CAMRADATA

UK Insurance CIO Whitepaper

Sponsored by

Payden&Rygel

WAVERTON

Clear and Independent Institutional Investment Analysis

We provide institutional investors, including pension funds, insurance companies and consultants, with data and analysis to assess, research and report on their investments. We are committed to fostering and nurturing strong, productive relationships across the institutional investment sector and are continually innovating new solutions to meet the industry's complex needs.

We enable institutional investors, including pension funds, insurance companies and consultants, to conduct rigorous, evidence-based assessments of more than 5,000 investment products offered by over 700 asset managers.

Additionally, our software solutions enable insurance companies to produce consistent accounting, regulatory and audit-ready reports.

To discuss your requirements
+44 (0)20 3327 5600
info@camradata.com

Find us at camradata.com

Join us on LinkedIn

Follow us on Twitter @camradata

© Copyright CAMRADATA Analytical Services October 2022.
This marketing document has been prepared by CAMRADATA Analytical Services Limited ('CAMRADATA'), a company registered in England & Wales with registration number 06651543. This document has been prepared for marketing purposes only. It contains expressions of opinion which cannot be taken as fact. CAMRADATA is not authorised by the Financial Conduct Authority under the Financial Services and Markets Act 2000.CAMRADATA Analytical Services and its logo are proprietary trade-marks of CAMRADATA and are registered in the United Kingdom. Unauthorized copying of this document is prohibited.

Contents

03 Introduction

04 Insurance Roundtable

10 Roundtable Participants

16 Payden & Rygel -
Time - tested investments for testing times

20 Waverton -
The Truth behind ESG Integration

Welcome to CAMRADATA's UK Insurance CIO Whitepaper

So far, the year 2022 has been one investors would like to forget, but their losses might be too painful to pass from memory soon. To the end of August, gilts were down 19.5% and global bonds are down almost 16%, slightly better than equities. The MSCI ACWI index ended August at almost -17.5% in dollar terms.

General insurers have diversified somewhat into alternative assets such as real estate and infrastructure; as well as absolute return strategies already. Both have provided a modicum of support in falling markets, as has decent stockpicking in credit. The big question for now is whether insurers continue to derisk. With inflation coursing through the economy, they cannot simply sit on cash. But if central bankers do raise interest rates so as to create a recession, not only will inflation weaken but also the strength and prospects of plenty of corporate lenders. After generous spending during Covid and ongoing support to businesses and households in the energy crisis, sovereign lenders are not in the best of shape either.

For better active managers, some winnowing is long overdue and no bad thing. The generosity of central banks hitherto has kept so-called "zombie" companies stumbling along while helping to drive the price of government bonds artificially high. A successful, shallow recession next year could actually result in decent returns on govvies.

In the meantime, insurers may have to rely on more subtle, possibly quicksilver opportunities in credit, duration and currency management to eke out returns. Markets' pessimism could well last into 2023.

Insurance Roundtable

The CAMRADATA Insurance Roundtable took place in London on 21st September 2022.

SO FAR 2022 has been a horrible year for financial markets, with losses almost everywhere bar the energy sector. The CAMRADATA Insurance roundtable thus began by asking participants what their portfolio performance looks like year to date. For Foresters Friendly Society, Corrado Pistarino, CIO said that the return-seeking portfolio of its with-profits fund was down about 8% (the liabilities are hedged). Foresters' much smaller Benevolent Fund, which has a less constrained investment policy, is up 3% to the end of August.

Pistarino said the difference was that the with-profits fund caps at 20% its exposure to Private Markets whereas the Benevolent Fund is invested almost entirely in UK properties and in a diverse range of Private Markets products and strategies. "A return of 3% is comforting but we are not complacent," said Pistarino. "Private Market investments will suffer too in a major economic downturn." He noted, however, that shifting out of public markets had reduced "superficial performance volatility."

Nigel Jenkins, Investment Policy Committee member and a Managing Director at Payden & Rygel, a bond manager, said absolute performance varied significantly depending on the type of mandate. Broadly, he suggested short maturity strategies were down 1-2% year-to-date but clients who choose very long duration portfolios for LDI purposes had experienced much sharper losses. Relative to benchmarks, however, Jenkins said: "It's been a pretty good year for our clients on duration, as we have had a material shorter-than-benchmark bias all year. Credit positions had struggled a bit more but overall relative returns were solid."

For MS Amlin, Paul Amer, CIO said that at the aggregate level, his funds were down -1.9%. That low loss reflected a policy decision coming into 2022 to reduce risk. As an indication of the effectiveness of that decision, a recently commissioned actuarial study found that actual losses for the first half of the year would have been significantly worse - around 4%-5% lower - using another approach. The losses avoided would only have grown in the third quarter.

Anthony King, COO for Charles Taylor Investment Management (CTIM), said its reference fund was down 6% to the end of August. He explained that dynamic asset allocation meant that risk had been dialled down early in the year. "What has been surprising has been the level of absolute returns," said King. "It has been tricky sitting down with clients and discussing that."

For Waverton Investment Management, Jeff Keen, fund manager of the Waverton Sterling Bond Fund, agreed that it had been a really tough year. "Our multi-asset fund is down mid-single

"The CAMRADATA panellists were then asked to explain further the nature of the liabilities which they are investing to cover"

digits where most markets are down 20%," he said. "The Sterling Bond Fund is down 12%, its worst drawdown ever – although gilts are down 23%."

Mark Wilgar, head of manager selection at Riverstone, a consolidator in the insurance market, said that to the end of August, it was down approximately 1.5% across all positions in aggregate. He explained that the avoidance of heavy losses was much due to Riverstone's current situation: it has a new owner and has been heavily in cash and short-dated bonds while it builds up an inhouse investment function [Wilgar is a new recruit] and then rerisks. "We have been underweight duration relative to our liabilities, at 1.5 years compared to 3-5 years," he said. "We now need to find better spreads and higher yields than recent history."

The CAMRADATA panellists were then asked to explain further the nature of the liabilities which they are investing to cover. Amer said that in aggregate, MS Amlin manages to a duration of 3.5-4 years. "The asset-liability gap is in the process of being closed, especially in the U.S.," he said. "We are now reviewing whether UK and European underweights should be changed."

King said CTIM's targeted liability duration is 3.5 years. "We have been barbelling around that, using very short-dated duration at one end. At the other end, a bright spot has been longer duration private assets.

King noted that often contagion spread from public to private markets but that has not been evident this year. "There have been significant swings but no trouble transacting," he said.

CTIM accesses renewables and energy assets in fund form, buying units rather than illiquid partnerships. King also clarified that private assets here meant debt not equity. He gave the example of Commercial Real Estate (CRE), which has undergone all kinds of uncertainties since the introduction of lockdowns globally. "Through COVID, entire working practices have changed," said King. "One thing CTIM picked up on was prime CRE. That has benefitted from COVID and the return to work because to get employees back, companies have had to offer superior workspace."

Amer said that MS Amlin obtained its real estate exposure via a fund of funds, which is up 16% this year and outperformed over both five and ten years. "We haven't given them a benchmark, so they choose where they think the value is," said Amer. "Four years ago they reduced exposure to offices and increased more defensive areas such as assisted living residences."

On infrastructure, Amer said MS Amlin used a specialist that had outperformed by 5-6%. Going forward, 70-80% of returns in these areas would be now coming from income rather than capital.

Amer described current conditions as an inflationary bear market. MS Amlin is now down to half its maximum volatility tolerance and considering paring back further. "For now, we are hunkering down," he said. He expected the strains of rising rates to feed through into private equity over the next six to nine months, so next summer would be the earliest time to reconsider buying either public or private equity.

Wilgar was cautious on where private markets are today. He acknowledged that they have a place in investors' portfolios but added that the illiquidity premium net of fees had recently looked more like an illiquidity discount. "Yields and spreads are low because of the weight of demand and capital chasing private markets but investors should be paid for locking up capital."

He added that, generally, he struggled to stomach General Partners (GPs) retaining a share of origination fees. He said the private equity model was generous in that GPs were free to draw on capital when they wanted in the first years of a fund – without the associated cash-drag for maintaining liquidity to do so affecting the returns attributed to them - and then terminate the vehicle years later if they wished to avoid crystalizing gains (or losses) in a less supportive market.

Keen said that although real assets weren't his asset class, he was cautious: "There has to be some knock-on from bond markets and a nasty slowdown in Europe and possibly the U.S. If interest rates go up, asset values go down."

"Waverton as a firm has downsized its office space post-COVID by 40%. What about all that other space out there? It can't all undergo a change of use. We've had over ten years of extremely stimulative policy that has supported the property sector. I'd be cautious now on UK real estate in general."

“Central banks had been too loose for too long, especially whilst fiscal policy was also being eased during COVID.”

He noted that the Waverton Real Assets team has found value in specialist niches, including warehousing, student accommodation and supermarkets. In bonds, Keen recalled few bright spots this year. “We’ve used hedging on a small amount of the fund to protect against tail risk: we should have done more in hindsight. Selling anything has been a plus.”

For Jenkins likewise, bright spots had been few and far between. Being short duration and credit derisking were two he aired. Like many other bond managers, he admitted that Payden & Rygel had probably underestimated the persistence of inflation.

Where do we go from here?

Jenkins said it was really hard to say which way things were going to go. “Historically, we felt that central banks ‘had your back’ if economic growth dropped off a cliff. Now it’s vital to understand where inflation has come from and where locally it will persist.”

In this context, Jenkins mentioned bottlenecks coming out of COVID and energy costs. But he also noted that central banks had been too loose for too long, especially whilst fiscal policy was also being eased during COVID. “Central Banks’ largesse may have seemed necessary at the time to soothe the economy. But now?”

Jenkins’ first concern was how high interest rates will go. The second, more profound issue was how long they stay there. “Our big disagreement is with current pricing,” he said. “The US Fed is up to 4.5% but markets are pricing in 3% in two years’ time. A growing fear we have is that inflation will be more persistent than currently priced in markets.”

Jenkins said there were now folk celebrating inflation rolling over at 8% as something to cheer about; and likewise its possible fall down to 4% over the next two years. “Is that moderation?” he queried.

As a remedy for inflation anxiety, Jenkins noted that TIPS offering more than a 1% real yield were one solution. He noted that equivalent UK linkers were offering 0%, albeit an improvement on the recent nadir of -2.8%.

Keen, however, queried whether even 1% was a good deal. With UK linkers down something like 30% year to date, he suggested inflation-linked swaps were a much more efficient means of protection.

Pistarino here noted organisational constraints. “There is a regulatory advantage in hedging inflation exposure,” he said. “Foresters doesn’t have the capability to do derivatives so we are pushed into sub-optimal assets like Inflation-linked gilts, locking in negative real rates. The alternative would be to actively deploy capital and allocate to risky assets with inflation-hedging attributes.”

Keen expected more of a risk premium in real yields to come, although he distinguished between the necessity of tactical moves over the next six to twelve months versus a longer outlook. “The investment horizon at Waverton is five years,” said. “We don’t typically accept clients who don’t share that vision.”

Regarding the largesse of central banks and governments [which has finally caused trouble for the latest UK government], Keen described it as Pandora's Box. "Consumers keep coming back for more. We have discovered the printing press."

He saw this as part of the denial hitherto about inflation. "We are now in the catching-up phase," Keen said. "Even folk at the ECB have said that the level of interest rates is nowhere near high enough. So rates are probably going to be higher than expected. That's one reason why I am more cautious about the economy. Consumers are not panicking yet but are going to start leaning more on their credit facilities. So there will be a lot more duration in our funds with long-dated gilts call options on long bonds as a form of insurance."

Keen agreed with Jenkins that for the insurance sector as investors, high quality investment grade at one-year duration could eke out a nice return.

"I've never been an inflationist; I've been bearish on bonds since the Global Financial Crisis, which has hurt at times," admitted Keen. "But I'm now becoming more positive. I think inflation will come under control. It might not be nice but the central banks have lots of assets to dump on markets." His query was who would buy those gilts.

The benchmark is cash

The CAMRADATA panel were then asked whether Absolute Return strategies and benchmarks can be helpful in the current environment. Pistarino said that Foresters has an Absolute Return benchmark expressed through a Strategic Asset Allocation. He explained that there the portfolio manager has a tactical risk budget to express short-term views. "We are targeting different levels of return in each portfolio depending on the specific risk appetite" he said.

Amer said that MS Amlin has exposure to Absolute Return strategies, with £2bn in its own UCITS vehicle, the Blue Fund. He said there were different approaches, with varying cash + targets. But so far this year, the Blue Fund has managed only -1.6%, with one underlying strategy performing less well due to duration positions. "The performance of the Blue Fund has been disappointing – it should be doing more," Amer said.

At the same time, he noted that heightened volatility tended to shorten clients' time horizons. They are now looking month-to-month whereas the focus should remain on the excellent track record over the medium and long term. (Wilgar chipped in that since joining the investment team of an insurer during a bear market, colleagues from parts of the firm unrelated to investments asked regularly what he'd lost them).

Jenkins said there was hidden beta in most Absolute Return Bond strategies. "If you focus purely on completely avoiding beta, it is a challenge to really generate a cash-plus return on a consistent basis," he explained. "It is very hard to do year in, year out."

King said that CTIM had a volatility arbitrage manager that had made no money this year in spite of the abundance of ups and downs in markets. "It is a very granular trading technique; they have just been in the wrong parts of the market," he explained. "You have to be very specific about what you want them to do and what you expect them to do."

Amer had no complaints about the transparency or monitoring of MS Amlin's Absolute Return strategies. "We are much more active in terms of keeping tabs on what underlying managers are doing on behalf of the insurer," he said. "We see their positions when they are dealing; we see the risks they are running. You need this transparency in order to know whether or not they are pursuing diversification.

"We want the managers to make money in every possible market but no one is good enough to do that consistently. So what we are monitoring is whether something has materially changed. Have they got wedded to a particular idea or chasing losses?"

One source of disgruntlement for both Amer and Jenkins was the treatment by Solvency II of certain securitised products that each felt could boost diversification. For Jenkins, it was Collateralised Loan Obligations (CLOs). For Amer, it was Mortgage-Backed Securities (MBSs).

"Payden & Rygel makes widespread use of securitised products, some of which for regulatory reasons cannot be used economically in Europe and the UK for insurers," he said. Jenkins argued that their absolute return strategy gave competitive advantage in an ongoing form, unlike quicksilver alpha opportunities from some Absolute Return strategies.

"The more liquid the component, the greater the challenge to come up with alpha year after year," he warned.

Amer noted that MBS held in the portfolio are backed by Ginnie Mae, a Federal agency, but because of hangovers from the Global Financial Crisis, UK insurers are penalised for holding it.

The ESG narrative

With so much uncertainty in Europe around energy supply, the CAMRADATA panel's closing discussion was whether ESG has taken a back seat to keeping the lights on and factories running this winter.

King was adamant that the topic of ESG has not disappeared because it is too much of a public concern. CTIM's underlying business is shipping insurance and as transporters of fossil fuels the ethics of global transportation were debateable. "So for us ESG is more of a long-term investment," he said. "What we do focus on is the longer-term likelihood of any of our investments becoming stranded assets."

In the investment portfolio, King gave the example of a privately-

held chain of gas stations in the U.S. The addition of convenience stores inside the gas stations has been a theme that has worked. But the U.S. is not a leader in green infrastructure. CTIM has suggested to the General Partner of the portfolio that offering electric vehicle charging points would be a good step for the future. He noted that CTIM was leading on this whereas domestic interest from the U.S. itself was "fledgling". King thought over the 3-7 year cycle of a holding, electrification had to be relevant.

Jenkins said that an issue Payden & Rygel has mulled over has been quantitative versus qualitative ESG inputs, and how these are best incorporated into an investment process. "Incorporating data has been easier than just talking about it," he said. "We prefer to do something which incorporates data and can be objectively demonstrated to the outside world."

A popular example is registering strategies as Article 8 in line with the EU Taxonomy.

Riverstone is in the process of establishing its ESG policy but Wilgar broadly agreed with Jenkins: "You need a framework but not too beholden to backward-looking ratings or carbon intensity data. These figures can be misleading

"You need a framework but not too beholden to backward-looking ratings or carbon intensity data. These figures can be misleading without understand the full context in how they are formulated"

without understand the full context in how they are formulated," said Wilgar. "The framework should be more qualitative than quantitative in the absence of reliable and consistent data."

Keen said that the demand for ESG assets has cooled down this year but Waverton is seeing a lot of regulatory pressure to ensure the investment process aligns with ESG. "So we have invested in our systems to record a more granular level of ESG data. But we try to be pragmatic and sensible."

He gave the example of BP in the Sterling Bond Fund because it has spent lots of capital on green projects. "You can't exclude the whole Energy sector: we need oil for some time yet."

Pistarino concluded the roundtable with the notion that ESG is a narrative rather than an investment process. He claimed it was hard to employ ESG factors as value drivers on which to base investment decisions. "I don't think ESG provides a viable basis for an investment discipline," he said.

KNOWLEDGE BANK

Bringing your content to life

Deliver your thought leadership exclusively to the institutional investor market through the Knowledge Bank feature on CAMRADATA Live.

A free service for subscribing Asset Managers to upload content including articles, whitepapers, podcasts and videos as well as the opportunity to feature in our weekly newsletter with full 360 reporting. Share your knowledge, your way, with the people that matter.

info@camradata.com

CAMRADATA

Roundtable Participants

Nigel Jenkins

Managing Director

Personal Profile

Nigel Jenkins is a Managing Director at Payden & Rygel. He is a member of the firm's Investment Policy Committee and oversees the Global Fixed Income strategy team, which manages all global, European and UK benchmarked fixed income portfolios.

Nigel is also part of the three strong leadership team of our unconstrained fixed income team, with a focus on absolute return and multi asset credit portfolios. He is a director of the firm's UCITS range of funds and Chairman of our Alternative Investment Funds, which houses Payden Multi Asset Credit Fund.

Nigel serves on the board of Payden & Rygel Global Limited. Prior to joining Payden & Rygel, Jenkins was a founding partner of Centric Capital LLP, a fixed income and currency hedge fund.

Nigel also serves on the board of a Cambridgeshire Community Land Trust. Nigel Jenkins holds the ASIP designation of the UK Society of Investment Professionals. He earned an MA degree in Economics from the University of Cambridge.

Payden&Rygel

Payden & Rygel

Company Profile

Payden & Rygel is one of the largest independent, employee-owned investment managers globally. Founded in 1983 and managing in excess of £110 billion in assets, we are a leader in the active management of fixed income, equity and multi-asset portfolios.

Payden & Rygel is an active participant in Global ESG initiatives, for example the Net Zero Asset Managers Initiative, Climate Action 100+ and a signatory to the UK Stewardship Code.

Collaborating with some of the world's leading institutions, including Pension Funds, Central Banks and UN Agencies, we partner with our clients and aim to provide strong performance and customised real-world solutions which meet their return objectives and reflect their values and goals

Jeff Keen

Director and Head of Fixed Income

Personal Profile

Jeff joined the company in June 2009 and is a Director and Head of Fixed Income. He is a member of the Asset Allocation Committee and the lead manager of the Waverton Global Strategic Bond Fund and the Waverton Sterling Bond Fund. He is also lead manager of the Protection Strategy which was launched in April 2016.

He joined Waverton from TriAlpha Investment Advisors where he was CIO and Chairman of the Asset Allocation committee as well as lead manager on their global bond mandates including the TriAlpha International Bond Fund. Prior to this he worked for Colonial Mutual (which became First State) managing funds across a range of asset classes before becoming Head of UK Equities.

Jeff graduated from Bristol University with a degree in Mathematics with Statistics in 1984. He is a Chartered Member of the Chartered Institute for Securities & Investment (CISI).

Waverton Investment Management Limited

Company Profile

Waverton is an independent, owner-managed, investment management firm based in London, with approximately £8.6 billion of assets under management as at 30 June 2022. Today, the company creates high-quality investment solutions for clients across four distinct channels: Private Clients, Charities, Adviser Solutions and Institutional Solutions.

Waverton's principal aim is to generate attractive real returns for clients over the long term, using an active, flexible approach through bespoke portfolios or specialist funds and mandates. Waverton attaches significant importance to directly investing in what its specialist investment teams believe to be the best ideas worldwide, be that in individual stocks, fixed income, alternative asset classes or (if the firm does not have the in-house capability) third party funds.

Waverton Investment Management is regulated by the Financial Conduct Authority and has SEC authorisation.

Roundtable Participants

Anthony King

Chief Operating Officer

Anthony King is Chief Operating Officer at Charles Taylor Investment Management Limited, a private insurance services company delivering solutions exclusively to insurance clients globally.

Formerly he was Regional CEO, EMEA at PineBridge Investments and has expertise in numerous regulatory regimes and serving the needs of insurance clients across fixed income, listed equity and private markets. Prior to Pinebridge he designed and managed insurance investment strategies at AIG Global Investments Corp, combining interest rate, currency and credit risk, to provide a broad selection of alpha opportunities applicable for insurance clients.

Mr. King began in finance in 1989 at J.P. Morgan, managing investments for pension funds and private clients. At J.P. Morgan Investment Management he undertook positions in capital markets research, fixed income trading and portfolio management.

Corrado Pistarino

CIO and Chair of the Climate Risk Forum

Corrado has over 25 years' experience in investment banking, asset management and insurance. He is CIO and Chair of the Climate Risk Forum at Foresters Friendly Society.

Corrado holds a degree in Physics from Turin University and a Masters in Finance from London Business School.

Paul Amer

Chief Investment Officer

Paul Has been MS Amlin's Chief Investment Officer since 2019 having joined the firm in 2015. As CIO, he is responsible for the development and implementation of the firm's strategic asset allocation and external manager monitoring.

Prior to joining MS Amlin, Paul fulfilled numerous senior portfolio management roles at Insight Investment and Barings Asset Management with a focus on multi-asset investing.

He started his career at State Street Global Advisors. He holds a degree in Economics and Statistics from Birmingham University and is a CFA Charterholder.

Mark Wilgar

Head of Manager Research & Selection

Mark works with the investment team at Riverstone International and is primarily responsible for undertaking research and due diligence on external asset managers on behalf of the companies balance sheet. Riverstone International specializes in the management of non-life legacy and run-off insurance businesses.

Mark was previously a Senior Investment Director in the Credit Investment Group at Cambridge Associates in London. The team worked to seek out investment ideas and carry out due diligence on institutional quality asset managers with a focus on private and public credit and alternatives.

Prior to joining Cambridge Associates in 2014, Mark worked for P-Solve Investments Limited (River and Mercantile Solutions) as a member of the investment team managing the £6 billion fiduciary management portfolio. Mark has worked in financial services since 2009 with experience across front and back-office functions including performance analysis, trade planning and execution, transition management, client portfolio management, investment & operational due diligence, and process improvement.

Moderator

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.

KNOWLEDGE BANK

SUSTAINABILITY

DIVERSITY & INCLUSION

ANALYSIS

Bringing data to life

We provide institutional investors, including pension funds, insurance companies and consultants, with data and analysis to assess, research and report on their investments.

CAMRADATA is committed to fostering and nurturing strong, productive relationships across the institutional investment sector and are continually innovating new solutions to meet the industry's complex needs.

info@camradata.com

CAMRADATA

Time-tested investments for testing times

Payden&Rygel

Bond markets have repriced dramatically this year. Short duration credit offers a much better risk-reward profile today as a result. On a twelve-month horizon, it would take a second consecutive year of extreme market moves for investors to experience negative returns in short duration investment grade corporate bonds. This is possible but unlikely. Furthermore, in a highly uncertain world, maintaining an allocation to safe and liquid assets will help take advantage of market opportunities as they arise. Now that investors can meet their return targets with time-tested assets, they no longer need to venture into less liquid and transparent private credit investments.

The 2022 inflation surprise has brought a sudden halt to the low yield environment of the post-Global Financial Crisis (GFC) world. It is too early to assess whether these inflationary pressures are a short-term phenomenon or a longer lasting regime shift away from the disinflationary environment of the last four decades. In any event, this recent experience will lead insurance CIOs to reconsider some of the investment strategies born out of the post-GFC 'forever low yield' world.

"Investment strategies born out of the post-GFC 'forever low yield' world are being reconsidered "

The GFC has had many long-term implications. For instance, the most significant changes to financial regulation in the last fifteen years have been shaped by the crisis. Securitised assets' punitive capital treatment under Solvency II is just one of many of examples. Conversely, private credit barely existed as an asset class during the GFC. Unlike securitised, private credit was not 'part of the problem' and therefore received favourable capital charges under Solvency II. In the extraordinarily low yield environment of the post-GFC world, giving up liquidity (and transparency) to enhance returns in capital efficient private assets has been a popular strategy. Now that bond yields are normalising, many investors are reconsidering the approach. Specifically, when return targets can be met with time-tested liquid assets, why give up liquidity and transparency in an untested asset class? Private credit will undoubtedly remain an important part of the strategic asset allocation for investors with long duration liabilities who can genuinely afford to give up liquidity for parts of their portfolio but there has also been a number of newer investors in these markets who are not as well positioned to give up liquidity. In addition, liquidity is very difficult to measure, forecast and plan for in practice. The LDI strategies used by defined benefit pension plans in the UK have been a prime example of this challenge: the cash calls have been coming a lot sooner than many had anticipated leading to reports of fire sales of private credit portfolios to meet cash calls.

Given the sharp monetary policy tightening and outsized market moves this year, second order effects are likely to impact some corner of global financial markets. In Warren Buffett's words: 'Only when the tide goes out do you discover who has been swimming naked'. It is always difficult to identify trouble spots in markets ahead of time but holding liquid assets today will help take advantage of the attractive opportunities future disruptions will likely bring.

Whilst most fixed income portfolios have experienced significant losses so far this year, maintaining an allocation to liquid fixed income assets will help take advantage of tomorrow's opportunities. Importantly, the risk-reward profile of short fixed income investments has improved dramatically in recent months.

The much higher starting yields on short corporate bonds will better cushion against future volatility. For instance, as indicated in Table 1 below, a 1-3 year investment grade corporate portfolio yields 5.5% today compared to 1.3% at the beginning of the year. Put another way, four times higher yields imply investors can withstand a four time larger upward move in yield before experiencing any loss. Table 2 shows that yields on a short maturity investment grade corporate portfolio would have to rise to nearly 8.5% for investors to experience a loss in the coming year. This is not impossible but

Author:

Eric Delomier, CFA

Senior Vice President

Table 1: Short Maturity Corporate Yields – What a Difference a Year Makes

	31/12/2021	25/10/2022
US 1-3 year Investment Grade	1.3%	5.5%
US 1-5 year Investment Grade	1.4%	5.6%
US 1-5 year High Yield	3.5%	8.7%

Source: Bloomberg US Corporate Index for Investment Grade and ICE BofA BB-B US Cash High Yield Constrained Index for High Yield

Payden&Rygel

Table 2: Scenario Analysis – It Takes a Lot More to Experience Negative Returns Now

	Yields 25/10/2022	Yield Rise Needed To Return 0%	1Year Total Return Scenarios Yields Up 0.50%	Yields Down 0.50%
US 1-3 year Investment Grade	5.5%	3.0%	4.5%	6.4%
US 1-5 year Investment Grade	5.6%	2.1%	4.2%	6.9%
US 1-5 year High Yield	8.7%	3.2%	7.4%	10.1%

Source: Bloomberg US Corporate Index for Investment Grade and ICE BofA BB-B US Cash High Yield Constrained Index for High Yield

unlikely. To put this in historical context, with the exception of a few days at the height of the GFC, we have not seen a 8.5% yield on this short corporate index in over thirty years. Put another way, a 3% rise in 1-3 year corporate yields over the next year would be nearly a three standard deviation event. 2022 has just proven such moves are possible but it is highly unlikely for this type of moves to happen two years in a row.

In such an uncertain environment, geopolitical risks and policy responses diverge across countries: diversification is therefore paramount. The ongoing volatility in Sterling assets since September shows that macro risks are rising and are not impacting markets uniformly. The time-tested principle of diversification is more than ever critical to managing risks. For property and casualty insurers with less interest rate sensitive liabilities, global fixed income portfolios hedged back to the desired currency can help mitigate part of the interest rate risk. For instance, in the third quarter of 2022, a 1-3 year global corporate bond index hedged back to Sterling returned -1.5% versus -4.2% for a Sterling corporate bond index of a similar maturity profile.

Whilst diversifying interest rate exposure can help better manage risks, a more uncertain growth trajectory going forward argues for building well-diversified credit allocations across sectors. Some parts of private credit markets such as infrastructure debt bring genuine diversification of corporate credit risk. It is however worth noting that securitised assets offer a liquid alternative to achieve similar diversification benefits. For non-life insurers with relatively short liabilities, securitised assets would be an ideal asset if it was not for prohibitive Solvency II capital charges. In practice, securitised is really only a practical diversifying option for entities with comfortable capital positions or those able to take the capital charge in more favourable jurisdictions such as Bermuda or the US.

Securitised has been severely tested as an asset class during the GFC. Whilst certain structures and practices have thankfully disappeared, the overall securitised market has reformed and is today a lot more resilient. When it comes to securitised allocations, the CLO market is often the first port of call for insurers. With spreads of approximately 220-230bp on AAA-rated tranches and 280-300bp on AA-rated tranches, they currently offer good value relative to competing alternatives. Beyond their yield pick-up, CLO 2.0's improved structures and their extremely low default history strengthen the case. In addition to CLOs, securitised markets offer a wide range of collaterals: Consumer Asset-Backed (ABS) and Commercial MBS (CMBS) have grown significantly, and relatively new markets in the U.S. for Single Family Rental (SFR) and Agency RMBS Credit Risk Transfer (CRT) bonds continue to grow. Taking advantage of this wide range of collaterals beyond CLOs can strongly diversify an insurer's credit exposure, and allows for a range of durations, maturities, and credit risks. The loan level data of many structures also provides an interesting opportunity for ESG and impact investment screens with more details than provided by vague corporate commitments.

In today's testing times, investors are reconsidering some of the investment strategies born out of the post-GFC 'forever low yield' world. Time-tested liquid corporate bonds are once again offering an attractive risk-reward profile. For many investors, getting close to 6% on high quality short duration investment grade corporate bonds will be 'good enough'. Furthermore, in an uncertain environment, holding liquid assets to take advantage of opportunities as they arise is critical. Private credit made sense in the 'forever low yield' world but why give up flexibility and transparency now that return targets can be achieved with straightforward short corporate bonds? Simplicity, transparency and liquidity are back in fashion.

GLOBAL STRATEGIES, TAILORED SOLUTIONS

Innovative Investment Solutions

Customised to Your Needs

Collaboration with Our Clients

Where **Performance** means more than just **Alpha**

Talk to Our Dedicated Insurance Experts to Find Out More

Erinn R. King, CFA®
eking@payden.com

Eric Delomier, CFA®
edelomier@payden.com

Aysenur Bellamy, CFA®
abellamy@payden.com

PARTNERING WITH INSURERS FOR OVER 35 YEARS

Payden&Rygel

LOS ANGELES | BOSTON | LONDON | MILAN

PAYDEN & RYGEL GLOBAL LTD | 1 BARTHOLOMEW LANE | LONDON | EC2N 2AX
+44 (0)20 7621 3000 | payden.com

Payden & Rygel Global Limited is authorised and regulated by the Financial Conduct Authority

INDUSTRY
BOARD
CULTURE
PROMOTION
RECRUITMENT

Diversity for asset managers is at a critical tipping point.

CAMRADATA now hosts the Asset Owner Diversity Charter within CAMRADATA Live, making it free to access for both asset owners and asset managers alike.

The Asset Owner Diversity Charter was formed with an objective to formalise a set of actions that asset owners can commit to improve diversity, in all forms, across the investment industry. It seeks for signatories to collaborate and build an investment industry which embodies a more balanced representation of diverse societies.

info@camradata.com

CAMRADATA

Award-winning, active strategies forming a complete multi-asset solution

Our equity, fixed income, real assets and absolute return strategies are also available as individual building blocks to help your clients meet their goals

Get in touch
funds@waverton.co.uk
www.waverton.co.uk/institutional-investors

Financial Promotion issued by Waverton Investment Management Limited.
Capital at risk.

The Truth behind ESG Integration

As the term ESG has become more widely used, it has attracted a growing range of uses, turning it into an umbrella term. The fact it stands for Environmental, Social and Governance doesn't change, but in some quarters ESG has begun to be used as a catch all term for multiple styles of investing – often using obfuscating ESG scores as the rationale behind buying or excluding different investments. We understand that, in fact, ESG refers to a type of analysis.

ESG analysis involves looking at what aspects of the three components (E, S and G) are material to an investment, or may be material in the future, and seeking to determine the risks or benefits that may come to have an impact, positive or negative. This is not a new approach, just a new label. It has always been good practise for fundamental managers to look at what might be on the horizon for an investment, the growth of ESG analysis just highlights the growing understanding of the importance of ESG materiality analysis.

" This is not a new approach, just a new label. It has always been good practise for fundamental managers to look at what might be on the horizon for an investment "

As the figure below shows, there is a spectrum of investment options under the ethical umbrella. ESG analysis is ultimately based on how material an E, S or G input is and thus this approach can lead to a range of investing outcomes.

Once the analysis has been done, the degree of weight ascribed to it can affect the style of investment. It may be that there is a strong expected return in an asset, but the risks that the ESG analysis shines a light on mean that there is an unjustifiable level of risk associated. Conversely the expected return may justify the perceived risks – but it is important to consider all aspects of the risks, as it always has been.

It is not just risks that may impact the possible returns of the investment that need to be considered. Increasingly the reputation of a company can suffer by association if they were invested in what turned out to be a poorly behaved company, even if a trade was profitable, and even if a trade was some time prior.

Another important element to consider when looking at the ESG credentials of a company is the direction of travel. For example, a company might be ranked as a D, but making significant improvements that suggest that it ought to be ranked as a B in a couple of years. Investing in companies that exhibit this upward momentum, not only funnels capital to companies that are contributing to a positive transition, but also can see stronger financial returns, since investors who do solely invest based on the ratings may overlook these improvers, and demand for them may increase alongside their rating.

It is also worth considering that ESG ratings are both imprecise and untimely. A comparison of the ESG ratings from one provider against another shows almost zero correlation – what is material to one provider doesn't necessarily show up in the ratings of another agency. Just like Fund Managers, their view on materiality differs which is why it is so important to understand the inputs and their weightings. Furthermore, the sheer volume of data that is needed to compute these ratings means that there is, by necessity, a large amount of guesswork, extrapolation, and assumptions. There is not a device on every chimney measuring emissions. Not only are the ratings of questionable quality, but they are often released with a significant lag, and may not be representative of the company's current form by the time that they are released, for example, the emissions data for over half of the MSCI ACWI is over 18 months out of date.

Author

Paris Jordan

Senior Multi-Asset Analyst

WAVERTON

> *“ By considering the ESG materiality of each potential investment individually, we are able to identify companies that are on an upward trajectory, and those which we believe are incorrectly rated”*

At Waverton we have an integrated approach to ESG analysis, the risks and opportunities are included at all stages of the research process, as the established bottom-up and top-down elements are. We do not have an exclusionary process; there are no sectors or companies that we directly omit, but the sieve is fine – because we have such high standards for investment, many assets will not pass our selection criteria.

By considering the ESG materiality of each potential investment individually, we are able to identify companies that are on an upward trajectory, and those which we believe are incorrectly rated. Our selection process means that we end up with a very highly rated selection of assets, and a process that most closely aligns with the “ESG integration” definition in the table below.

Greater transparency, data availability and understanding means that it is easier to include ESG issues into the research process. The temptation to distil a company down to a single ESG score and invest based upon this is diverting from what ESG actually is, a form of analysis. We believe that proper application of ESG analysis can both help provide capital to worthy companies and enable strong returns for the investors.

Ethical Investment Options (Spectrum of Capital)

	'TRADITIONAL' INVESTMENT	ETHICAL & RESPONSIBLE INVESTMENT							PHILANTHROPHY
		ESG INTEGRATION	NEGATIVE SCREENING	BEST-IN-CLASS OR POSITIVE SCREENING	SUSTAINABLE INVESTING	THEMATIC OR NORMS BASED INVESTING	ENGAGEMENT OR ACTIVIST INVESTING	IMPACT INVESTING	
INVESTMENT FOCUS	No regard for ESG, Sustainable or Responsible factors e.g. Macro-driven, top down, quant or passive funds	Mitigate risky environmental, social and governance practices in order to protect value	Sectors or companies are excluded to avoid risk or to better align with values	Investments that target companies or industries with 'better' ESG performance	Investments that specifically target sustainability metrics or businesses with sustainability practices	Investments that focus on ethical themes (e.g. water, clean energy) or norms (e.g. SDG, UN Global Compact or Paris Climate Alignment alignment	Actively working with companies to improve or, in the extreme, force corporate change via gaining control if consortium efforts have failed	Address societal challenges while generating returns usually via providing debt or equity to social enterprises or charities	Grants that target positive social and environmental impact with no financial return
LIKELY INVESTMENT STYLE	All	All	Quality/Growth	Growth	Quality/Growth	Cyclical/Growth /Small-cap	Value/Blend	All	NA
IMPACT INTENTION	Agnostic	Avoids harm			Contributes to solutions				

Meet the Team!

Sean Thompson

Managing Director

Natasha Silva

Managing Director,
Client Relations

Amy Richardson

Managing Director,
Business Development

Sam Buttress

Associate, Business Development

Sarah Northwood

Marketing and Events
Coordinator

CAMRADATA
5th Floor, 11 Strand,
Charing Cross, WC2N 5HR

+44 (0)20 3327 5600
camradata.com

Join us on LinkedIn

Important Notice

This document is produced by CAMRADATA Analytical Services Ltd ('CAMRADATA'), a company registered in England & Wales with registration number 06651543. CAMRADATA is neither authorised nor regulated by the Financial Conduct Authority in the United Kingdom nor the Securities and Exchange Commission in the United States of America.

This document is a marketing documentation and is not intended to constitute an invitation or an inducement to engage in any investment activity. It is not intended to constitute investment advice and should not be relied upon as such. It is not intended and none of CAMRADATA, its holding companies or any of its or their associates ('CAMRADATA Group') shall have any liability whatsoever for (a) investment advice; (b) a recommendation to enter into any transaction or strategy; (c) advice that a transaction or strategy is suitable or appropriate; (d) the primary basis for any investment decision; (e) a representation, warranty, guarantee with respect to the legal, accounting, tax or other implications of any transaction or strategy; or (f) to cause the CAMRADATA Group to be an advisor or fiduciary of any recipient of this report or other third party.

The content and graphical illustrations contained in this document are provided for information purposes and should not be relied upon to form any investment decisions or to predict future performance. CAMRADATA recommends that recipients seek appropriate professional advice before making any investment decision.

Although the information expressed is provided in good faith, the CAMRADATA Group does not represent, warrant or guarantee that such information is accurate, complete or appropriate for your purposes and none of them shall be responsible for or have any liability to you for losses or damages (whether consequential, incidental or otherwise) arising in any way for errors or omissions in, or the use of or reliance upon the information contained in this document. To the greatest extent permitted by law, we exclude all conditions and warranties that might otherwise be implied by law with respect to the document, whether by operation of law, statute or otherwise, including as to their accuracy, completeness or fitness for purpose.

CAMRADATA Analytical Services and its logo are proprietary trademarks of CAMRADATA and are registered in the United Kingdom.

Unauthorised copying of this document is prohibited.

© Copyright CAMRADATA Analytical Service October 2022 .