

Embargoed until: **12.00am, Monday 1 May 2006**

## **Do investors have too much of a good thing?**

Top Australian fund managers have a clear view that their credit investments may fall in value in the next 12 months – but are currently overweight and are still keen to increase their exposure in the short term, according to the ANZ Credit Sentiment Survey, released today.

The survey, which analyses the intentions of Australian and New Zealand Fund Managers, provides a snapshot which suggests that nearly half of the 'Top 11' fund managers (those with an excess of A\$3billion funds under management) think credit spreads are over-valued.

"Investors are showing a strong overweight credit bias, and plenty of appetite for the next three months, with nearly 30% of the Top 11 looking to increase their credit exposure," Head of Credit Research at ANZ, Sarah Percy-Dove, commented. "Yet at the same time, nearly half of all investors say spreads are over-valued, and 75% expect credit spreads to widen in the next 12 months."

"It seems that they are prepared to take an educated risk that any anticipated spread widening would not be enough to remove the 'carry' or additional yield they receive for investing in credit," she said.

The ANZ Credit Sentiment Survey, which tracks investors' attitudes to credit, the investment outlook and expectations for the credit asset class, shows most investors believe that corporate credit ratings will remain unchanged in the next six months. Although investors expect to see wider spreads in 6 to 12 months, they don't believe they will change in the next three months.

"The survey shows investors are facing a conundrum," Ms Percy-Dove said. "Current economic conditions have convinced them that the bull market for credit is fading. At the same time, they're worried that company management continues to favour shareholders to the detriment of credit investors.

"Yet they're having to be fairly courageous about what they see. Because despite these concerns, spreads continue to tighten, and investors simply cannot afford to pull back from their investments. As long as credit continues to perform, fund managers will reap the benefits," she said.

The survey also reveals that increasing numbers of investors are prepared to pay for some insurance, in the form of covenant protection in bond documentation.

"Lower rated companies are most likely to see demand from investors for this form of insurance. Providing covenants is an effective way for issuers to allay investor concerns, while reducing their cost of funds. But whether they think this benefit is worth it remains to be seen," Ms Percy-Dove said.

## Key findings

Weighting vs benchmark	69% of investors are moderately or outright overweight credit versus their benchmark. Just 6% are underweight.
Are spreads fair value?	53% of investors think spreads are fairly valued. 47% think spreads are overvalued. No one thinks spreads are undervalued.
Credit holdings	In the next three months, 75% of investors expect to maintain their credit holdings, while 16% expect to add to their holdings. Interestingly, 27% of the Top 11 expect to add to holdings.
Spread direction	There is a slight tightening bias to spreads short term, and a strong widening bias longer term. No one thinks spreads will be wider in the next month, and just 13% think they will be wider in 3 months. Out 6 months, sentiment changes, with expectations evenly split between unchanged and wider. In 12 months there is clear consensus – 75% of investors think spreads will be wider, and no one thinks they will be tighter.
Credit ratings	Investors see little impact on corporate credit ratings in the next 6 months. 69% think aggregate Australia/New Zealand credit ratings will be unchanged while 25% think they will be lower.
Value	Where is value? 'A' rated, Financial, fixed or floating, 2-5yr paper hits the spot!
Losing sleep over ...	Investors are worried about shareholder friendly activity and lack of supply. There is also some concern over increased volatility and higher interest rates.
Supply	63% of investors think there will be more supply in 2006 vs 2005.
The price of covenants	71% of investors say they will pay up for covenants. How much? 18% said they would give up 1-2 basis points, 43% said 3-5bps, 7% said 6-10bps while 4% said more than 10bps.

*Source: ANZ Investment Bank April 2006*

## About ANZ's Credit Sentiment Survey

ANZ's Credit Sentiment Survey is a monthly survey, which aims to identify investor's attitude to credit, investment outlook and expectations for the asset class.

The survey was conducted from 7 - 11 April 2006, across Australian and New Zealand fund managers. The results were split by size of credit assets under management. Fund managers with AUM greater than A\$3bn ("Top 11") were split from those funds with less than A\$3bn AUM.

## About Sarah Percy-Dove

Sarah is the Head of Credit Research Markets at ANZ, where she is responsible for developing credit research with an emphasis on the Australian corporate and Kangaroo bond market.

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