Q&A with Joon Hyuk Heo, CFA

Head of Global Fixed Income Investments

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1. What are the unique strengths of Mirae Asset Global Investments in managing fixed income?

Our investment decisions are based on our top-down approach that focuses on the downside risks of the fixed income assets that we invest in. We select five to 10 big themes that may have negative effects on the market and we follow the development of each risk factor on an ongoing basis. This allows us to control overall downside risk within a pre-set limit. Our performance in the past 10 years proves this is an effective approach to controlling downside risk.

2. What is your industry background and experience with the firm?

I joined Mirae Asset in 1999 and spent seven years in the Korean domestic bond market as a fund manager and strategist. When the company launched its first overseas investment fund in 2006 I moved to Hong Kong, where I spent three years as assistant manager and macro analyst of emerging markets (EMs). In July 2008, I became the lead manager of our global bond fund, which I am still managing from New York.

3. What is the composition and structure of the fixed income investment professionals housed within the firm?

Most of our fixed income professionals are based in New York and Seoul. New York is an investment hub with four portfolio managers and two portfolio analysts. Seoul serves as the Asian investment and global research hub with two portfolio managers, two global macro analysts, three emerging macro analysts, four emerging credit analysts, and two fund analysts. We also have local investment desks in São Paulo, Mumbai, Hong Kong and Taipei.[1]

[1] Mirae Asset Global Investments (October 2016)

4. What are the core issues facing the financial system and how may they be addressed by policy makers?

The greatest risk is the lack of tools available to central banks (CBs). Even though most CBs insist they have many tools, there are always questions over the credibility of such tools, i.e. the support from politicians and the public. Recently, CBs have even been attacked by certain politicians in their own countries. Conflicts between the political class and CBs are not a great concern under normal conditions, but current asset prices are purely based on very low interest rate forecasts. If this low long treasury rate, which has already been sustained for long time, is in question, asset prices could adjust quite a lot, reflecting a different level of discount factors.

The second risk is the deteriorating relationship between the US and Europe. Recovery from the Great Recession is based on global cooperation at both the government and CB levels. As financial markets are globalized, efforts from one country can easily be nullified by another country that pursues sovereign interests that undermine collective goals. Changing political environments in the US and Europe lower the chance of further collaboration, compounding difficulties in the case of another downturn in the global economy. The overall dynamics in growth, business and debt hint at an increasing risk in the global financial system.

There is no easy solution to these challenges as political assets in most developed markets (DMs), except in Japan, have been nearly depleted. We believe the best strategy is to pay more attention to risk management, identify the tipping point and make the portfolio as liquid as possible.

5. What is your view on emerging market fundamentals and their macro backdrop?

Emerging Market financing conditions are not too bad overall. Most EM governments are sourcing their spending demand from the local debt market. While most EM corporates have found adequate financing through very long term bonds, they are still trying to reduce capex spending. Lower commodity prices in the last three years have made EM companies more conservative in their investments. During the 1980s and 1990s, EM companies relied heavily on bank financing, and then lending rates were hiked by considerable amounts within a very short time period. This time around, the EM long-term financing situation is much more robust, reducing the chances of a crisis.

Economic fundamentals are still weak but they are improving steadily. Even though the prices of most commodities have not recovered significantly, many EM countries have achieved a turnaround in their current account balance. These current account adjustments stem from extremely weak domestic demand driven by foreign exchange (FX) depreciation. Thanks to free-floating FX systems, devaluations of currencies served to make EM countries' exports more competitive without wage cuts, which helped EM governments maintain their political approval.

Finally, China has been very supportive to domestic spending, which alleviated the burden on commodity exporting EM countries.

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6. Are we at an inflexion point with regards to quantitative easing (QE), and what are the implications to inflation within a global context?

We still don't know if QE will be used continuously because this non-traditional policy tool's positive effect on the economy and on asset values has already been depleted. Focus is now moving to inflation as it is the last way to boost asset prices. Helicopter money – printing money to fund government spending – should be understood from such an angle. Central banks will have to receive approval from the public and political powers before they implement another QE. Chances of a smooth transition from the current QE status to a new QE status are slim due to increasing political and public opposition.

Therefore, we do not see significant risk in inflation. The only chance of runaway inflation is if oil prices are fully controlled through OPEC and non-OPEC collaboration. The chances of this happening are relatively low but we cannot ignore this risk.

7. What would a shift from monetary to fiscal policy entail for central banks and governments?

Government expenditures in many countries somewhat outstrip what their budgetary capabilities suggest. Most DM countries are still showing budget deficits of 2-3% under the current interest rate environment.[2] Business investments are not vigorous because businesses do not expect growing demand from households due to a lack of spending power.

If fiscal policy takes the driver's seat, we will see a short term rebound in growth, short term higher inflation expectations and higher interest rates. But interest rates cannot go much higher because such a change will dampen the spending capacity of governments and will prompt households to save more. Effects from fiscal spending will last a little longer if CBs do not guarantee yield curve control. If they do guarantee it, the effects will be very short lived.

8. How can investors navigate a landscape where developed market bonds are increasingly moving into negative yield-to-maturity territory?

Negative yield assets should be avoided as their values are based only on the expectation that CBs are the bigger fool in continuing with bond purchases and lower interest rates, which may be proved otherwise. Risk in term premium is poorly compensated while risk from EM is fairly compensated. We are therefore focusing on short term and mid-term EM bonds.

9. What are the notable opportunities and risks in the medium-term and how do they translate into your portfolio positioning?

The best opportunities are in EM local currency bond markets. As DM countries are likely to soon employ helicopter money, valuations in EM countries where helicopter money is not necessary should rise. Higher oil prices will be accompanied by a stronger dollar this time in our view, and this correlation will hurt most current account surplus countries' FX, including the yen and euro. However unlike previous experiences, such FX movements will not be harmful to commodity exporting countries' FX due to higher oil prices and a low level of short term funding linkage.

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[2] OECD (2016), General government deficit (indicator)

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