On the look-out for inefficiencies

People who invest in traditional time deposits or money market funds are punished by the so-called "market" by having the real value of their investments destroyed. Even the alternative playing field where debt issuers with weak or weaker credit ratings are to be found has become highly contaminated in the meantime and is often unacceptable from a regulatory or contractual perspective. So far - so bad.

Nevertheless, it is worthwhile even in present conditions to take a good look at one particular aspect of the capital markets: their efficiency and transparency.

If one seeks to discover how market-efficient they are with regard to bond management, one is often met with an incredulous look and a reference to their allegedly oh-so high levels of transparency. However, the opposite is the case! The bond market, which clearly occupies a dominant position by size and by economic significance, is full of inefficiencies, distortions, anomalies and lack of transparency. The appropriate and proven argument has it that it is possible to achieve yield premiums without increasing market price risks to the same extent. The talk is of "skewed" opportunity/risk relationships.

We take it for granted that fundamentally all information of relevance to the market and to price is available. However, such information is available to market actors to a varying extent with regard to geography, time, content and quality. This harbours enormous opportunities.

The premiums that can be gained from identified inefficiencies can essentially be divided into the following types: information premiums, currency premiums, liquidity premiums and a special form - anomalies.

Can bonds that have the same issuer and term be worth such highly different amounts simply because their ISINs designate different countries? Can a fully-hedged foreign-currency bond be worth 150 basis points more than the euro equivalent when issued by the same house? Can such striking yield spreads be adequately explained solely by a slightly structured coupon? Do bond dealers offer "closing down sales" at preferential rates from their own trading portfolios in order to keep their "book" as empty as possible? Do smaller issue sizes often provide higher returns simply because they circulate "under the radar" of funds worth billions of euros? Question upon question, but always the same answer:

This astonishingly large market harbours great potential. There are specialists nowadays who have built up particular expertise in a variety of sub-segments. And if the premiums that can be achieved are also flanked by interest rate hedges together with strict quality, selection and term rules, there is little to stand in the way of a successful liquidity investment. This is despite the current global "central management" of interest rate markets by the leading central banks.

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