

In a low-rate environment, investors are desperate for yield. That has encouraged some investors to return to the so-called

eurozone periphery, buying Italian, Spanish, Irish and Portuguese bank and corporate bonds. Others have bought hybrid or subordinated debt or looked to emerging markets.

As investors chased ever-riskier assets, recent events are testing the strength of the Draghi pledge. Following an inconclusive result in Italy's election in February, investors were left wondering if they were about to enter another period of weakness in European markets.

Without a unified government, Italy stands little chance of meeting the type of conditions necessary for it to ever ask for the OMT to be activated. While Italy has not indicated it needs this to happen, analysts argue that the credibility of the ECB backstop is dependent on a unified and

Movement in bond yields could create interesting buying opportunities for fixed income investors

rapid response to any reforms or conditions set.

Alan Wilde, head of fixed income and currency at Baring Asset Management, says the key is not the immediate reaction to the Italian result, but what happens next.

For Italy to need to activate the OMT, a series of factors would have to fall into place, including a sharp drop in appetite for government debt, a downgrading of the country's credit rating or a big rise in yields.

Mr Wilde says while political instability could lead to a hiatus in the reforms Italy has to carry out and "the market is always premature in assuming things are getting better", he expects the euro to initially take most of the strain, rather than bond markets.

"The volatility is not over," says Neil Williamson, head of European credit research at Aberdeen Asset Management. "The OMT backstop and Draghi's promise to do whatever it takes still matters, but the electoral upset in Italy shows political risk is still very real in the eurozone."

There are other reasons for caution.

In Spain, for example, while the threat of a downgrade by Moody's, the rating agency, appears to have receded, there is still a strong risk that budget issues could cause the country's debt to be downgraded to junk, says Mr Williamson. That is a problem for investors such as Aberdeen that have a large number of funds restricted to investment grade ratings.

February's presidential ballot in Cyprus, meanwhile, saw Nicos Anastasiades voted in as leader. While his appointment will please his European partners, he still needs to reach agreement on the terms of the heavily indebted country's bailout plan.

For now, worries over Italy, Spain and Cyprus appear containable. Yields on Italian and Spanish government debt are still way below the 7 per cent levels seen last summer.

"We've now moved from 'crisis contained' to 'crisis not solved'," says Ian Kelson, head of global fixed income at T Rowe Price International. "Growth is still weak, especially in Spain and Italy, and the politics are becoming noisier."

He says while the outcome of the Italian election has triggered debate about the activation of the OMT and raised concerns over how political instability may affect the reform programme, investors still believe the ECB will provide the ultimate backstop to the market.

In the meantime, he says, movement in bond yields could create some interesting buying opportunities for fixed income investors.