

# Investment perspectives



**Rodwell Chadehumbe**

Portfolio Manager

First Investors Limited Duration Bond Fund

## Key highlights:

- First Investors Limited Duration Bond Fund has been investing in high yield bonds<sup>1</sup> since January, which has helped the Fund maintain its competitive yield.
- We expect additional tightening this year by the Federal Reserve.
- Sharp swings are largely triggered by Fed action and, historically, have been better absorbed by short-dated securities than those further out on the yield curve.
- The most attractive bonds appear to be found in the front end of the curve.

## Why consider shorter duration in a rising rate world?

Rodwell Chadehumbe, Portfolio Manager, recently shared an update on the [First Investors Limited Duration Bond Fund](#) and his economic outlook.

**What has changed about the First Investors Limited Duration Bond Fund?**

**Rodwell Chadehumbe (RC):** The first change to note is that, as of January 31, the First Investors Limited Duration High Quality Bond Fund was renamed the **First Investors Limited Duration Bond Fund**. Second, Muzinich & Co., the subadviser for First Investors Fund For Income and First Investors Floating Rate Fund, was retained to subadvise a high yield allocation in the Limited Duration Bond Fund. We have discretion to now add a position from 0% to 10% in that sector. Third, the Fund's management fee rate was reduced, with the fee contracted before the first breakpoint reduced to 0.41% of average daily net assets from 0.66%, a reduction of 25 basis points. We are excited about what these enhancements potentially may offer our investors.

**Has the Fund's objective changed at all?**

**RC:** No. The objective remains to seek current income consistent with low volatility of principal in a short duration portfolio containing maturities of less than six years. We remain very mindful of where these bonds fall along the duration path. High yield bonds tend to be on the shorter-end of the yield curve, but they could fall beyond five years which, by prospectus, the Fund is permitted to purchase. By including high yield securities in its investment universe, the Fund has now added an asset class that can help increase its overall yield and total return.

**The Fund changed peer groups earlier this year, moving from Lipper to Morningstar. How has that affected the Fund?**

**RC:** The Fund's overall maturity is shorter compared to its benchmark, the Bank of America Merrill Lynch 1-5 Year US Broad Market Index, and versus its category peers. We have shortened the Fund's duration to be more in line with its new peer group. We feel this is prudent, especially given that we expect the Fed to continue to raise rates this year.

**The Fund has been investing in high yield securities for a few months now. What does that allocation look like?**

**RC:** The Fund currently has approximately 5% of the portfolio in high yield securities, which is fairly comparable to its peers. Using this allocation, we have been able to increase the Fund's yield. Of course, we would point out that past results do not indicate future performance. Overall, the Fund's average quality remains investment grade.

**How is duration<sup>2</sup> managed?**

**RC:** We manage the Fund's duration within the existing parameters of between one and six years. The Fund may, from time to time, sell U.S. Treasury futures to help manage its overall duration.

**Do you invest in any international securities?**

**RC:** No. The Fund only invests in U.S.-issued securities, although it does, on occasion, invest in foreign companies that have U.S. dollar-denominated issuances. The Fund's top 10 holdings as of 6/30/18 are shown in *Exhibit 1*.

**What is the Fund's typical cash level?**

**RC:** We do not necessarily want to have any uninvested cash in the Fund, as we would prefer to deploy it in the market. However, generally speaking, our cash level can range from 0% to 5%.

**Where are you finding opportunities today?**

**RC:** Given how much higher yields have moved recently, we think the most attractive bonds can be found in the very front end of the yield curve. Generally speaking, when you look at where rates have been and where they are year-to-date, on a risk-adjusted basis, the shorter-dated securities offer solid levels of yield for investors. Also, the Fed is still in the middle of its tightening cycle, so investing in a combination of fixed and floating rate bonds is likely to mitigate the effects of continued rate hikes.

<sup>1</sup> Commonly referred to as "junk" bonds.

<sup>2</sup> Duration is a measure of the sensitivity of the price (or the value of the principal) of a fixed-income investment to a change in interest rates. It is expressed as a number of years. Bond prices are said to have an inverse relationship with interest rates. Therefore, rising interest rates indicate bond prices are likely to fall, while declining interest rates indicate bond prices are likely to rise.

### Exhibit 1: First Investors Limited Duration Bond Fund

#### Top 10 holdings as of 6/30/18

| Security  | % of Total Net Assets |
|---|-----------------------|
| Federal Home Loan Bank, 2.375%, 03/30/2020      | 3.5%                  |
| U.S. Treasury Notes, 2.250%, 03/31/2020         | 3.0%                  |
| Royal Bank of Canada, 2.200%, 09/23/2019        | 2.7%                  |
| Morgan Stanley, 5.500%, 07/28/2021              | 2.5%                  |
| Stadshypotek AB, 1.875%, 10/02/2019             | 2.1%                  |
| Bunge Limited Finance Corp., 8.500%, 06/15/2019 | 2.1%                  |
| Entergy Corp., 5.125%, 09/15/2020               | 1.9%                  |
| JPMorgan Chase & Co., 4.500%, 01/24/2022        | 1.6%                  |
| O'Reilly Automotive, Inc., 4.625%, 09/15/2021   | 1.6%                  |
| Capital One Financial Corp., 3.050%, 03/09/2022 | 1.5%                  |
| <b>Total</b>                                    | <b>22.5%</b>          |

Why should an investor consider allocating to a short-term duration bond fund like the First Investors Limited Duration Bond Fund?

**RC:** If you want to reduce risk related to interest rate movements, a short duration fund makes sense for a number of reasons. First, there is the inherently defensive nature of these types of funds. With a short-maturity horizon, there is a higher likelihood that bonds in these portfolios will pay investors back. Also, if you look at the bond market yield curve and its fluctuations, there have been significant swings, and we think these sudden spikes are likely to increase in frequency. When these movements occur in the intermediate- to long-term portion of the curve, they can have a substantial impact. But, in the short-end, where the Limited Duration Bond Fund invests, these swings tend to be better absorbed than those further out on the curve. We also think that being able to invest across various fixed income sectors offers a high level of diversification for an investor and is a key consideration for this Fund. Finally, combined with the lower volatility typically experienced in this sector, this Fund can offer its investors an attractive level of income.

**On the topic of active versus passive management, can you discuss some of the advantages for using an actively managed fund in the short duration space versus an ETF or a passive manager?**

**RC:** There have recently been some high levels of volatility in the market compared to the past three or four years. During periods such as these, it is important to have an active manager to help mitigate risks within a fund, be it credit or duration risk. Through our forward-looking approach, our team is able to make adjustments to the Fund. We consider the portfolio mix and economic trends so the Fund's holdings are evolving along with any new challenges appearing in the market. Passive management doesn't really incorporate that approach. Our style allows us to be more adaptive and flexible to market changes.

Oil prices have recently rallied and with a high yield market dominated by energy issuers, it would seem the sector has benefited from the spike. Is that accurate?

**RC:** Yes, if we look back to when oil prices were really depressed, many energy-related companies suffered as a result. The overall quality of issuers in today's high yield universe is stronger as firms that could not withstand that level of market stress have since defaulted. We now have a much more efficient high yield sector.

**Do you think that default risk is increasing as rates increase?**

**RC:** We don't necessarily think that default risk is rising in this environment, but given the current level of spreads, especially amongst lower-rated issuers, we believe that investors are not really being compensated for buying longer-dated debt. The opportunity cost across the curve, today, seems very flat regardless of a credit's quality. From a historical standpoint, credit spreads are almost at their tightest margin (see *Exhibit 2*), which indicates that there could be a market correction.

**What are your expectations for the U.S. Treasury yield curve?**

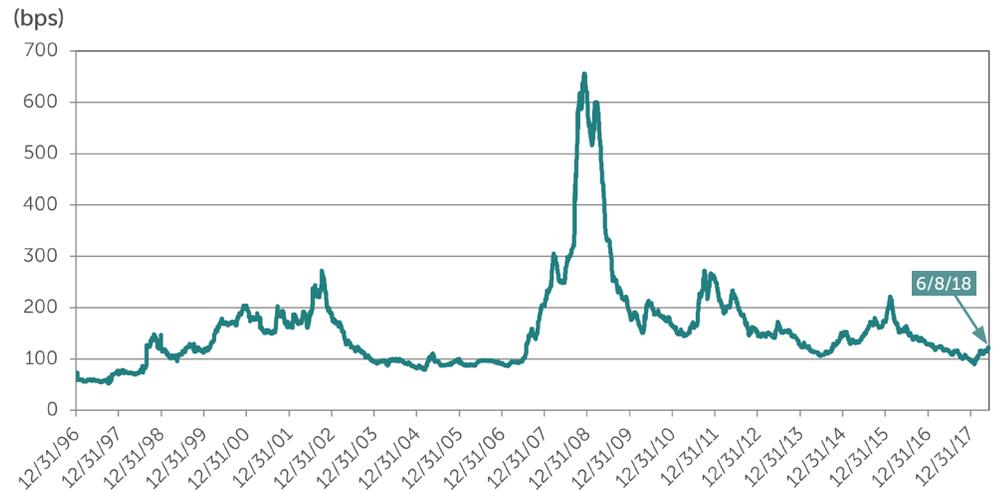
**RC:** As long as the Fed remains in its current hawkish stance, our expectation is for the curve to continue to flatten, especially on the long end between 10 and 30 years. Some market observers have suggested that an inverted yield curve may be looming, which, according to conventional market wisdom, suggests that a recession may be on the near horizon. We don't think that is particularly likely at the moment, but feel that there could be a downturn further along the road.

**It is early in Chairman Jerome Powell's term at the Fed, but do you have any thoughts about how is he doing and how that transition has worked so far?**

**RC:** In our opinion, the transition from Janet Yellen to Jerome Powell has gone very well. We think Chairman Powell will favor a balanced style and that the Fed's stance is going to remain in a gradualist approach to the economy, with the expectation of additional Fed tightening this year.

## Exhibit 2:

## Credit spreads near historic lows



Source: Federal Reserve Bank of St. Louis, FRED, 6/8/18. Based on ICE BofAML US Corporate Master option-adjusted spread, daily, not seasonally adjusted.

These views represent the opinions of the Portfolio Manager, who is employed by Foresters Investment Management Company, Inc., and are not intended as investment advice or to predict or depict the performance of any investment. These views are as of the close of business on June 30, 2018, based on the information available at the time and are subject to change at any time based on market or other conditions. We disclaim any responsibility to update such views. The Fund's portfolios and strategies are subject to change.

Nothing shown herein should be construed to be a recommendation to buy or sell a security. All investments involve risk, including possible loss of principal. You can lose money by investing in a fund. There is no guarantee that the Fund's investment objective will be achieved. The principal risks of investing in the Fund are Interest Rate Risk. Credit Risk. Exchange-Traded Fund Risk. Prepayment and Extension Risk. Derivatives Risk. High Yield Securities Risk. Sector Risk. Market Risk. Security Selection Risk. **Past performance does not guarantee future results.**

The ICE BofA Merrill Lynch U.S. Corporate Master Index is an unmanaged index comprised of U.S. dollar denominated investment grade corporate debt securities publicly issued in the U.S. domestic market with at least one year remaining to final maturity.

The Bank of America Merrill Lynch 1-5 Year US Broad Market Index tracks the performance of U.S. dollar denominated investment grade debt publicly issued in the U.S. domestic market, including U.S. Treasury, quasi-government, corporate, securitized and collateralized securities.

Investors cannot invest directly in an index. Indexes are unmanaged and do not reflect the performance of any particular security.

First Investors Funds are managed by Foresters Investment Management Company, Inc. and distributed by Foresters Financial Services, Inc.; each is a wholly owned subsidiary of Foresters Financial Holding Company, Inc. (FFHC).

*For more information about First Investors Funds from Foresters Financial Services, Inc., you may obtain a free prospectus by calling 800 423 4026 or visiting foresters.com. You should consider the investment objectives, risks, charges and expenses of the funds carefully before investing. The prospectus contains this and other information about the funds, and should be read carefully before you invest or send money. An investment in these funds is not a bank deposit and is not insured or guaranteed by the Federal Deposit Insurance Corporation (FDIC) or any other government agency.*

Foresters Financial™ and Foresters™ are the trade names and trademarks of The Independent Order of Foresters, a fraternal benefit society, 789 Don Mills Road, Toronto, Canada M3C 1T9 and its subsidiaries, including Foresters Financial Services, Inc. Foresters Financial Services, Inc. is a member of the Securities Investor Protection Corporation (SIPC).