The first rule for fixed income investing? Protect the downside | Gene Tannuzzo, Deputy Global Head of Fixed Income

The fixed income market really is a game of basis points, and we say that because you can make money with an eyedropper but lose it by the bucketful if you're not careful.

Really, fixed income investing is all about protecting the downside. We can all look at the yield that's available on the marketplace and choose the highest-yielding asset, but if you don't protect the downside, you'll lose out to defaulting companies and drawdowns that clients really do not want in their portfolio.

I don't think risk has to be considered a bad thing, but we have to be very careful to understand what risk is. For us, risk is fundamentally the factor that drives return in a portfolio. So we think about four different kinds of risk in a bond portfolio, duration or interest rate risk; credit risk, the risk that the borrower defaults; currency risk that is driven by changes in exchange rates; and also inflation risk as prices move around. If we can understand those variables, analyze them independently, and then put them together in a construct that is more balanced, we think we can generate better outcomes for clients.

In the bond market, it's very interesting that there are a lot of noneconomic buyers. Some of those are foreign governments or foreign central banks who are buying to accomplish a policy goal, but not necessarily trying to buy the most attractive security out there. So that can create distortions. It can also create opportunities. So if certain buyers are buying things that are only rated single A and paying a very high price for those, we have the ability to ignore what the rating agencies might consider risk of a security and really focus on the true underlying risk.

We definitely believe that Columbia Threadneedle has a tremendous research advantage. We have a very disciplined and consistent research process across all of our sectors, and our analysts look at all of the bonds in their sector and evaluate them on a proprietary rating scale, so very different from what a traditional rating agency would use. We are looking at evaluating each bond on the basis of risk-adjusted return, so where are we getting the best opportunity to generate alpha in client portfolios.

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