Century Bonds Illiquid: Towers Watson

By Editor Test *Wed, Sep 22, 2010*

Geert-Jan Troost, an investment consultant at Towers Watson, said that while these bonds can serve as a "great" diversifier from a liability point of view, there were a number of issues to consider.

Towers Watson has argued that pension funds have little to gain from investing in centenary bonds, as the often small issuance results in an inherently illiquid market, IPE.com reported.

Rabobank in the Netherlands recently announced it would issue $350m (€267m) worth of 100-year bonds with a 5.8% interest rate, with a dozen investors from Europe, the US and Asia contributing funds.

However, Geert-Jan Troost, an investment consultant at Towers Watson, said that while these bonds can serve as a “great” diversifier from a liability point of view, there were a number of issues to consider.

“The first is liquidity in the secondary market,” he said. It looks like a large issue because there is not much comparable around. If your pension fund is lucky enough to acquire some of these bonds, what would be the reason to sell it? Once these things are sold, there’s a very illiquid secondary market.”

Troost said the problem for Europeans investing in the Rabobank bonds was the mismatched currency. He argued that, while over a long period it should be an effective investment, in the short term, no guarantees could be made that the US dollar and the euro would evolve at the same pace, resulting in a mismatch in liabilities.

“It is written nowhere that, in the short term, which can be several years, the US dollar curve would move in the same direction and extent as the euro curve,” he said. “The euro curve is, of course, where the liabilies are discounted against. In our studies, for instance, we completely discard any investments that are done in dollars for reasons of duration matching because you don’t want to match your durations and be vaguely right in 10 years’ time.”

Troost said an interesting alternative investment would be the recent zero-coupon version of 50-year bonds issued by the French government. “That’s not a bad alternative relative to the 100-year bond, which probably has a duration that is quite comparable,” he said.