

# Global Bond Investing: Evolving Strategies & Tactics

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**BLACKROCK**

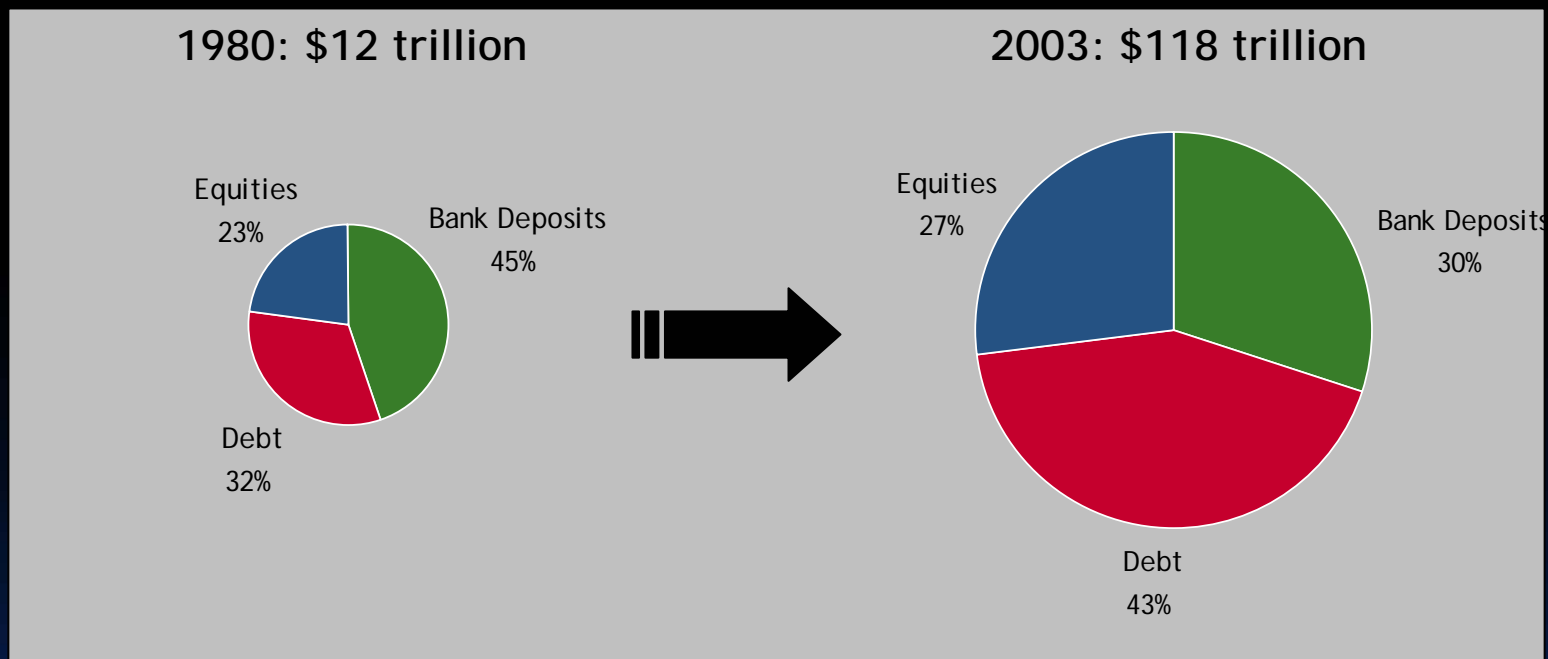
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# Evolution of the Global Bond Market

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# Enormous Growth in Global Financial Assets

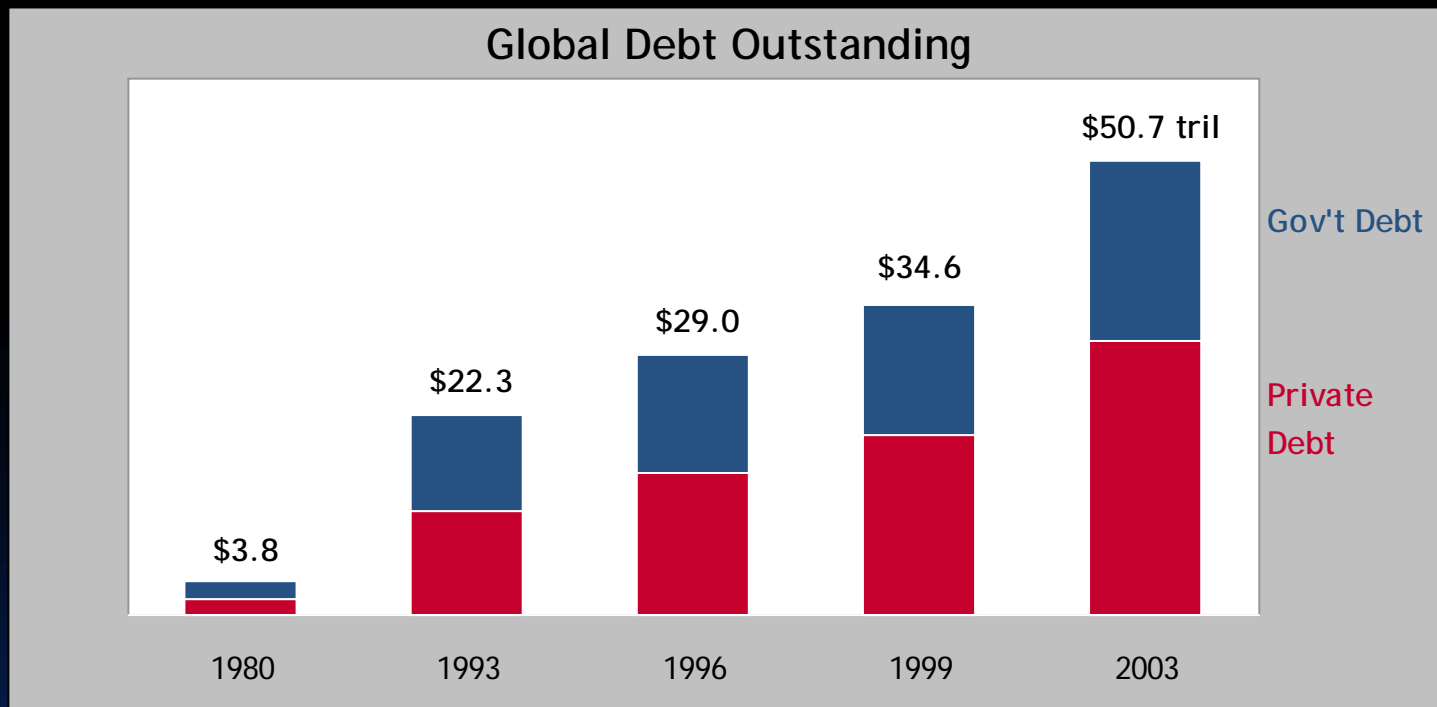
- \$12 trillion to \$118 trillion over the past 25 years
- Debt replaced bank deposits as the largest component
- Almost all equity growth from market appreciation



Source: McKinsey Global Institute

# Explosive Growth in Global Bond Markets

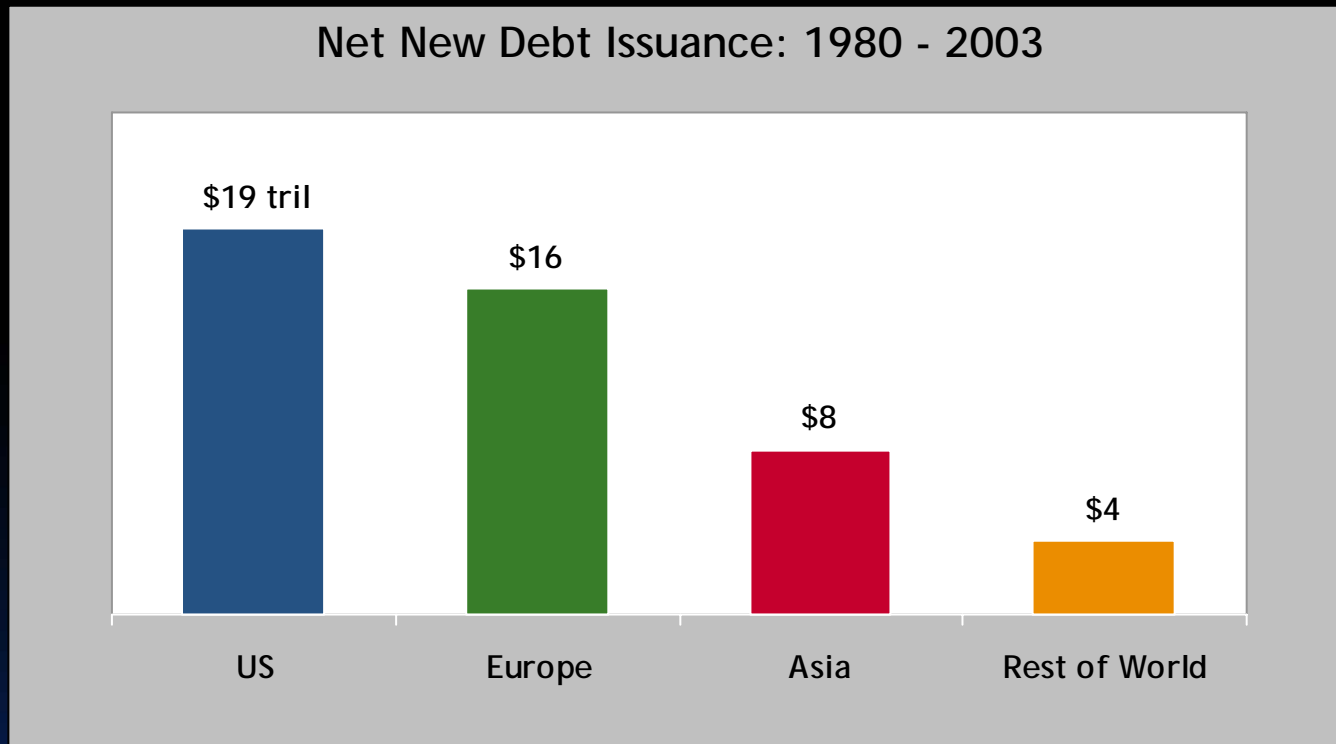
- \$3.8 trillion to \$50.7 trillion over the past 25 years
- Represented 44% of overall growth in global financial assets
- All from net new issuance (market appreciation not counted)



Source: McKinsey Global Institute

# Regional Debt Issuance

- Global bond market growth driven by U.S. and, increasingly, European issuance... is Asia next?
- Factors driving U.S. growth illustrate global market potential



Source: McKinsey Global Institute

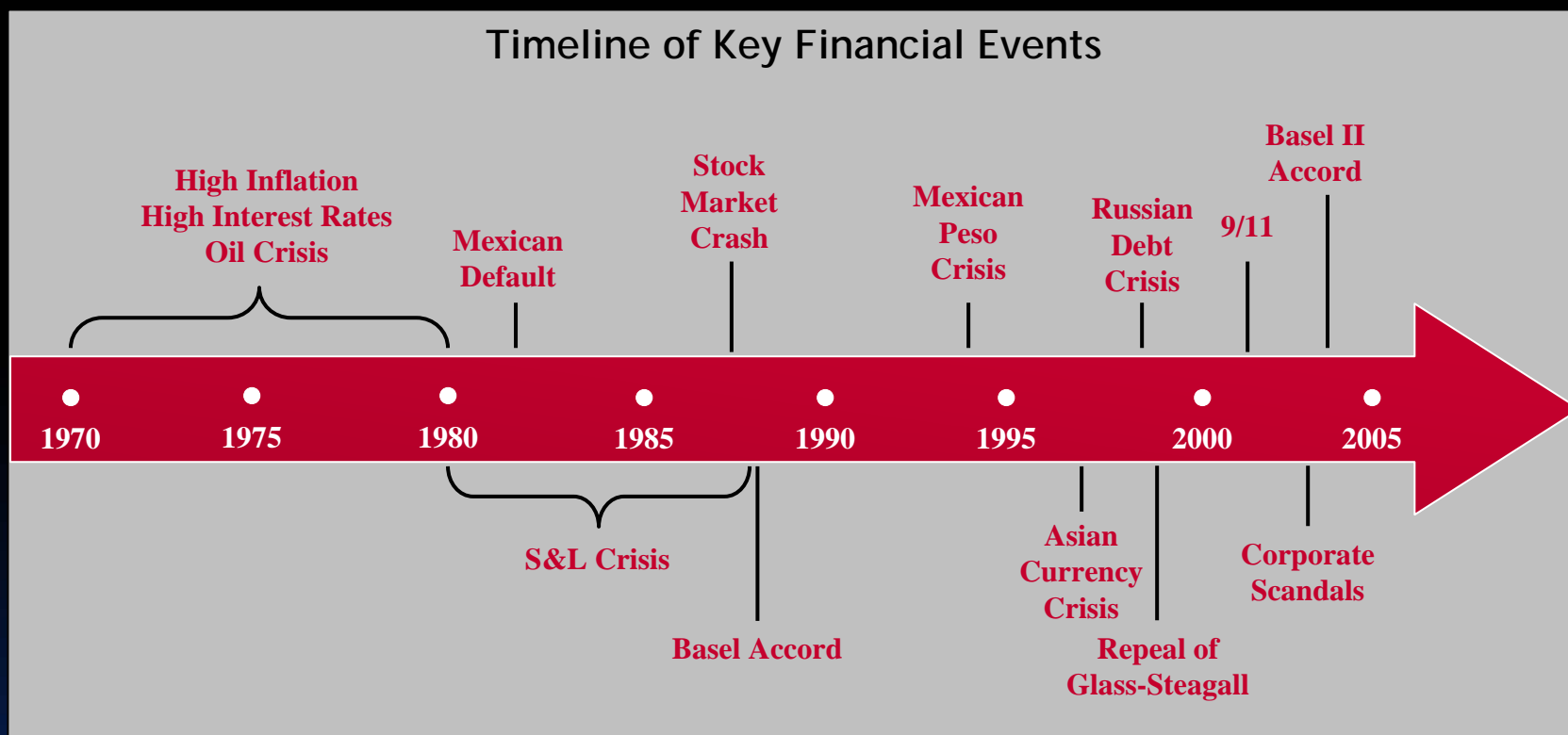
# U.S. Bond Market Growth Factors

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- Bank and insurance industry dynamics
- Securitization
- Increased flow of funds into capital markets
- Favorable environment for debt issuers

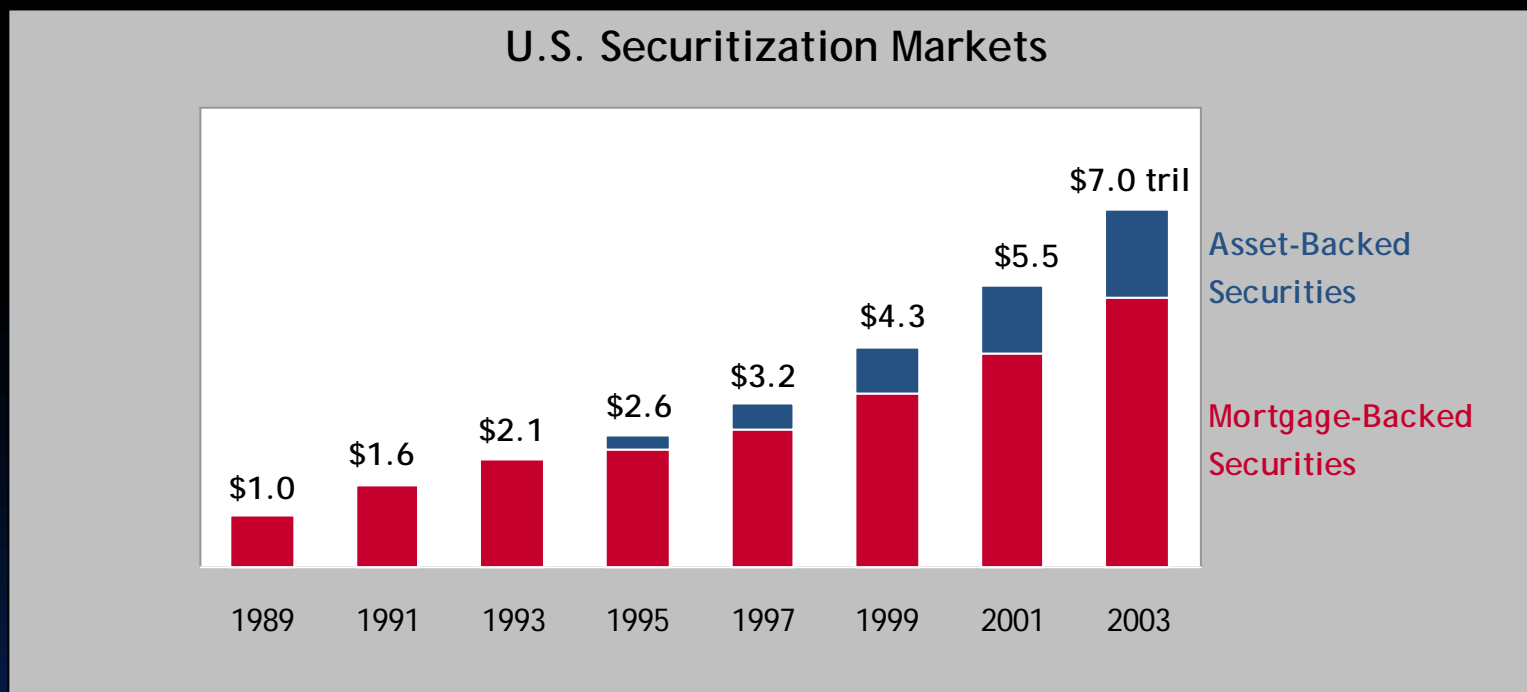
# Banks & Insurance Companies

- Traditional lenders weakened by crises of 1980s & 1990s
- Evolving capital requirements diminish appetite for lending



# Securitization

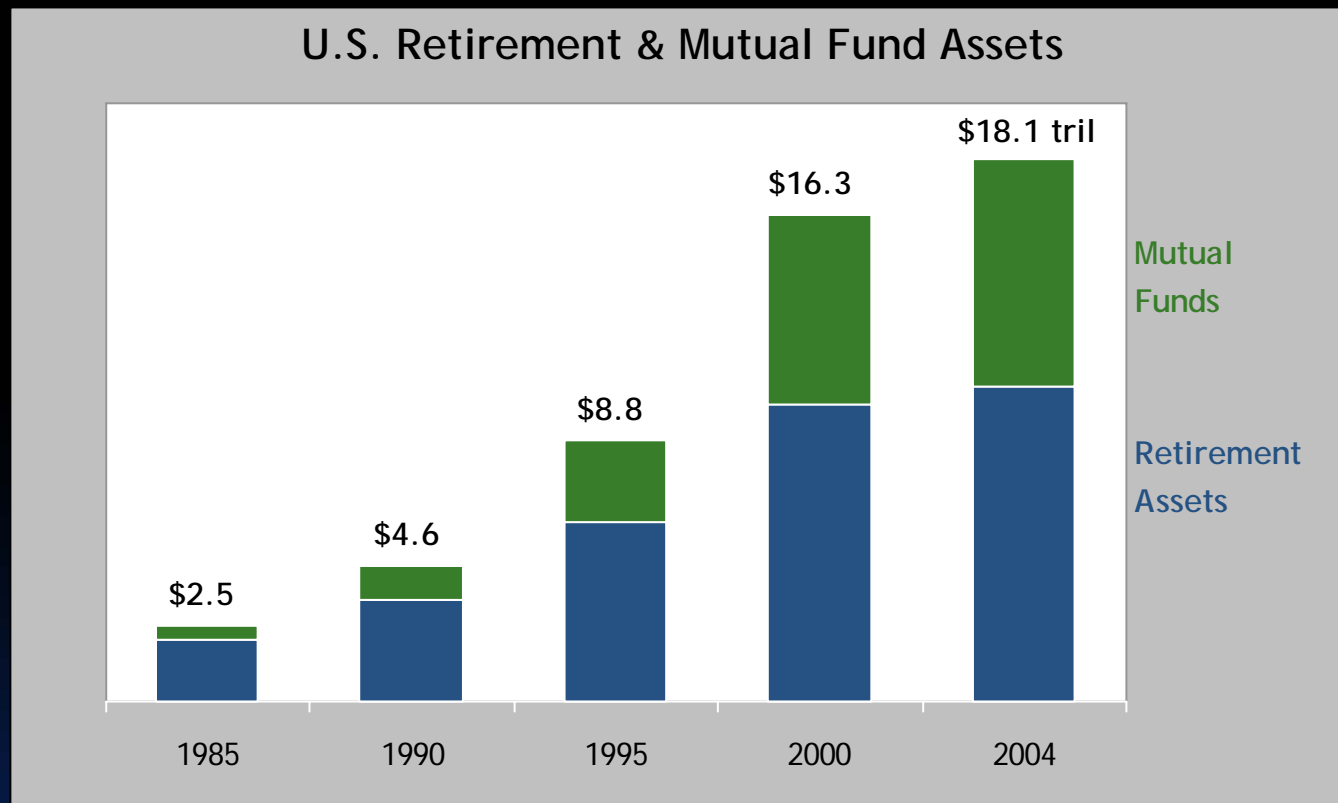
- Began with residential mortgages and spread to most types of assets traditionally held by banks and insurance companies
- Permits “slicing and dicing” of cash flows to customize risk profiles of securities offered



Source: McKinsey Global Institute

# More Money To Be Put To Work

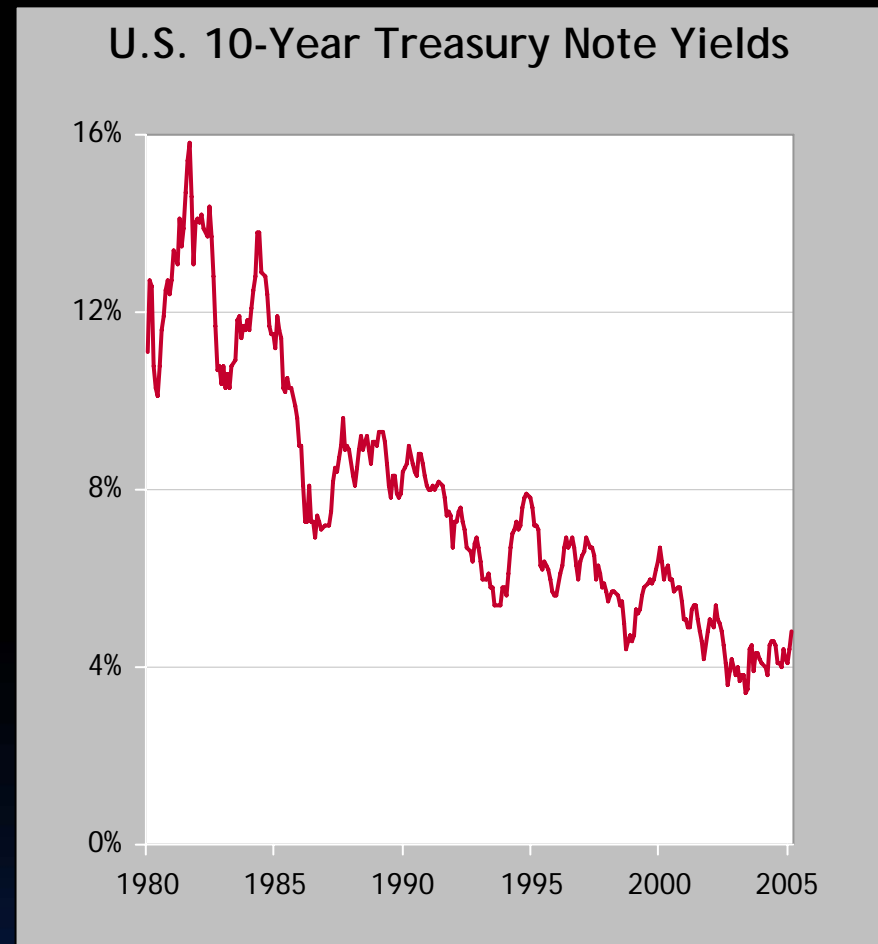
- Six-fold increase in U.S. retirement and mutual fund assets
- Similar trends at work globally



Source: Fed Flow of Funds; not adjusted for retirement assets held in mutual funds

# Favorable Environment for Issuers

- Sustained decline in real and nominal interest rates
- Ability for capital markets to absorb supply



# All Signs Point to...

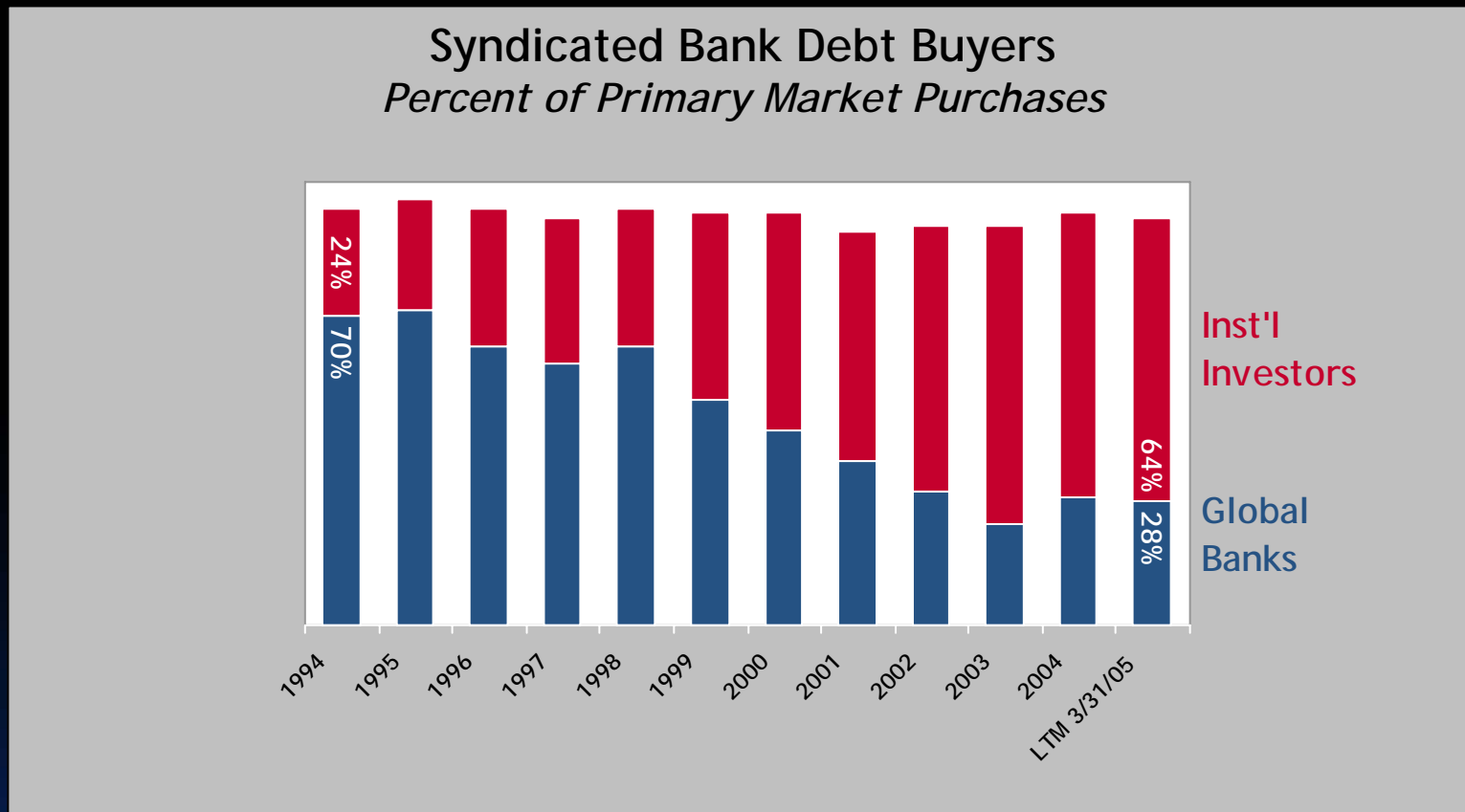
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## One Overriding Secular Trend:

The continuing disintermediation  
of traditional lenders  
in favor of the capital markets

# For Example, Bank Loan Market

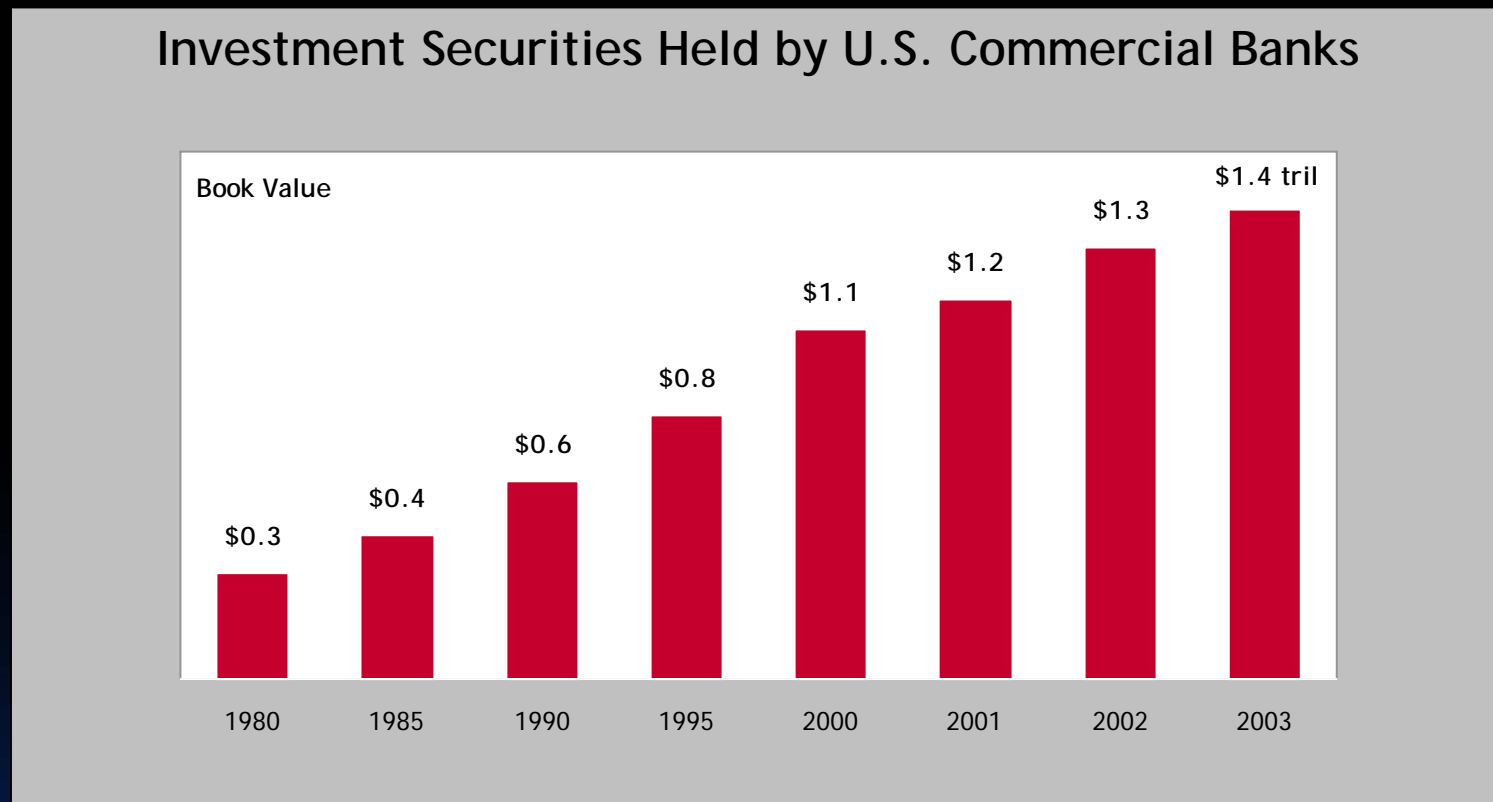
- Institutional investors have replaced banks as the dominant force in the bank loan market over the past 10 years



Source: Standard & Poor's/PMD; finance companies and securities firms account for remaining purchases

# Reliance on Investment Earnings Up Sharply

- What happens when the curve flattens?



Source: FDIC

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## Challenges & Opportunities for Investors

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# Investing in Bonds is Hard...

- Most issuers have only one stock but many debt issues, including both credit and cash flow instruments
- Tremendous burden on investors to be able to evaluate:
  - Credit risk
  - Duration risk
  - Yield curve risk
  - Cash flow risk
  - Liquidity risk
  - And other exposures



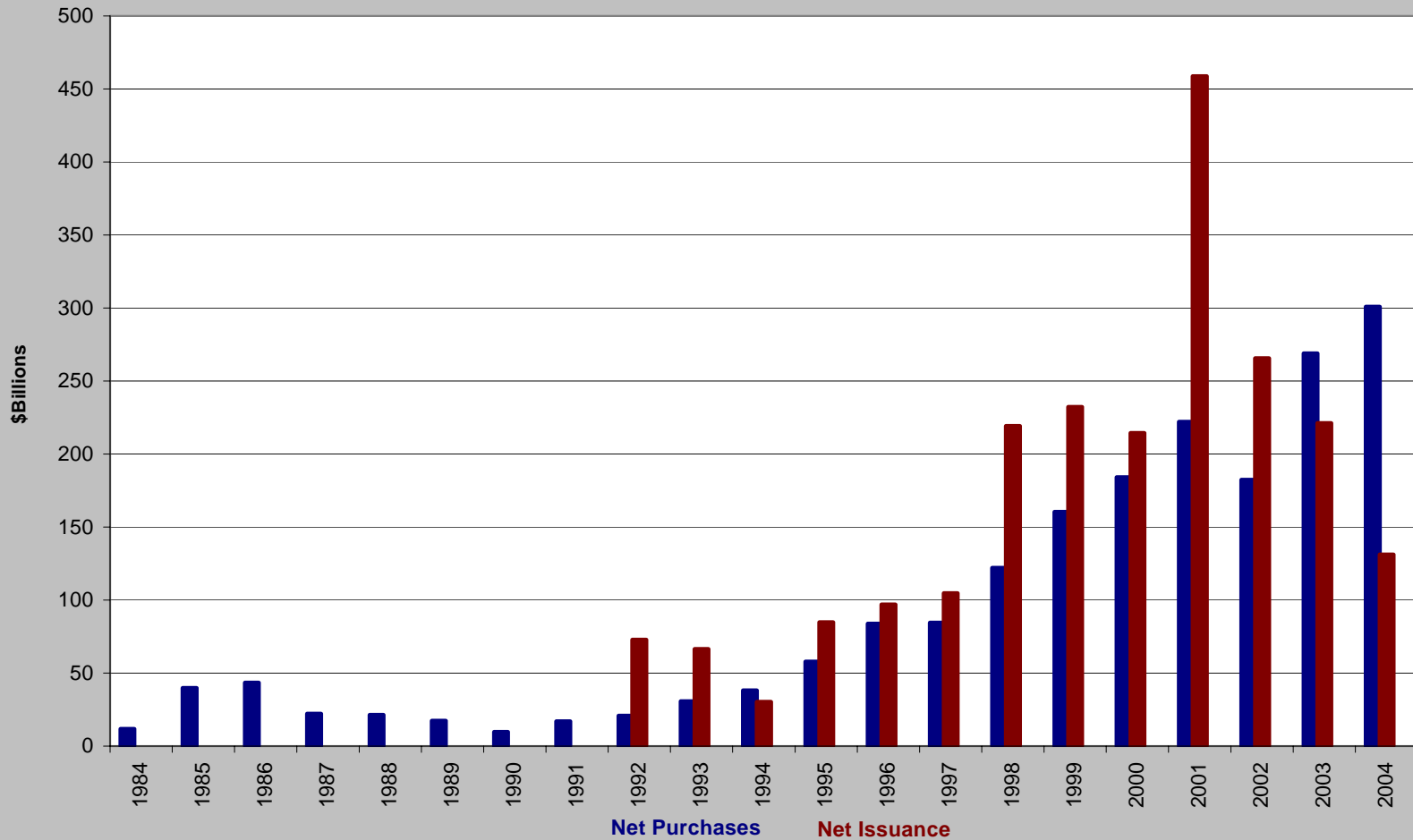
## ...and Getting Harder

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- Too much money chasing the same opportunities
- Flattening yield curve
- Widening spreads
- Greater global simultaneity
- Far greater uncertainty

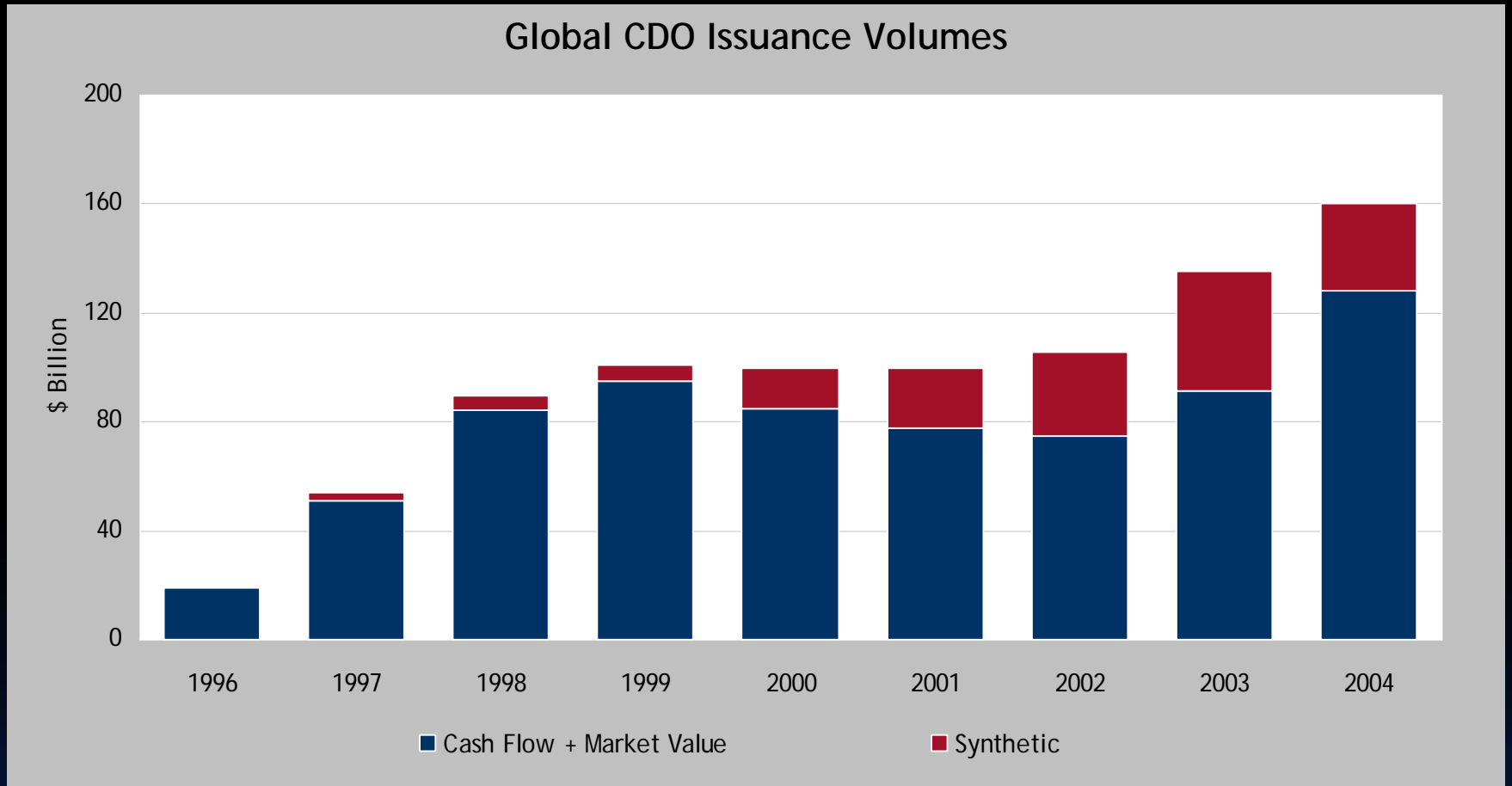
# Global Search for Yield

## Foreign Net Purchases of US Corporates vs. Net Issuance



Source: Bloomberg, BlackRock

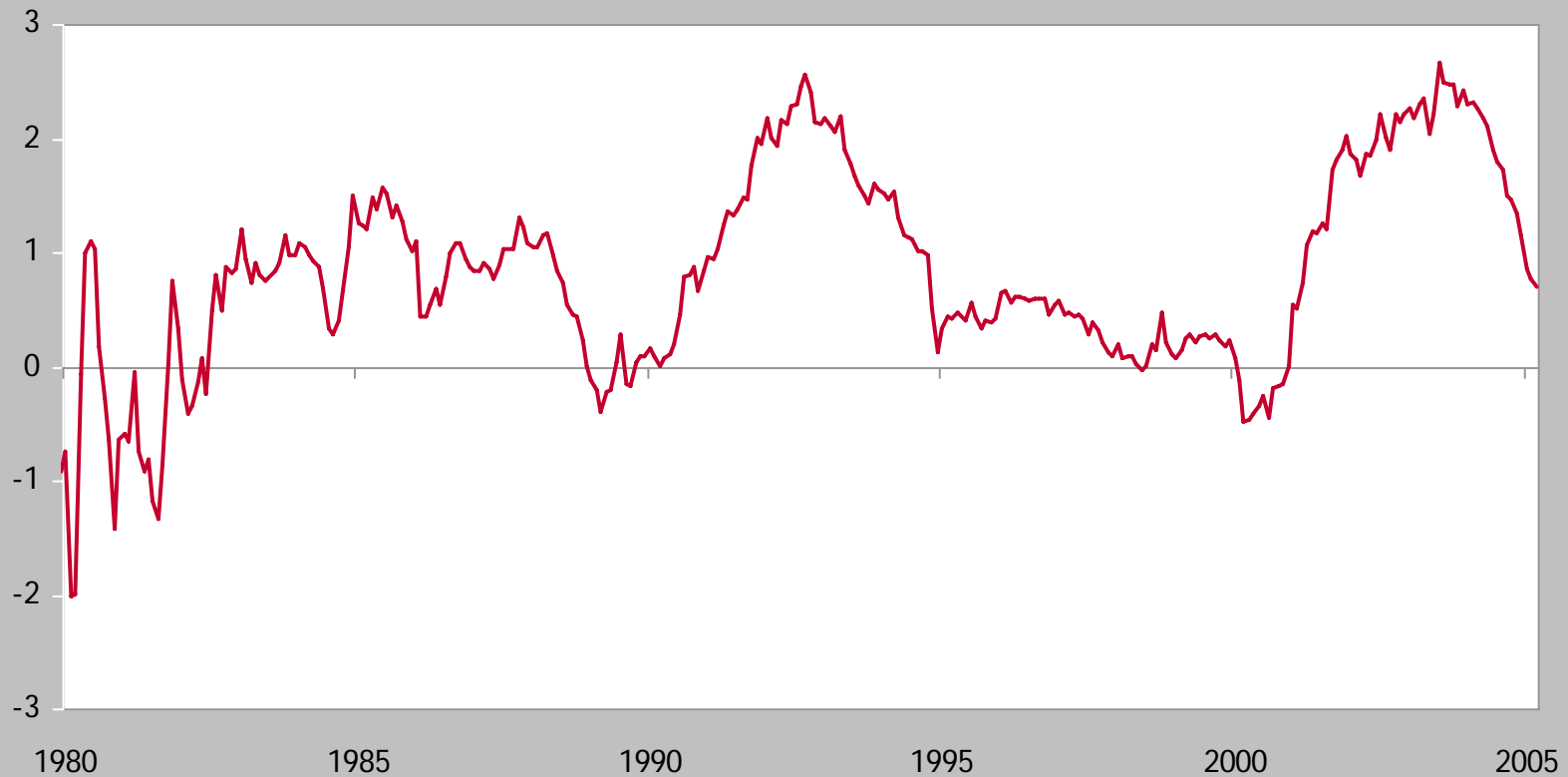
# Global Search for Yield II



Source: Lehman, BlackRock

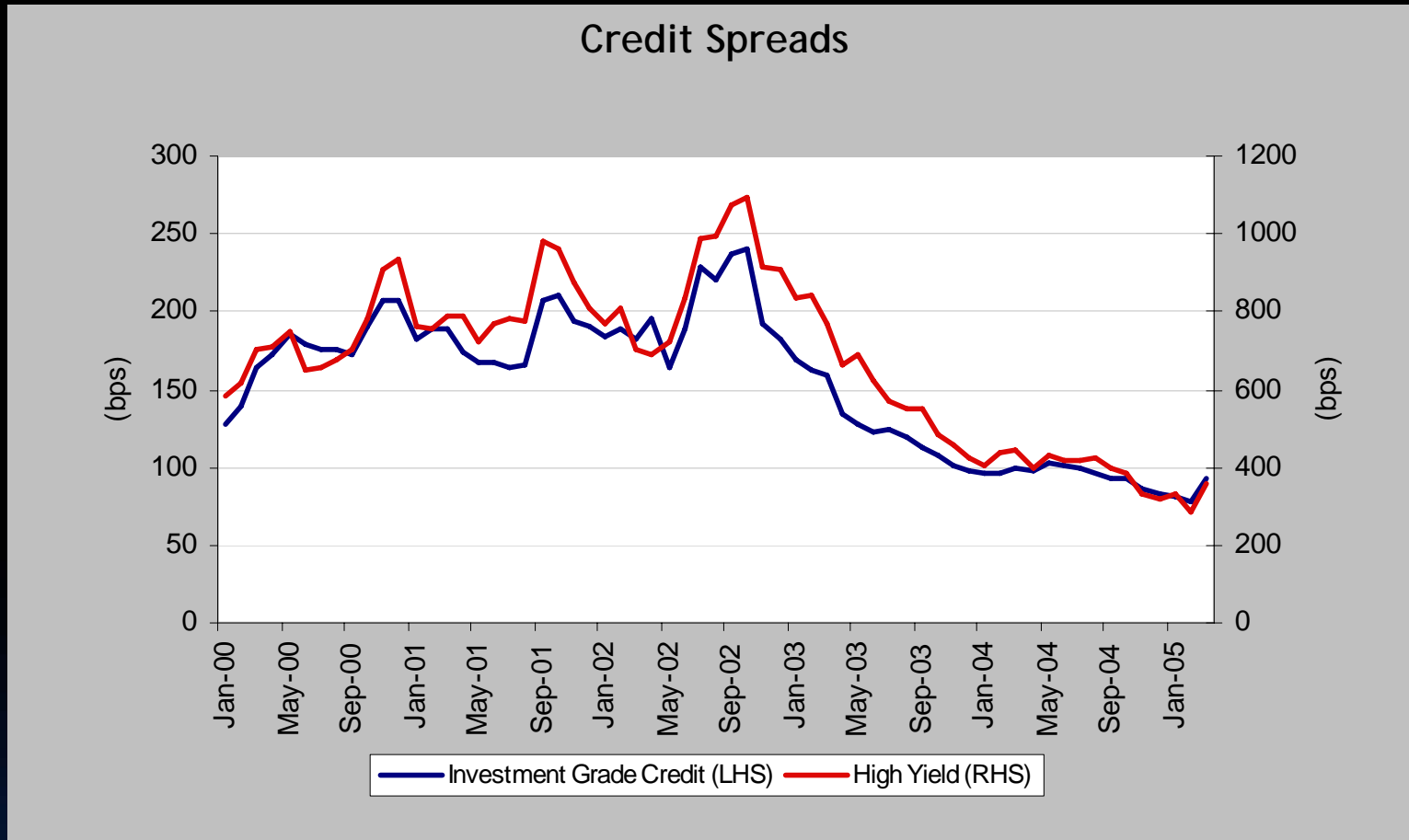
# Flattening Yield Curve

U.S Treasury Yield Curve 2-year to 10-year Spread



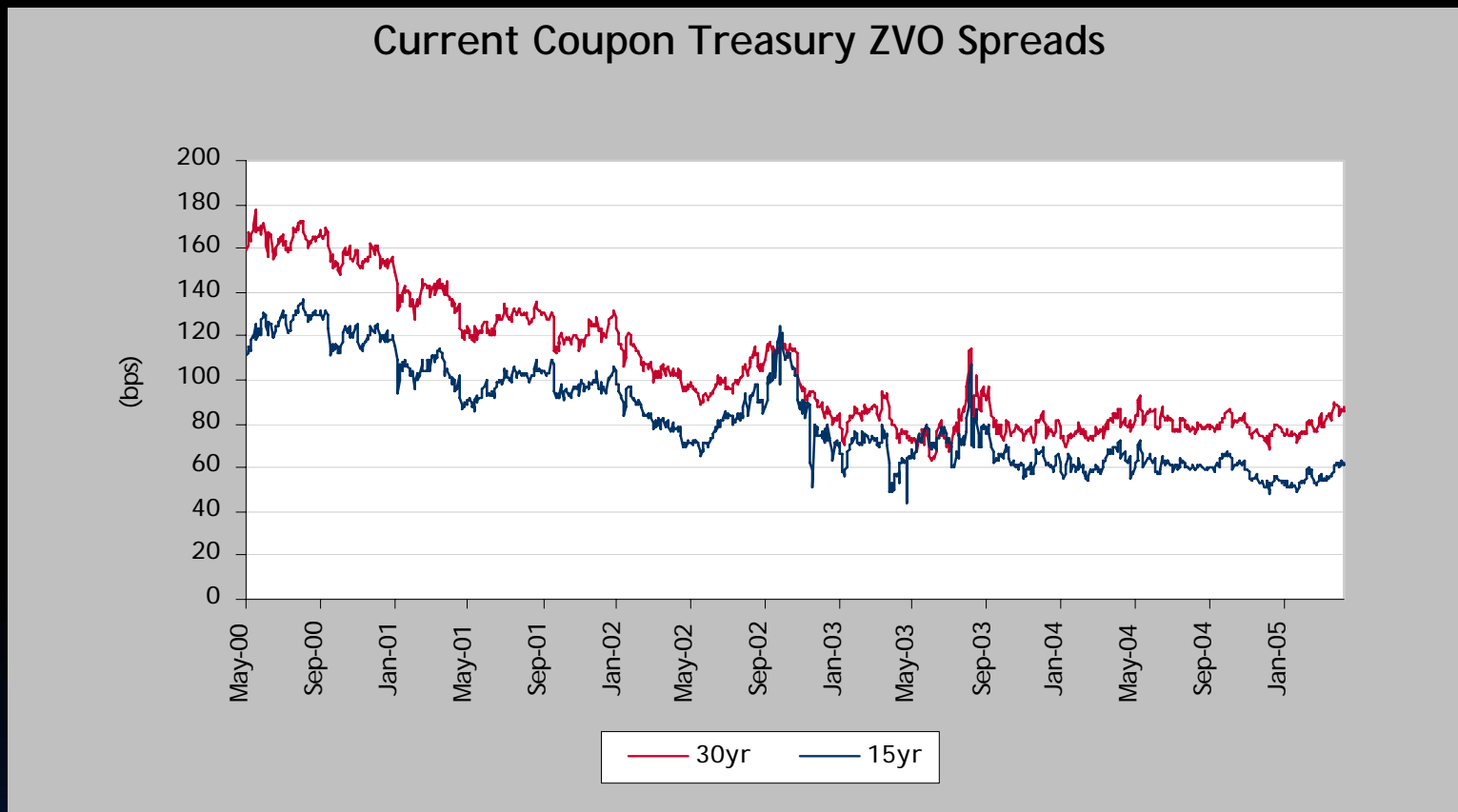
Source: Bloomberg

# Credit Spreads are at Very Tight Levels



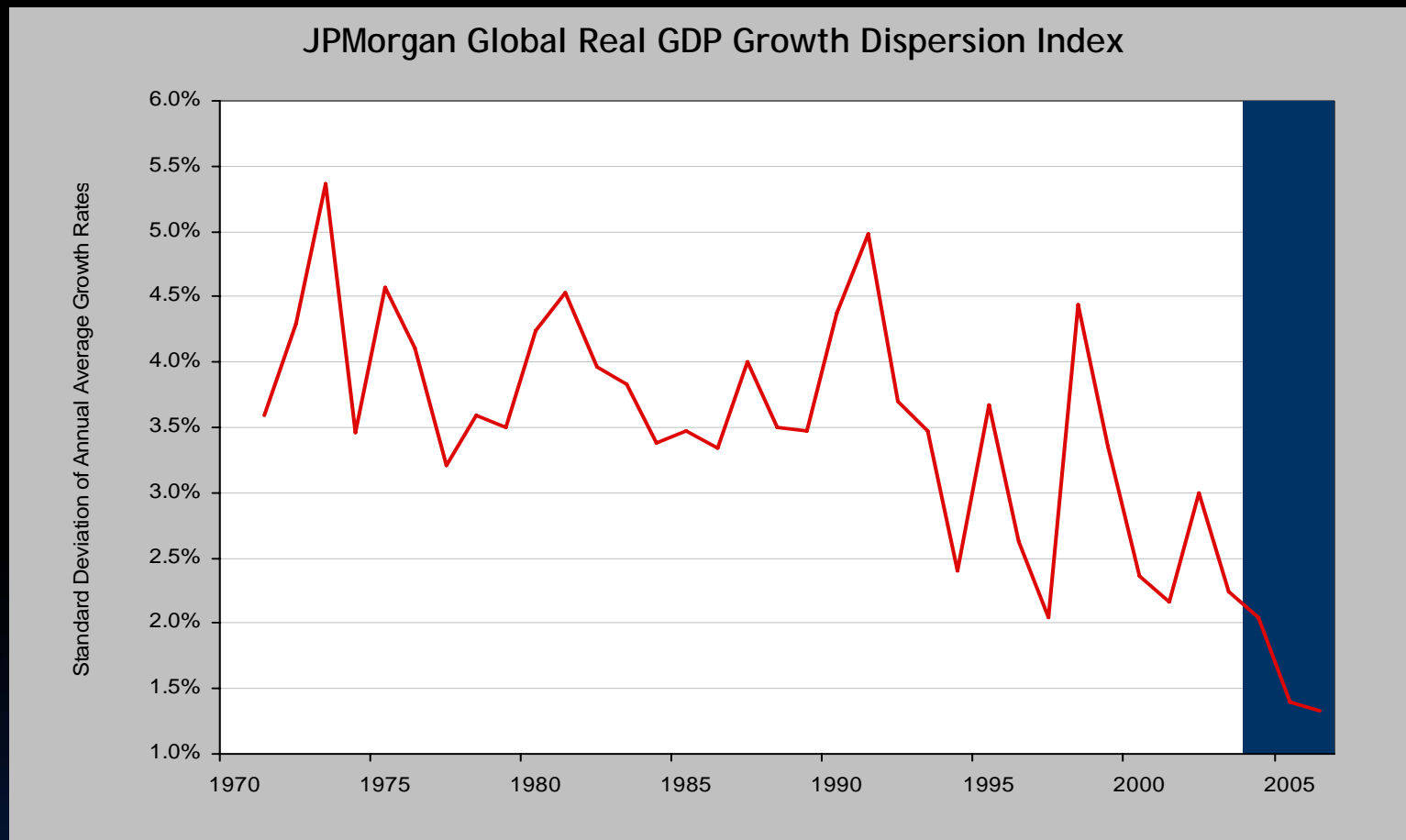
Source: Lehman, BlackRock

# Mortgage Spreads at Very Tight Levels



Source: Lehman, BlackRock

# Unprecedented Simultaneity of World Growth



Source: JPMorgan, BlackRock

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**There will be blow ups**

Do you know what you are investing in?

Most investors don't

# Why Bother Investing in Bonds?

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- Your investment objective is likely defined by your liabilities
  - Balance sheet leverage
  - Future obligations to beneficiaries
- You probably cannot afford unlimited earnings volatility
- A bond portfolio can be structured to provide appropriate correlation between your assets and your liabilities

# Why Bother Investing in Bonds?

- There are great opportunities to make money...
  - More issuers globally
  - More issues denominated in local currencies
  - More types of instruments
- ...if you have the tools and the know-how
  - Portfolio (asset/liability) management
  - Risk measurement and management
  - Outsourcing is becoming more important: a “window on the market”

# Whatever You Do...

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- Be prepared to manage your portfolio in a flattening yield curve environment
- Be prepared for credit events

*Making money will be harder*