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A I M's Tip: Buy Bonds

When Houston-based A I M Management Inc. speaks, those from whom the firm manages $2.1 billion worth of pension funds, mutual funds and individual assets tend to listen closely. And what A I M says is, listen to the credit market. That recent dip of the prime interest rate from 20.5% to 18% could well be the "first move" in a long and deep decline. A I M's response: a current 95% commitment of its funds to long-term securities.

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A I M's Tip: Buy Bonds

Fund Managers See Recent Drop As 'First Move' in Rate-Easing

By SAM WEINER

Watch the drum major at the head of the parade – bond prices – for a clue as to when a for-real stock market rally is developing.

Otherwise, it might be just another of Wall Street's series of 15-point upsurges that vanish when the starting gong sounds on exchange floors the next morning.

So believe the principals of A I M Management Inc., who manage some $2.1 billion in securities investments for corporate pension funds, a stable of six mutual funds, and wealthy individuals.

Noting that the stock market isn't likely to go up much until interest rates come down, A I M President Charles T. Bauer and other principals of the Houston-based money management firm are closely watching short-term rates these days.

Changes in those rates may be the tip-off as to what long-term bond rates will do and once long-term bond rates start dropping appreciably, Wall Streeters will no longer have to guess as to whether higher stock prices can be sustained, Bauer indicated.

"Short-term rates have come down about 300 basis points in the last month," Bauer said. "Commercial paper was about 17½% and maybe a little above that a month ago, and now it's down to around 15%, so that's the first move." (In bond industry lingo, one full percentage point is equal to 100 basis points.)

That "first move" spurred a bit of a rally in the bond market, but the drum major is still prancing up and down virtually in place, practicing the twirling of his baton while he waits for the signal to get the parade moving.

A I M, however, isn't waiting until the parade goes by before it swings into action.

"We've already had a major commitment to long-term bonds in our (mutual) funds, of course, and we've been investing in both long-term bonds and longer-term convertible securities (convertible bonds and convertible preferred stocks)," said Gary T. Crum, a vice president of A I M and manager of its fixed-income and high-yield securities sector.

But, Crum was asked, with the interest rate picture still hazy, are you buying long-term bonds right now?

"Yes, we are," said Crum. "We had a cash position earlier in the year which might have been as high as 15%, and that's probably down to 4% to 5% right now."

That's another way of saying that the funds are about 95% to 96% invested in long-term securities at present seemingly reflecting optimism on the part of A I M principals that they are not only "locking up" the highest interest rates in history, but that interest rates will moderate in the future and push bond prices up.

Crum cites the drop of approximately 300 basis points in short-term interest rates from their highs, and says that A I M principals believe that interest rates "are going to gradually trend downward."

"I think they (short-term rates) might go down maybe another 200 basis points in the last half of this year and into the first part of 1982," he said, "but I think it's going to be much harder for long-term rates to drop.

"You will see long-term rates slowly start to edge down when it becomes apparent that economic activity has, in fact, slowed."

PRESIDENT CHARLES T. BAUER

Some influential investment bankers and economists including Henry Kaufman, chief economist of Salomon Brothers, are skeptical of the short-term rate declines, including the recent move of bankers' prime lending rate from 20½% to 18%.

Kaufman has forecast that interest rates are likely to advance again to new highs within six months, although there could be declines in the interim, with the bank prime rate perhaps going down to as low as 16% to 17% before turning up again.

Likewise, Felix Rohatyn, a partner of Lazard Freres & Co., cautions that the present retreat in short-term rates probably won't last long.

Rohatyn and Kaufman got some added ammunition in their arsenal recently when the nation's basic money supply (dollars in circulation, plus those bank deposits against which Americans can write checks), rose sharply just when it seemed to be on a downward course.

That places an even further burden on the tight-rope walking act of the Federal Reserve Board, the government agency created by the Congress (after the 1911 money panic) to regulate the nation's money flow.

The Reagan administration, fearful of a further downturn in economic activity, particularly in the depressed housing and auto industries, has been trying to persuade the Fed to ease up on its tight credit stance.

VICE PRESIDENT JACK PAINTER

VICE PRESIDENT GARY T. CRUM

Jack W. Painter, an AIM vice president and manager of the company's convertible securities sector, notes that the Fed, which prides itself on its independence from the White House and the Congress, is faced with the problem of not only making the right moves, but with simultaneously maintaining a credible image.

From one standpoint, Painter said, loosening credit could be to the Fed's advantage at this point, since the money supply is still running below the agency's monetary target.

"But how far they loosen, and how quickly they loosen, are two important variables," Painter said, adding:

"If they loosen too quickly and overshoot the monetary target, they will

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add to the uncertainty of the economic outlook and continue to put pressure on the outlook for the fixed-income and equity markets.

"But if they ease gradually for an extended period of time – I'm talking about over a couple of months – then I think the markets will respond in a positive manner."

What's worrying Wall Street, Bauer declares, is that "after having embraced President Reagan's supply side economics" signs began to appear that the federal budget deficit would be much higher than almost everyone expected, and that the nation is now faced with the possibility of a $60 billion to $70 billion deficit.

"And as Jack (Painter) said, the Fed has to show credibility to one and all and be sure that they're not going to just play politics and ease money while we're having these problems," Bauer said.

But Bauer wasn't taking either the Reagan Administration or the Fed to task.

"One thing this administration has got to do is break inflationary expectations," he said.

He stressed that one of the things that consumers in the U.S. have had going for them in the past several years have been skyrocketing home prices – about a $28,000 average home price in 1968 vs. about $80,000 at present – which has tended to make the consumer feel wealthy.

"At that price, sales started coming down, because people can't finance new homes, and now he isn't going to feel quite so wealthy," Bauer said. "His rate of savings may increase rather than decreasing the way it has for the past five years. And maybe that, in itself, will also bring down the rate of inflation.

"Some of that is already happening. Houston is an exception. All around the country, prices are already starting down."

Painter says there are other signs, too, that inflationary expectations may be waning.

Not only are housing prices not going up as fast as they were, but oil prices have come down and provided another "drag on inflationary expectations," he said.

"Reagonomics also may have a part in the downward pressure on prices," Painter said. "And to it the downturn in the fixed income and equity markets, and it becomes apparent that consumers are not doing as well as before.

"Layoffs are certainly increasing. So the consumer may start to feel a change in his psychological makeup as he goes from a spending mold to a savings mold as he worries about his situation.

"The prospect now is that he is being given a vehicle where he can earn interest rates that are real – in other words, over and above the rates of inflation. So maybe his savings rates also will start going up."

That, undoubtedly, would cause the economy "to retreat somewhat," Painter said.

Bauer says that with the "real interest rates" being at the level where they are – at what some say is about a 35-year high – "it seems to me, there is room for a decline in (interest) rates."

He defines the real rate of interest as being the stated interest rate minus the rate of inflation.

Currently, long-term U.S. Treasury bonds are yielding around 14½%, and the rate of inflation is running below 10% – which means that the net difference, or real interest rate, is now at approximately 5%.

"In October of last year," says Gary Crum, "long-term Treasuries were yielding 11.7%, and I would guess that a year ago inflation was probably about equal to long-term interest rates, so there probably wasn't much of a real rate of return."

What apparently is making many investors hesitant about rushing in to take advantage of that real rate of return is the fear that inflation could actually worsen – especially if a $60 billion to $70 billion federal budget deficit materializes – and push bond prices even further down.

The collapse of bond prices in recent years has wiped out billions of dollars in market value. Those are paper losses and don't affect holders of bonds unless the bonds are sold before maturity. At maturity, bonds are redeemed at their face value.

Bauer, however, believes some silver linings could be on the horizon for bond prices, and he points to the stabilization of prices in some sectors of the economy, particularly home prices, oil prices, and some food prices.

"The only thing that's really going up are transfer payments (Social Security payments, unemployment payments, etc.), and, of course, the interest factor and the cost of money itself," Bauer said. "Not only that –, but we're having a moderation of the inflation rate, which should be reflected in long-term interest rates."

Although Bauer expects considerable money to go into the new all-savers certificates and for a large flow of funds to move back into the stock market once it shows signs of making a sustained

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NEW ISSUE

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uphill climb, he doesn't believe investors will abandon money market funds.

"I think the money market funds are permanent," he said. "People are used to them. They like them. They're getting good service on them, and they're getting competitive rates.

"They don't have to think about re-investing every six months. There are now some $160 billion or so in the funds, and the funds may lose some of that if stocks get going, but it's going to be a permanent part of the market."

Of approximately $2.1 billion which A I M manages, about $100 million comes from private accounts – wealthy individuals or families and corporate accounts – and the other approximately $2 billion is in the mutual funds the company operates.

The company doesn't handle a private account unless it has at least $10 million to invest. That tends to make A I M one of the bluest of the blue chips among professional money managers in the Southwest, and that's the way the A I M principals structured the organization.

"We visualize ourselves as managers of big blocks of money," says Bauer.

On the other hand, investors in the six mutual funds that A I M is managing can get in for as little as $1,250. Those funds have thousands of shareholders, spread throughout the country and overseas. Many are retired people in California, Arizona and other Sun Belt areas.

A I M's oldest mutual fund is High Yield Securities Inc., which was brought out in 1977. Convertible Yield Securities Inc. was introduced in the spring of 1978, and a few months later, the company established Short-Term Yield Securities, a money market fund. First City National Bank of Houston is the advisor on Short-Term Yield Securities, and A I M is the administrator and distributor.

A I M also has the Edson Gould Fund Inc., which was acquired from Anametrics Inc.; it manages the fund, although Anametrics, of which Edson B. Gould is a principal officer, acts as sub-advisor.

Another A I M fund is an institutional money market fund called Short-Term Investments, and a new fund, Alex Brown Cash Reserve Fund, was introduced about 45 days ago.

Before becoming one of the founders of A I M several years ago, Bauer was president of American General Capital Management, a Houston company with more than $3 billion under management. Bauer has more than 30 years of experience in portfolio management and security analysis.

Similarly, Gary Crum has extensive experience in securities – particularly fixed income securities. He was formerly portfolio manager of fixed income securities in excess of $400 million with American General.

Painter and other principals of the firm likewise have wide experience in the securities industry.

The company's officers include Bauer, as president; M. D. Moross, an investor and large shareholder who resides in London, board chairman; Roy Hannison, vice president and treasurer; Gary Crum, vice president; W. Thomas Fiquet, president of A I M Distributors Inc., a subsidiary; Robert H. Graham, vice president and corporate secretary; Jack W. Painter, vice president; Stephen H. Pouns, vice president - research; James A. Smith, vice president, and J. Abbott Sprague, assistant vice president.

Altogether, the firm has a staff of about 30 people.

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