Sydney Airport is one of the world's most expensive listed airports, an example of the inflated nature of defensive assets in the 'new normal' at risk of a fall, Roger Montgomery says. **Sarah Keayes/Fairfax Media**

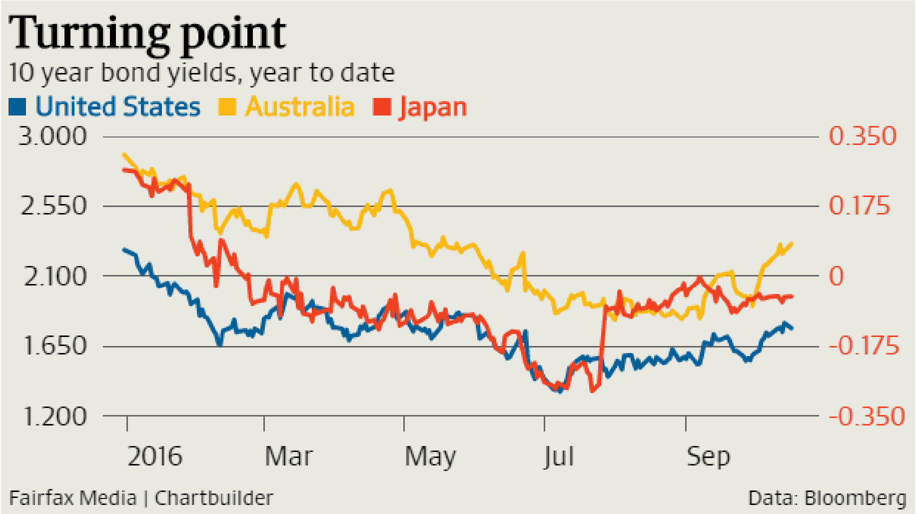
by **Vanessa Desloires**

Investors are under-appreciating the threat of a rapid rise in bond yields, which will have a serious and permanent effect on a swath of inflated asset classes, high-profile fund manager Roger Montgomery says.

The price of assets including shares, property and even art and music memorabilia has hit record highs, but while investors are fixated on central bank moves, they should be looking at the moves in long-dated bonds as a guide to where prices are headed, the chairman of Montgomery Investment Management writes in his October white paper.

"We know that low interest rates have caused investors to chase higher yields and migrate from saving deposits to higher risk assets such as shares, hybrid securities and property," he said.

The resulting crowding effect in safer sectors within the riskier sharemarket such as infrastructure and utilities means defensives such as Sydney Airport and Auckland International Airport have become the most expensive listed airports worldwide.



The tide is turning for bonds.

"They aren't the biggest airports and they aren't the most conveniently located, yet they are the most expensive. This so-called 'new normal' is anything but normal," he said.

Echoing the warnings of fellow high profile investors this month including Charlie Aitken and Ray Dalio, he said that, while this investment strategy may have worked until now, the turning tide of long-dated bonds on the back of among other factors, rising inflation, is putting investors' retirement savings at risk.

Montgomery points to rising wages and falling unemployment in the US as inflation drivers amid a tightening jobs market.

"It is currently our view that long bond rates are at the end of a 35-year decline coinciding with the end of an even longer-term expansionary credit cycle," Mr Montgomery said.

Ten-year bond yields have already begun marching higher, with the US 10-year yield climbing from 1.38 per cent in July to 1.74 per cent and yields on its Australian counterpart have also risen, from 1.82 per cent in August to 2.3 per cent.

Perpetual head of multi-asset head of investment strategy Matthew Sherwood noted that rates matter for equity markets, with a steepening yield curve pointing to a more buoyant economy.

"There is no doubt that the yield play has driven the outperformance of 'growth' over 'value' and 'defensives' over 'cyclicals' over the past year, but recently this has begun to reverse," he said.

While Mr Sherwood said he didn't see bond yields moving much higher, all eyes are on growth through the fourth quarter of this year to determine whether the solid economic data of the third quarter was a bounce or the beginning of a new trend.

Mr Montgomery warned, however, that bond yields can move steeply, noting the 10-year US rate rose by more than 200 basis points in a matter of weeks in 1994.

"If inflation does indeed emerge as an influence for bond investors, the possibility of traders beginning a fight against the US Fed increases."

An acceleration would have serious and permanent effects on investors who have bought into so-called "safe stocks".

As a result, Mr Montgomery said his fund has been slowly increasing its cash holding which, while it yields little, he believes is a smart place to hide. Cash allows flexibility to jump into inflated assets if they sell off, he said, adding there is more money to be made in businesses than in bonds, cash or property.

The firm has also launched a long/short fund and a market neutral fund in a bid to take advantage of falling asset prices, which he notes is generating interest from professional investors.

Fairfax Media Australia