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Goldman Sachs Wins Bond Investors to Flexible Mutual Fund: Bloomberg.

Goldman Sachs Group Inc. (GS) is drawing record deposits into a bond mutual fund that's making money even as interest rates rise, giving the bank a boost in one of the few Wall Street businesses it hasn't dominated.

The Goldman Sachs Strategic Income Fund (GSZAX) attracted $9.8 billion in the first 11 months of 2013, more than three times the net new cash taken in by the New York-based company's previous best-selling mutual fund in a calendar year, according to Morningstar Inc. (MORN) data going back to 1993. The $12.5 billion fund returned 5.3 percent in 2013 through Dec. 13, beating 96 percent of rivals, according to data compiled by Bloomberg. The fund has quintupled in size this year.

Strategic Income is raising the bank's profile in the $14.6 trillion U.S. mutual-fund industry by standing out among a breed of bond products whose managers can invest across the fixed-income spectrum, including bets that pay off when interest rates rise. The unconstrained funds have caught on as investors flee conventional fixed-income funds in anticipation of rates climbing further and spurring losses in bonds when the Federal Reserve scales back its asset-buying program.

"This portfolio has a shot at making money in any rate environment," co-manager Michael Swell said in a telephone interview from New York. "You will see money flowing out of traditional fixed income into products like this one."

Slowing stimulus may lead to higher interest rates, which reduces the value of interest-paying securities with fixed rates.

Shifting Deposits

Non-traditional bond funds pulled in a record $51.5 billion this year through last month, according to Chicago-based Morningstar, while intermediate-term bond funds, the core fixed-income product for many investors, had $73.2 billion in redemptions.

The $28 billion Pimco Unconstrained Bond Fund (PUBAX) won $9.6 billion, while Bill Gross's $244 billion Pimco Total Return Fund (PTTRX) had $36.9 billion in withdrawals, Morningstar estimates. Pimco Total Return, which lost its title as the world's largest mutual fund in October, fell 1.5 percent through Dec. 13, compared with a decline of 1.8 percent for the Barclays U.S. Aggregate Index.

Gross, 69, took over Pimco's unconstrained fund Dec. 5 when manager Chris Dialynas went on sabbatical at Newport Beach, California-based Pacific Investment Management Co.

Investors may not appreciate that the flexible funds, whose assets grew 20-fold after the 2008 financial crisis to $119 billion, carry their own risks even with limited exposure to rising interest rates, said Eric Jacobson, Morningstar's director of fixed-income research.

High Yield

Many of the funds, including Goldman Sachs's, own high-yield and emerging-market bonds, which can lose value if economies falter or stock markets slump, Jacobson said. Goldman Sachs Strategic Income fell 2.5 percent in 2011, trailing 95 percent of its peers, as large positions in mortgages not guaranteed by the U.S. government declined amid a selloff of riskier assets, Swell said.

For Goldman Sachs, the popularity of its go-anywhere fund has given the bank success in an area where it has historically trailed better-known competitors. Previously, the bank's top-selling mutual fund in a full calendar year was the Goldman Sachs High Quality Floating Rate Fund, which took in $2.8 billion in 2002, according to Morningstar.

"They've never been much of a player in mutual funds," Geoff Bobroff, a fund industry consultant based in East Greenwich, Rhode Island, said in a telephone interview.

'Uphill Climb'

Goldman Sachs had $81 billion in U.S. long-term mutual fund assets as of Nov. 30, ranking 23rd with less than 1 percent market share, Morningstar data show. The totals don't include money-market funds. In the past five years, the bank's U.S. bond funds outperformed 57 percent of their peers and its stock funds beat 49 percent, according to Denver-based Lipper.

One hot fund such as Strategic Income can boost a firm's visibility, Bobroff said. "It is still an uphill climb to become much bigger given all the competition," he said.

Goldman Sachs attracted more stock and bond mutual-fund money, $12.8 billion, than all but six U.S. firms this year through November, Morningstar's data show.

"This business is a focus for us and we are pleased with what we are seeing," James McNamara, president of the bank's mutual-funds business, said in a telephone interview.

Goldman Sachs has added salespeople who deal with brokers and advisers in the U.S., Europe and Asia in a bid to increase market share, McNamara said.

Global Network

Goldman Sachs Asset Management, the unit overseeing more than $900 billion, last month raised $826 million for its first closed-end fund, which will invest in energy partnerships. Closed-end funds have a fixed number of shares outstanding and usually trade on a stock exchange.

Investment management accounted for 18 percent of the bank's revenue in the third quarter, compared with 14 percent a year earlier.

Strategic Income managers Swell and Jonathan Beinner, both 47, get input at weekly meetings and via e-mail from 250 Goldman Sachs employees around the world with expertise in areas such as interest-rate risk, emerging markets and currencies. The fund is put together based on a series of independent judgments, rather than one top-down view of the global economy, Swell said.

Swell joined Goldman Sachs in 2007. He has a bachelor's degree and a master's in international economics and finance from Brandeis University in Waltham, Massachusetts.

'Constructive Path'

The fund has bet on rising U.S. interest rates for most of 2013, Swell said. Yields on long-term Treasury securities have surged since May, when Fed Chairman Ben S. Bernanke indicated that the central bank might begin to reduce its $85 billion monthly bond purchases. The yield on the 10-year U.S. Treasury note climbed to 2.88 as of yesterday from 1.93 percent May 21, the day before Bernanke first spoke of tapering.

“With the U.S. economy on a constructive path, we are short across the yield curve,” said Swell, who predicted that the Fed might start raising short-term interest rates as soon as 2015.

The stronger economy has lifted high-yield bonds and non-agency mortgages, asset classes that together made up 15 percent of Swell’s portfolio at the end of October.

High-yield bonds, or corporate debt rated below investment grade, returned 6.8 percent in 2013, according to the Bank of America Merrill Lynch U.S. High Yield Index. Non-agency bonds gained 9.6 percent through November, according to Amherst Securities LP.

Municipal Selloff

The portion of Strategic Income’s assets in municipal bonds rose to 6 percent as of Oct. 31 from zero in June, according to Goldman Sachs. Municipal bonds declined 2.5 percent this year through Dec. 13, Bank of America Merrill Lynch indexes show, as investors spooked by the bankruptcy of Detroit and the fiscal woes of Puerto Rico pulled money from the funds.

“This market is retail driven, so when a selloff begins sometimes it takes a life of its own,” Rafael Costas, co-head of municipals at Franklin Advisers Inc. in San Mateo, California, told Bloomberg News in an interview this month.

The selling has created bargains, especially among higher-quality municipals, Swell said. The fund owns the securities while hedging the interest-rate risk, a bet that will pay off if the difference in yield between municipal and Treasury securities narrows. Spreads tighten when investors perceive less risk, demanding smaller premiums.

One wager that hasn’t worked is an investment in emerging-market debt, which lost 5.6 percent in 2013 through Dec. 13, based on the JPMorgan Emerging Markets Bonds Index. The bonds have been hurt by the perception that the Chinese economy is slowing and by concerns that a reduction in Fed stimulus will prompt yield-seeking investors to pull their money from emerging-market economies.

China, Brazil

“The stories about the collapse of China are exaggerated,” said Swell, who had 12 percent of his fund in emerging-market bonds as of Oct. 31. Interest rates in countries such as Mexico and Brazil are too high, he said. In Brazil, Goldman Sachs is betting that as rates fall, bonds will appreciate and the currency will decline.

The fact that the fund has such varied investments at the same time is a plus, not a concern, Swell said.

“The only free lunch in investing is diversification,” he said.

By Charles Stein Dec 16, 2013 9:00 PM PT

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