



CAMRADATA

Multi Asset Credit Whitepaper

Where lies the future for Multi Asset Credit?

July 2017



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For many years investors have considered fixed income as a pretty safe haven especially when investing in it to help offset more volatile and risky investments held in their portfolios. The risk of capital loss in bond portfolios was generally viewed as limited especially during years of falling interest rates. However, investors are now becoming more concerned about the risk of losing money with rates more and more likely expected to rise.

Plus with pension liabilities increasing and insurance firms' liabilities still requiring to be met the returns available from fixed income assets to help fund them are still relatively low. In addition, one could argue that some of the largest and most liquid segments of the global fixed income market do not appear particularly attractive today.

But do investors need to be as concerned as they are especially now there are opportunities in fixed income strategies where they are not constrained to one type of investment but have the opportunity to allocate capital and adjust their risk exposures dynamically across the full fixed income spectrum.

This is why Multi-Asset Credit strategies have become increasingly popular... it is their flexible and diversified approach that makes them attractive to investors investing in this asset class.

However, given the continuous challenges in the fixed income market does Multi-Asset Credit still meet the needs of the investors not just now but more importantly for the future as well? And how are asset managers reviewing their allocation in this strategy and what changes, if any, are investors making in their approach to this asset class?

CAMRADATA's Roundtable will therefore focus on the opportunities offered by Multi-Asset Credit and investigate what the future holds for this asset class both in this current macroeconomic climate and going forwards.

“ Multi-Asset Credit strategies have become increasingly popular... it is their flexible and diversified approach that makes them attractive to investors ”

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**Eaton Vance Investment Managers**
Company Profile

Eaton Vance is a leading global asset manager with history dating back to 1924. With offices in North America, Europe, Asia and Australia, Eaton Vance and its affiliates manage \$380.9 billion in assets (31/03/2017). We offer individuals and institutions an array of investment strategies and wealth management solutions through a multi-affiliate structure that leverages the expertise of several investment management firms, including Eaton Vance Management, Hexavest, Parametric and Calvert Research and Management*. We are a market leader in the management of floating-rate loans and also offer equities, US and Global high yield, multi-asset credit, global macro and municipal bond capabilities. Our long-standing record of providing exemplary service, timely innovation and attractive returns through a variety of market conditions has made Eaton Vance the investment manager of choice for many of today's most discerning investors.

* Eaton Vance acquired the business assets of Calvert Investment Management, Inc. on December 30, 2016 and formed a new subsidiary, Calvert Research and Management (Calvert).



Justin H. Bourgette, CFA
Portfolio Manager

Justin Bourgette is a vice president of Eaton Vance Management and portfolio manager on Eaton Vance's customized solutions team. His areas of expertise include multi-asset/credit valuations and allocation. He is a named Portfolio Manager on Eaton Vance's Multi-Asset Credit strategy, where he works closely with all of Eaton Vance's fixed-income teams. Justin joined Eaton Vance in 2006.

Previously, Justin was affiliated with Investors Financial Services as an analyst in corporate finance, and with National Grid, where he worked in business planning and engineering. Justin earned a B.S. from Worcester Polytechnic Institute and an M.S., with high honors, from Boston University. He is a CFA charterholder and a member of Eaton Vance's Asset Allocation Committee.

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Franklin Templeton Investments Company Profile



**FRANKLIN TEMPLETON
INVESTMENTS**

Franklin Templeton Investments is one of the world's largest dedicated asset management companies. For more than six decades, it has been committed to delivering exceptional risk-adjusted returns over the long-term. A single-minded focus on investment excellence, supported by a unique global presence and perspective, enables it to uncover opportunities and to offer a breadth of investment solutions that few can match. Franklin Templeton's institutional business development and client servicing teams have considerable experience in providing tailored services to consultants, pension funds, charities, local authorities and other institutional investors.



Thomas Raftery Vice President, Senior Product Manager

Thomas Raftery is a vice president, senior product manager responsible for US Taxable and Global Fixed Income Strategies at Franklin Templeton Investments. Tom has over 15 years of experience in the investment industry.

Prior to joining the Franklin Templeton Fixed Income Group in 2015, Tom worked at Mercer, where he most recently served as a research consultant responsible for advising institutional clients on fixed income portfolio strategy and investment manager selection. He worked for Mercer in this capacity in the US, Australia, and Hong Kong.

Tom holds a BS in finance from the University of Illinois and an MBA from the University of North Carolina. He is a Chartered Alternative Investment Analyst (CAIA) charterholder and a member of the CAIA Association.

Sponsor



Asset Management

Investec Asset Management
Company Profile

Investec Asset Management provides investment products and services to institutions, advisory clients and individuals. Our clients include pension funds, central banks, sovereign wealth funds, insurers, foundations, financial advisers and individual investors. It all began in South Africa in 1991. We were a small start-up offering domestic strategies in an emerging market. Over two decades of growth later and we're an international business managing approximately £95 billion* for clients based all over the world.

*As at 31 March 2017



Jeff Boswell
Strategy Leader

As strategy leader, Jeff is responsible for managing and leading the development of the developed markets credit platform at Investec Asset Management. His responsibilities include acting as a portfolio manager across a range of Investec

Asset Management credit funds.

Prior to joining the firm Jeff worked at Intermediate Capital Group PLC as Head of Portfolio Management within its Credit Fund Management division. He was also a member of the investment committee across both liquid and illiquid Credit Fund Management strategies. Prior to this he was at Investec Bank Limited as Head of Acquisition Finance, where he established the Acquisition Finance platform and led the development a third party asset management CLO platform alongside. Previously he has also held structured and leveraged finance roles at NIB Capital (London) and BOE Merchant Bank (South Africa).

Jeff holds a Bachelor of Commerce Honours (Cum Laude) from University of South Africa. He is also a Chartered Accountant (SA) and a CFA Charterholder

Participants



Keith Cornelius

Trustee of the American Express UK Pension Fund

Keith Cornelius is a Trustee of the American Express UK Pension Fund. He has been a trustee for 10 years, during which time the plan and its investment approach have changed to reflect the closure to new accruals. He leads the covenant assessment process and also chairs the Investment Subcommittee, working with investment advisors to ensure the Plan's assets are invested appropriately.

Prior to being a trustee, Keith worked for 25 years in a number of finance roles at American Express.

He graduated from Cambridge University with a degree in Economics.



Mette Charles

Senior Investment Research Consultant

Mette Charles is a Senior Investment Research Consultant for Aon Hewitt's Global Investment Management Team. Mette joined AON in 2007 and is based in the UK, specialising in Fixed Income research. Her role is to research and recommend Asset Managers for fixed income strategies to Aon Hewitt consultants.

Prior to this Mette spent 14 years with Merrill Lynch managing bond portfolios, both institutional and retail, across the Fixed Income spectrum. Mette started her career in bond sales with UBS Phillips and Drew. Mette holds a BSc in Economics and Politics from Bristol University, the IMC and Institute of Investment Management Research Cert.



Participants



Alistair Sutherland

Consulting Director, Investment Services Team

Alistair Sutherland is a Consulting Director within Deloitte's Investment Services Team, providing investment advice to public and private sector clients covering investment strategy, manager structure and selection, ongoing monitoring and governance reviews. In addition, Alistair is responsible for leading the manager research undertaken by the Investment Services Team.

Prior to joining Deloitte in 2007, Alistair was responsible for running Mercer's Investment Consulting business in Scotland.

Alistair has over 30 years of investment experience encompassing investment management, stock broking and consultancy.



Ravi Cheema

Senior Associate, Investment Team

Ravi is a Senior Associate within the Investment Team at P-Solve, chairing the Fixed Income Research Committee and serving as a member of the U.S. Investment Committee. He is responsible for conducting asset class research, manager selection and monitoring across fixed income and alternative strategies. Current coverage includes high yield, emerging market debt and private credit, which feeds in to allocation decisions for fiduciary portfolios and advisory services.

Ravi Cheema joined P-Solve in July 2012, having begun his career in the accounting industry in 2008 within the KPMG Financial Services Tax and Audit practice.

Ravi graduated with a First Class BSc (Hons) Degree in Economics from the London School of Economics, and is a CFA charter holder.

Participants



Greg Fedorenko
Vice President, Manager Research

Greg has responsibility for Redington's asset class and manager research in traded credit, comprising global investment grade, high yield, leveraged loans, ABS, and absolute return fixed income.

He joined Redington in 2011 after completing a PhD in Medieval French History from Cambridge University. Greg has been a CFA charterholder since September 2015.



Brendan Maton
Freelance Journalist

A highly experienced financial journalist with an expansive network of contacts in the UK and across Europe. Brendan has written about pension schemes and national welfare systems from Finland to Greece for 18 years and understands the retirement savings industry in each European country.

Brendan has interviewed EU commissioners and national ministers; central bankers; pension scheme heads; insurance chief executives; chief investment officers; actuaries; union officials; professional and lay trustees. He worked at Financial Times Business for eight years, finally as editor-in-chief of all international pensions titles. Brendan has spent the last ten years as a freelancer for a number of publications, including Financial Times, Responsible Investor, Nordic region pensions news and IPE. He is also Chief webcast host for IPE.

Brendan has acted as conference chair for Financial News, the UK National Association of Pension Funds, Dutch Investment Professionals Association (VBA), Corestone, Insight Investment, Marcus Evans, Robeco Asset Management, Sustainable Asset Management (SAM), Towers Watson.

Multi Asset Credit Roundtable

Where lies the future for Multi Asset Credit?



A decade after the Great Financial Crisis, credit is now seen as the go-to asset class to keep pension funds and insurers in good health. Bundles of mortgages, car loans, High Yield and Emerging Market debt are all deemed more attractive on a risk-adjusted basis than holding company shares; and more generous than safer government bonds.

“Credit is going to be part of the portfolio because of the attractive risk-adjusted returns,” said Justin Bourgette, a credit portfolio manager at Eaton Vance.

For those pension funds and insurers comfortably solvent, venturing down the risk curve may not be necessary. But these are the lucky few. As Ravi Singh Cheema, a senior investment associate at PSolve, points out: “Investors are hampered by an ever-decreasing set of liquid credits yielding significantly above cash.” As the cost of borrowing money has fallen ever since the Great Financial Crisis, this combination has been painful for them. Owning sovereign debt or similar “safe” AAA-rated paper is not enough to pay pensions or cover insurers’ liabilities.

It is not just market returns that have caused investors to alter their traditional allocations. The regulation of pension funds and insurers has also supported more exposure to credit. Under Solvency II, which affects both types of institution, there is a greater capital charge on equities to reflect their historical volatility. That makes investors think twice about buying company shares. A similar ethos is found in pension fund accounting. The biggest Value-at-Risk in many Defined Benefit schemes comes from equities, in spite of the advent of Liability-Driven Investing. So the current challenge is diversifying that equity risk.

Jeff Boswell, Strategy Leader of Developed Market Credit at Investec, said: “Pension funds are being forced to look for more return by hunting further along the risk spectrum.”

That journey brings asset owners to the likes of high yield, leveraged loans, structured credit and private debt, with a vast spectrum of available debt and credit options.

Moreover, as Greg Fedorenko, senior vice-president in manager research at consultancy, Redington, points out, many niche areas do not have a credible index to give a sense of the magnitude of the investable universe or its general characteristics. These niches offer potential opportunities to those investors willing to leave the comfort of transparent, liquid, information-rich investing to go “off map”.

“
Credit is going to be part of the portfolio because of the attractive risk-adjusted returns
”

But the variety of opportunities in debt and credit also begs the question of how pension funds and insurers allocate. Do they employ specialist managers for each niche of their liking or do they appoint managers with flexibility to invest in a range of debt markets on a dynamic basis? “I like Multi-Asset Credit Strategies (MACS),” says Alistair Sutherland, consulting director at Deloitte. “It’s a better way to go than putting 2% in High Yield and 3% in Emerging Markets. Asset owners say they have the governance to oversee discrete mandates but most don’t. Better to give the discretion to the asset manager and leave them to use the building blocks as they see fit.”

Many agree with Sutherland’s point of view. Assets under management in MACS have boomed over the past three years. Tom Raftery, Credit Product Manager at Franklin Templeton, added that the popularity of MACS has led to massive product proliferation. “Buyers of MACS are in a tremendous position,” noted Raftery.

Essentially every offering is unique given the range of credit sectors that fit this type of mandate, and the differences in the philosophy, expertise, and/or geographic reach of the managers creating them.

“To the extent that their research resources allow, consultants, other advisors, and investors can shop the market for MACS that offers exactly what they want in terms of sector exposure, risk/reward profile, and liquidity,” said Raftery.

Cheema told the CAMRADATA panel that PSolve has been advising clients on MACS ever since 2006. “They have been a really useful tool,” he says.

Do MACS exhibit much correlation with equities? Boswell replied that a great attraction of MACS was that not only did they exhibit low correlation with equities, but also offered better drawdown protection. Raftery added that as many consultants and managers had worked together on MACS development, both groups felt one of the key drivers of demand for MACS could be investors looking to de-risk their equity portfolio without significantly sacrificing total returns.

What else explains the appeal of MACS? For Mette Charles, senior investment consultant with Aon Hewitt, and a former fixed income portfolio manager, the basic premise of a MACS is to gather a clutch of credit betas from different parts of the credit market and exploit relative value opportunities between them. To the extent market liquidity and volatility allows, this should be a fairly active approach. There is relative value to be found both across credit sectors and within, as sector specific securities are chosen.

“The basic premise of a MACS is to gather a clutch of credit betas from different parts of the credit market and exploit relative value opportunities between them”





The exposure to High Yield and Leveraged Loans, or any industry subset of those categories such as energy or financials will change over time as the manager weighs up relative value and market conditions. Aon Hewitt expects the majority of total return to come from fundamental exposure to the underlying credit sectors with a smaller slice of alpha on top, depending on the skill of the manager.

To give some sense of the types of credit under discussion, observe the informal benchmark many MACS use: 50% High Yield/50% Leveraged Loans (both categories are global although North American issuance dominates). But MACS are not confined to High Yield and Loans, which is why many prefer other benchmarks, including *Labor+*, to reflect their flexibility and breadth of choice. Fedorenko is not the only consultant who mentioned ‘off map’ opportunities. Cheema has seen recently launched MACS take on less liquid debt markets.

The three MACS present, however, tend to play in more liquid categories, including Investment Grade. Raftery said Franklin Templeton’s MACS should have a 5-15% allocation to Investment Grade over time for any of a number of reasons. A common reason is if the firm’s sector, industry, and/or company analysis shows the most compelling risk-adjusted opportunities are presently investment-grade-rated. But strategically, while Franklin does not track the company or industry profile of its 50% High Yield/50% Leverage Loan benchmark, the team does use factors of the stated reference benchmark, such as interest rate duration, as guideposts. Investment Grade corporates are a reliable means of adding ‘hard’ duration to portfolios, and in this case strategically having 2 to 2.5 years of duration, which is what the 50/50 benchmark typically reflects, means Franklin generally maintains a low correlation to interest rate moves while providing some protection when credit markets sell off abruptly. Raftery concluded by saying that 15% would typically be the upper bound for Investment Grade exposure since a higher allocation could be a drag on the team’s target yield.

Boswell said that the breadth of opportunity set afforded to a MACS manager allowed for far more flexibility in how to achieve your target return, whether that be through improved diversity in the sources of return, through to the ability to implement more creative, barbelled risk strategies across different credit asset classes.

“ The breadth of opportunity set afforded to a MACS manager allowed for far more flexibility in how to achieve your target return ”

Bourgette brought the conversation back to the value available from any buying opportunity. “We used the backup in spreads over late 2014 and into 2015 to extend spread duration buying long-duration BBB credit risk. For the next year and a half, they were our best performing sector,” he said.

These examples attest the flexibility and dynamism in MACS. “There is US\$12trn+ worth of credit globally. Within the Investec MACS we are just looking for the best 100-120 ideas across those markets,” says Boswell. And all three firms – Eaton Vance, Franklin Templeton and Investec – have heavy resources to call on to find and select their desired issues.

The next question is whether consultants and asset owners can keep up with MACS’ sophistication. Many UK pension funds are in a similar position: they need to improve their Sharpe Ratio but they also want something that is simple to implement. Charles told the CAMRADATA panel that Aon Hewitt has done much education with clients on the topic of MACS and found that attitudes to differing approaches varied widely. Most preferred the simplicity of a bottom-up approach as opposed to top-down and a portion shy away from overly complicated or heavy derivative use. As regards comparing products on a like-for-like basis, this is problematic given the range. For example, as regards benchmark, if a Libor+ benchmark is given, while this ensures freedom from benchmarking, it then becomes tricky to assess how and where a manager has added alpha.

Here then is an issue: how to attribute skill when there is much dynamism and multiple reference benchmarks but no universally accepted composite available. Charles’ criticism was that some managers give themselves a very wide total return objective. Having said this, she said that understanding MACS requires knowledge of a manager’s approach in addition to their own stated risk-return objectives. A MACS can then be reviewed on the basis of expectations knowing a manager’s skill and likely exposures at the outset. “Each manager has a different way,” she said.

Fedorenko said there was a case for funds benchmarking themselves against a 50%HY/50%Loans composite, given that Redington views MACS as a strategic alternative to an allocation to these two asset classes, and that their results “should not be a million miles away over time”. Eaton Vance details its tracking error against this composite. Bourgette clarified, however, that attribution from sector rotation became difficult the more granular the decision. He continued that the objective of attribution is to measure the different decisions at the different levels of portfolio construction.

“ Many UK pension funds are in a similar position: they need to improve their Sharpe Ratio but they also want something that is simple to implement ”





In terms of the lack of suitable market comparators for MACS strategies, however, “the fault arguably lies with the index providers, not the MACS managers,” commented Federenko. “We need more thoughtfully-constructed, transparent indices that represent what people want to invest in.” He gave non-agency mortgages as one example of an asset class for which no reliable benchmark exists.

Sutherland said: “I can easily get a buy-and-maintain credit portfolio. The real question is whether I can find a MACS manager who can serve me better. The answer is ‘yes’ on many reference points.” He shared, however, some of Charles’s reservations about MACS being created just to grab market share; and the pressure on the asset class in general to hunt in private markets just for extra yield.

On the last point, Bourgette replied that Eaton Vance could invest up to 40% of capital ‘off-benchmark’, that is away from High Yield and Leveraged Loans, for risk reduction or return enhancement. Cash, convertibles, Emerging Market debt and structured credit were four options, he noted. Raftery noted the same opportunity set with the addition of taxable municipal bonds as a potential allocation as well.

In response to questions about the length of track record observed in many MACS funds, Bourgette said that Eaton Vance only invested in debt strategies where it has proven competence through an economic cycle. Raftery echoed the point, adding that potential investors in Franklin’s fund used the underlying track records of the asset manager’s credit sector-focussed funds for due diligence. Boswell agreed: “Breadth and depth of experience are critical in effectively managing a MACS fund,” he said.

CROSSHEAD: THE YEAR IN REVIEW

At this point the CAMRADATA panel decided to ask the three MACS representatives to review 2016 as a means of better understanding their processes and way of working. As a preface, both Cheema and Fedorenko noted that it had been an unusual year. “We had one manager on our platform up 23%,” remarked Fedorenko. “The riskiest part of the high-yield credit universe performed most strongly. In a sense, it paid best to buy all the trash.”

“To be honest, everyone looks to have done well in credit last year,” said Cheema. “It made up for the previous couple of years.”

“We need more thoughtfully-constructed, transparent indices that represent what people want to invest in”

Boswell began with Investec's review: "2016 was a great year to illustrate the benefit that can be derived from a MACS approach which dynamically adapts to market conditions and opportunities. We purposefully started the year with only a modest allocation to US High Yield, driven principally by a lack of compelling value given the negative trajectory within that market. By the middle of February, we had however seen a significant re-pricing of risk within U.S High Yield, which resulted in us actively increasing our exposure to that market as we took profit on our European High Yield holdings which had outperformed. This divergence in asset class performance is a prime example of what we look to capture as MACS managers."

Investec are firm proponents of a global sector coverage model for its credit analysts, which it argues allows not only for a more holistic understanding of sectoral trends but also allows for more balanced, and unbiased relative-value decision-making, certainly in the context of MACS. Boswell argues that such an approach should be at the heart of MACS investing, whereby the inherent structural biases within traditional siloed credit asset class investing can be exploited.

Investec also actively allocated to the Bank sector in the latter part of the year, as the difference in credit risk premia between Banks and Corporates made the sector look particularly compelling. Whilst this was across the credit spectrum, Investec also invested in selective Bank Capital instruments (AT1s and CoCos), as an alternative source of return to traditional High Yield. To dampen any resultant volatility, Investec had a higher exposure to European loans than the other managers. Boswell noted that European loans were far less volatile than their US peers given differences in the buyer base, as well as a very tight supply/demand dynamic.

Boswell was frank that Investec arguably took some risk off the table too early, with the Investec MACS reducing U.S High Yield exposure in Q3, even though the market continued to rally into year-end. However, Boswell argued this illustrates the strength of the MACS proposition, whereby you're not forced to chase risk, and can be far more measured in portfolio construction given the broad opportunity set available.

What about the rising rate environment in the US? Proponents of High Yield like to point out how it has fared relatively well in most rising-rate periods in recent history. Boswell said the Investec MACS has historically had a duration of 3.5-4 years, although this overstates the potential rates impact on the portfolio. "We don't see duration as a source of alpha," he said, "but more of a side-effect you need to control."

He said the Investec MACS fund attempts to generate performance principally from credit spread, not taking any active positions on either interest rates or currencies. To the extent Investec felt the fund was exposed to unintended interest rate risk, they would look to hedge such volatility.

“ We don't see duration as a source of alpha but more of a side-effect you need to control ”



Rafferty's review of 2016 began with the observation that credit markets performed well in 2016, with the high yield commodity sectors leading the way. Franklin maintained exposure to a select number of energy companies that came under stress in 2015 as commodity prices were volatile. Despite the volatility, Franklin maintained the near to mid-term thesis that commodity supplies would be adjusted for better balance with demand. Exposure included a number of companies that restructured their balance sheets, as well as larger and more stable names that had more diverse businesses or hedges in place. "It was a good year for security selection, particularly as companies emerged from restructuring as commodity prices generally trended positively," he said.

"We favoured high yield to bank loans over the year. The ratio of the two sectors averaged 50%:35%, respectively." Rafferty went on to say that the wave of repricing in the bank loan sector had led to lower yields. This led leveraged loan analysts to believe that more and more company valuations were becoming stretched. While the high yield analysts were beginning to have similar concerns about certain companies and industries, they were able to identify opportunities in other industries.

Another example was in the healthcare sector. As healthcare became a platform issue during the election year in the US, many healthcare companies were being sold indiscriminately given uncertainty about the potential impact new policies could have on revenues. "Building positions in those we believed were being sold indiscriminately ultimately helped performance," said Rafferty.

"As rating upgrades and spread compression drove appreciation for our Investment Grade allocation toward 15% at year end, we looked to trim this and move to floating rate allocations to bring the benchmark back to the 2-2.5 year point," he continued. "With bank loans exhibiting "negative convexity" through an aggressive period of repricing, we turned to adding Credit Risk Transfer (CRT) securities, a form of structured mortgage credit with yields typically akin to higher quality high yield. Our allocation to CRTs is typically around 7-10% as they add floating rate yield and offer diversification benefits to the total portfolio. The securities have continued to benefit from a stable to improving US housing market. We also added BBB rated CLOs."

Franklin had generally been light on Europe for the year, and this had a mixed impact on performance. The situation with Brexit coupled with elections around Europe led analysts to pay more attention to 'bear case' scenarios in their fundamental analysis. However, sentiment turned following the French elections. "We have begun to redirect cash arising from flows and maturities to new ideas in Europe," said Rafferty.

“
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He reiterated that the intention for Franklin's MACS is to be a "best ideas" type portfolio, capturing credit risk premium by emphasizing bottom-up company and industry level research. Franklin's goal is to outperform a composite benchmark of 50% Global High Yield/50% Leveraged Loans on a risk-adjusted basis, over a full market cycle, and maintain a running yield in the 4-6% range. Indeed, security selection drove Franklin's outperformance in 2016. Both Investec and Franklin Templeton expect 70% of their added value to derive from bottom-up choices, and just 30% to come from top-down allocation.

This contrasts with Eaton Vance, which claims 50%/50% and says the two ought to be complementary.

Bourgette said Eaton Vance targets 100-200 basis points from both allocation and selection, plus up to 100 basis points from the yield curve, although in reality the excess return from the duration/curve position will be lower.

The sub investment grade sector, although it has positive duration, is not particularly sensitive to rate changes.

Bourgette then gave an interesting example on the art of security selection last year. Eaton Vance thought the consumer sector was strong early in 2016 but the retail sector was still cheap. When it investigated further, however, around 30% of names in the sector seemed fairly valued. So it acquired exposure by buying particular commercial mortgages that gave it exposure to the buoyant consumer market but had more security and diversity.

Other notable plays last year for Eaton Vance included passing on exploiting Brexit as it wished. Bourgette said analysts had fed through ideas for how to benefit if the UK voted to leave the EU – which it did – but the managers could not find suitable names in the UK to implement the strategy. Bourgette said this example proved that a good idea without good implementation would not happen. The danger otherwise would be to fall into a "value trap" i.e. buying an issue that suits all the positive criteria of the strategy but which carries some overwhelmingly negative traits or conditions too.

Eaton Vance would not try to force a good idea when there were not enough appropriate instruments to realise the belief. Bourgette said to do so would be speculating.

Elsewhere, he noted that Eaton Vance went big into US High Yield early in the year and sold mid-year. From late 2014 to February 2016 the High Yield exposure of the Strategy almost doubled to 65%. Thereafter, Eaton Vance's route to taking some risk out of the portfolio was to buy Fannie Mae and Freddy Mac mortgages – another way of benefitting from the improving prosperity of US consumers. As energy names continued to rally well into the year, Bourgette said Eaton Vance lagged behind as some lower-rated junk continued to rally.

“ The sub investment grade sector, although it has positive duration, is not particularly sensitive to rate changes ”



CROSSHEAD: GAPS IN THE MARKET

Evidently, MACS are dynamic. The three managers were asked what kind of trading costs were incurred by making so many moves. Boswell replied that bid-offer spreads had been much the same for the past five years. He did acknowledge that investment banks, as brokers, no longer had the deep balance-sheets to provide liquidity, which increased the potential of “gappy price moves” in disconnected markets. But Boswell said that MACS were not the products vulnerable to liquidity shortages. He said that it was the largest bond ETFs that had to buy and sell in a much proscribed manner whereas MACS could often exploit those ETF flow trades. Raftery added that the diversified nature of MACS can mitigate pressure on liquidity, particularly when that pressure is driven by sector-focussed ETFs or any other instances where selling is automatic. “Many investment grade managers must sell credits immediately when they are downgraded by a ratings agency, for example. And the same can be the case for a high yield manager holding a security that is upgraded. MACS are not forced sellers in either instance, and can therefore benefit from the price volatility that arises in these types of situations as a buyer or current holder.”

For the future, the challenge for MACS is establishing their territory. Plenty of pension funds and insurers are currently looking for Alternative Credit managers. Some of the funding will come from Investment Grade portfolios. MACS managers need to win the argument that they can cover the range from IG to Alternatives.

This need not be a winner-takes-all race. The consultants at the CAMRADATA roundtable said the variety of MACS meant that they could be appointed in combination to increase diversification.

If large bond ETFs and long-dated bond funds get hurt in a rising rate environment, then MACS will put on assets. Sutherland warned, however, that most MACS themselves have not experienced a period of rising rates. The question for investors is which type of strategy will better suit the times ahead, when neither businesses nor governments will be able to rely on cheap money.

“MACS managers need to win the argument that they can cover the range from IG to Alternatives”



Our Multi-Asset Credit experts are proving to be ‘smarter than the average bear’.

We aim not to take unnecessary risks in order to achieve our clients' goals. Our outstanding experience and track record makes us the natural choice in Multi-Asset Credit. A unique blend of experience, wisdom, considered strategy and tenacious, talented people.

- Managing bank loans since 1989, we currently handle £29bn in assets
- High yield specialists since 1982 managing assets totalling £10bn
- A risk-averse culture focused on loss avoidance through robust fundamental research
- A dedicated asset allocation overlay creating optimised portfolios based on investors' goal
- A clear focus on attractive risk-adjusted returns

Eaton Vance: The seasoned professionals in Multi-Asset Credit.

**For more information please contact David Morley
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eatonvance.com/Viewpoints

 **EatonVance**
Investment Managers

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What should pension trustees look for?



“ At Franklin Templeton, our analysts scrutinise individual credit opportunities on a case-by-case basis, identifying the most attractive potential investments in each sector based on their individual merits. ”



Written by
Thomas Raftery,
Vice President,
Senior Product Manager

Tom Raftery of Franklin Templeton Investments considers the key issues to examine before choosing a multi-asset credit fund.

With yields on core fixed income remaining close to their historic lows, the search by DB pension schemes for better fixed income returns continues. Yields on asset classes further down the credit quality spectrum such as high yield corporate bonds, bank loans and emerging market bonds continue to look relatively attractive. Combining these various fixed income instruments, each with their own characteristics, in a broader portfolio allows pension schemes to further improve their risk/return trade off and offers the potential to manage them opportunistically. However, exploiting this potential requires specialist expertise and comes with a greater governance burden: so enter multi-asset credit funds, or ‘MAC’.

Yet in an increasingly crowded universe, MAC funds’ risk, return and volatility profiles are disparate. It can be difficult for pension funds to know what questions to ask when selecting a MAC fund. We would suggest considering the following features.

Risk and return profile

The first point pension schemes should consider before making an allocation to a MAC fund is the level of risk they are comfortable with taking, as well as the level of return they expect.

The degree of risk taken by MAC funds depends on the scope of their investment universe. As many MAC funds may invest in non-core and below investment grade asset classes, such as securitised loans and non-agency residential mortgage-backed securities, one could argue that they take a higher degree of credit risk than their conventional fixed income counterparts.

Examining how MAC funds’ asset allocation shifts over time in response to events will help shed light on their approach to risk. Consider asking what is in a prospective fund’s investment toolbox, as well as what considerations underlie their evolving asset allocation. For instance, would-be investors could ask how significant market events (such as BREXIT) would impact on a fund’s asset allocation.

Liquidity is a further influence on a fund’s risk/return profile. Illiquid assets can offer an investment return premium, compensating investors for the inconvenience of locking up their money. Equally, by definition, illiquid assets can be difficult to sell quickly in circumstances when managers have to meet a number of client redemptions at once. As a prospective investor, it is important to gauge a fund manager’s approach to liquidity. Many MAC funds offer daily liquidity but others may not do so.

Investment process

Understanding a team’s investment process is vital before making an allocation to a MAC fund. Such processes can differ widely. For instance, at Franklin Templeton, our analysts scrutinise individual credit opportunities on a case-by-case basis, identifying the most attractive potential investments in each sector based on their individual merits. Simultaneously, the team analyses each sector (such as high yield corporate bonds or bank loans), considering how best to achieve a truly diversified and dynamic portfolio.

Duration management is one key area for investors to probe as it provides an indication of how much interest rate risk the fund takes. Effective duration management can offer protection from the risk of rising interest rates. In general, short-dated conventional bonds are less sensitive to rate rises than their long-dated counterparts. Whereas floating rate loans are largely immune to interest rate concerns because their coupons are reset as interest rates change. Franklin Templeton’s MAC fund managers take a non-aggressive approach to duration management. If we make any significant changes to the duration of the fund, it is a gradual process.

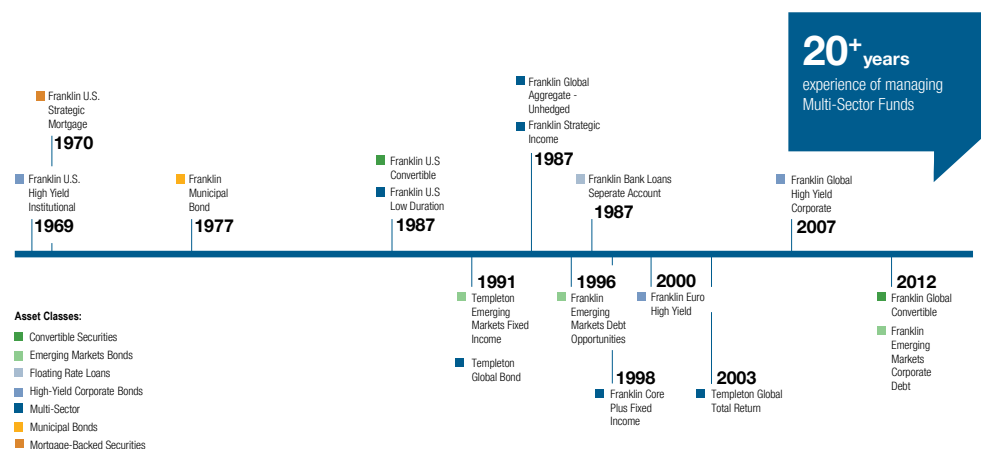
Prospective investors should also ask their investment manager about the number of positions they take at any one time. Franklin Templeton takes a relatively low number: in general, we seek to stay invested in around 125 credit issuers or less. To put that

into context, some of our peers have around 200-300 positions. This is in line with our research-intensive investment approach, which, we believe, ensures that only the very best ideas make the grade.

Depth of Expertise

Track record is a vital area of enquiry for prospective investors. They should enquire as to whether a prospective investment manager is a specialist in the underlying areas in which the fund invests. Most will be reassured by a long record of experience in the sectors, as this indicates a sign of commitment, as well as a high degree of specialism.

At Franklin Templeton, we have over twenty years' experience managing multi-asset fixed income funds. We have also been managing specialist funds which invest in the underlying asset classes which make up our MAC fund for decades (see graphic).



Research processes also vary from fund to fund. We recommend enquiring about the size, structure and experience of a prospective manager's research team. Franklin Templeton has one of the larger credit analyst teams. This experience gives our research process depth, context and continuity which, we believe, translates to an edge in terms of company, industry, and sector level research.

A fully global perspective is also important to the success of MAC funds which invest across the various international markets. At Franklin Templeton, asset allocation decisions begin with the Fixed Income Policy Committee (FIPC), which brings together the company's entire global fixed income platform to run through each sector in granular detail, with each specialist providing a detailed update.

The full picture

There are a number of factors for pension schemes to consider when choosing the right MAC fund. A great starting point for schemes is to assess what they want from their allocation to such a fund, including their own risk and return requirements. Once that process is complete, they will be in a good position to access the full range of options available. What is clear is that in today's fast-changing macroeconomic environment, nimble fund managers with access to extensive research resources are likely to thrive.

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Why is a MAC approach suitable now?



“MAC strategies seek to find the best risk-adjusted return within the credit markets, while also allowing the fund manager increased flexibility in managing portfolio risks.”

Global growth remains lacklustre and the outlook for inflation highly uncertain. As a result, central banks are continuously grappling with the efficacy of their monetary policy and how to sustain the economic recovery.

This has resulted in government bonds losing their income generating qualities, with investors having no choice but to look elsewhere. MAC strategies typically offer a higher yield, while offering defensive qualities through dynamic risk management using several different credit asset classes. The strategy seeks to provide a strong income element on a consistent basis that few other assets can provide. An investor must also consider the security of that income. If, for example, income generation is reliant on equity dividends, there is a risk that these could be deferred in the case of a bad year or poor outlook for the firm, while the coupon of debt securities is pre-determined.

Core credit

A substantial allocation to credit is increasingly being recognised as part of the solution in solving the yield conundrum many investors are facing. This asset class substitution is coming from a variety of traditional asset classes, from de-risking core equity holdings, to reinvigorating vanilla credit portfolios, through to addressing low-yielding government bond portfolios. Not to mention those DB schemes that are facing the threat of becoming cash-flow negative and struggling to pay pensions without selling-down assets. The capture of this credit risk premium is, however, difficult to execute in practice, with the relative attractiveness of individual credit markets changing on a daily basis. MAC strategies seek to find the best risk-adjusted return within the credit markets, while also allowing the fund manager increased flexibility in managing portfolio risks. We see this unconstrained, flexible approach to credit investment as ultimately replacing a large proportion of traditional segmented credit asset class investing.

Challenging rates and bond markets

With the US Federal Reserve (Fed) embarking on its rate hiking cycle and the European Central Bank (ECB) slowing the pace of Quantitative Easing (QE), this has raised concerns for fixed income investors about the impact of higher rates. In our view, while the likelihood of a normalisation of rates to long run averages (e.g. 6% for 5-year US Treasury) from today's levels seems low, any movement in that direction will have a significant impact on bond markets.

As we know not all fixed income instruments, or fixed income strategies, are created equal. Unconstrained multi-asset credit (MAC) strategies, which have the flexibility to derive returns from a broad opportunity set, have typically delivered robust performance through recent interest rate volatility. A key element of this performance is a focus on generating returns principally from credit spreads, rather than any significant duration views.

Volatility is on the rise

Volatility spikes have been a lot more common of late, with these spikes occurring twice as often over the last two years relative to the prior 25 years*. In our view, such volatility is likely to remain more common in these uncertain financial markets, increasingly fixated with central bank policy. Macroeconomics (low growth), monetary factors (low central bank rates, low dealer liquidity) and politics (anti-globalisation, terrorism, and divisive campaigning) are all contributing to the increasing spikes in volatility. In this environment, we believe a flexible and reactive investment strategy will be far better placed to navigate these array of risks with the potential to perform well in both up and down markets.



Written by
Jeff Boswell,
Strategy Leader

The future of MAC

The current yield challenges facing many investors undoubtedly require a new way of thinking in terms of asset allocation. While credit has long been a core income generating component of many traditional asset allocation models, the evolution of financial markets, coupled with the complexities of investing in the current environment, have cultivated a different way of credit investing.

We believe the breadth of opportunity set and flexibility afforded to the MAC manager in seeking its target return, should not only result in a better investment outcome, but also one that is better than the sum of the underlying constituent parts.

*Source: BofA Merrill Lynch Global Research, based on daily data from 02.01.90 to 23.09.16.

Investec Multi Asset Credit - A flexible, active credit strategy

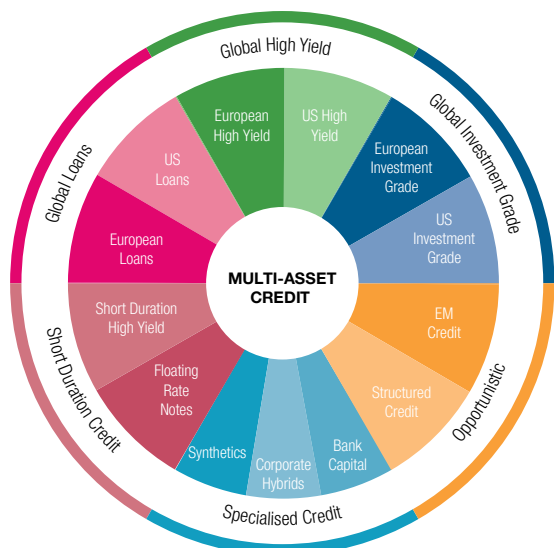
At its core, our MAC Strategy has its core focus in each of the significant developed global credit markets (Investment Grade, High Yield, and Leveraged Loans) including the specialist sub-sets within these markets. Alongside this core focus, we can opportunistically allocate to Emerging Market Credit and Structured Credit, should we see sufficient compelling value. Across these markets we seek to target the most efficient use of capital using security selection, beta management and asset allocation as sources of alpha. This dynamic portfolio will evolve and adapt to market conditions, value, risk premia and liquidity.

Unconstrained bottom-up investing

Given our unconstrained approach to investing, the MAC portfolio consists of our best ideas across the credit spectrum, with complete benchmark independence in asset selection. We fundamentally believe that constructing portfolios bottom-up, in a risk-controlled manner, ultimately leads to a better investment result.

Our MAC Strategy applies a disciplined process to build well diversified portfolios. The Strategy has a total return target of LIBOR + 4% – 6%* gross of fees over the full credit cycle.

* This is an aim and not a guarantee. The target will not necessarily be achieved.



Investec Multi-Asset Credit Strategy

- Targets cash +4-6% p.a. in the current environment*
- Unconstrained credit investing across the credit spectrum
- Targeting risk efficient allocation of capital using both beta and alpha return sources
- Benchmark independent in asset selection
- Dynamic portfolio evolves and adapts to market conditions, risk premia and liquidity

*Targets may not be achieved.

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