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FIXED INCOME Q&A WITH JIM BERNARD

By,
Jim Bernard, CFA
Managing Director, Fixed Income
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Q. What is your outlook for interest rates and the economy?

A. We will continue to see modest (2%-3% real GDP) domestic economic growth over the next few years, and if our forecast proves to be fairly accurate we would expect the 10 year U.S. Treasury to yield modestly above 3% either later this year or early in 2015. We further expect the FED to complete the current QE (Quantitative Easing) Program later this year or in early 2015. However, even when this program concludes we believe it will likely be six to twelve months before the FED takes any action to increase short-term interest rates.

Q. What risks do fixed income investors face at this point in the interest rate cycle?

A. As we enter the 5th year of historically low short-term interest rates, investors appear to be getting impatient earning very little on their short-term investments. It appears many are "throwing in the towel" and seeking out higher levels of investment income by either embracing longer duration bonds or lower credit quality bonds, both of which can add significant investment income to one's portfolio. Obviously the risk is that inflation may at some point reappear and force interest rates higher and thus drive down the prices and values of longer duration and/or lower credit quality bonds.

Q. What changes, if any, do you anticipate in Federal Reserve policy under Janet Yellen's leadership?

A. We see very little changes in policy or philosophy under Janet Yellen when compared to the last few FED Chairmen. Not only do we not see any fundamental differences at the helm, it also extends to the overall membership of the Board of Governors. All of which suggests a continued accommodative FED.

Q. How is the Detroit bankruptcy process going and what impact do you think it is having or will have on the municipal bond market?

A. There is still a long way to go in restructuring the debt and related expenses for Detroit. To date there has been little accomplished except for an approximately $100 million "haircut" for the owners of roughly $360 million of Unlimited Tax Obligation (UTGO) debt. The elephant in the room continues to be how the pension bondholders and/or current city employee benefits will be cut under as of yet to be negotiated deals. Our view continues to be that a long-term restructured debt plan with some additional "haircuts" and modest benefit cuts is the likely outcome of this situation. We believe this is only possible with some form of State of Michigan guarantee which we believe will likely occur. If this plays out as we have outlined it would be very positive for the municipal market but there is still lots of work to be done.

Q. What role does fixed income play for investors in such a low interest rate environment?

A. We believe conservative, risk adverse investors should have some exposure to investment grade debt at the minimum to act like an anchor for stability purposes in one's portfolio. Fixed income can produce reasonable investment income and stability and at times (like now) you have to focus more on the stabilizing benefits which are still important to achieving one's goals. We also continue to seek out some alternatives to traditional bonds as appropriate including dividend paying equities, REIT's, MLP's, Merger Arbitrage, etc.

Jim Bernard, CFA, is the Managing Director, Fixed Income at Ancora Advisors LLC a SEC Registered Investment Advisor. He is also a Registered Representative and Registered Principal of Safeguard Securities, Inc. (Member, FINRA/SIPC)
