

Credit

Credit markets will be key. Spreads have reached attractive levels for both investment-grade credit and high-yield debt. However, the right pockets need to be identified to avoid further losses. Examples of attractive pockets lie in strategies that invest in rising stars and fallen angels, i.e. credit that can rise higher in the rating spectrum over time and USD-denominated Asian investment-grade credit. Another area is convertible bonds currently offering higher yield than straight credit for the same risk and higher returns akin to equities if markets recover.

Lombard Odier Investment Managers head of UK and Ireland institutional clients and solutions, Ritesh Bamania

Investment-grade credit yields, particularly in the US, look attractive. Central Bank buying of debt helps put a floor under investment-grade debt prices. We do not expect default rates in this area to rise in the same way they could in high-yield debt. As such, opportunities exist in active credit strategies that can participate in new issuance.

Catastrophe bond (insurance-linked securities) spreads are wide versus recent history and should be somewhat immune to Covid-19. They continue to offer a strong diversification effect in portfolios.

BMO Global Asset Management head of UK fiduciary solutions, David Hickey

Credit spreads across the board have increased, which isn't surprising given the unprecedented nature of the crisis and how it is being managed globally. There is a lot of uncertainty, which means more return is required to compensate investors. As long-term investors, pension schemes can take advantage of this based on their situation. We have already seen some pension scheme clients top-up their allocations to buy

Silver linings

► **Economic disruption is just one of the many consequences of the coronavirus pandemic, sparking fears of a major recession on the horizon. *Pensions Age* finds out where the best investment opportunities may lie within the credit and equity markets during this challenging time**

and maintain credit, as well as enquire about opportunities in areas such as the high yield and private loans markets. The range of these is a clear indication that each client has been impacted slightly differently.

AXA IM senior consultant solutions, Herschel Pant

We see selective value in investment-grade bonds at spreads 100-150bps wider on the year. Even shocking these for twice or three times the level of historical defaults, they can still provide an attractive income and the possibility of some capital gain via spread tightening.

We are less convinced by sub-investment grade following the big rally, but again there are likely to be opportunities for those who take a very benchmark agnostic approach.

Asset-backed securities have lagged the broad-based rally in corporate credit. We think that higher-rated securities in this area look interesting, especially if it's possible to benefit from certain Fed initiatives to support this part of the market.

Redington CIO, global assets, Pete Drewienkiewicz

We currently view the global credit sector as splitting into three different buckets, all of which will present winners and losers, meaning that security selection will remain crucial.

Firstly, defensive businesses that have limited impact from the current



economic environment, but in an absolute sense are now priced attractively versus history because of the broad credit market selloff, such as utilities and telecoms. Cyclical businesses that, through second order impacts of the virus, are hurting, but we believe can weather the storm and will be survivors through strong balance sheet liquidity, eg pipelines and banks. And lastly, first order impacts from the virus containment measures where we have limited insight into the evolution of the lockdowns, and as such we continue to be cautious on, such as airlines and hospitality.

Insight Investment senior portfolio manager, Adam Whiteley

The most attractive asset class right now is high-quality credit assets (eg corporates, structured credit), which offer investors significant value supported by strong fundamentals and structural protections. Over the medium term, opportunities in real estate secondaries and distressed debt are likely to come to the fore as we have more clarity on the full impact of the crisis.

Isio partner, Nick Evans

Equities

Institutional investors may wish to play the short-term trading cycles, in which case we warn of better buying opportunities ahead as the markets start to differentiate more between the winners and losers at company, sector or country level. The next phase of this crisis should lead to more granular investment calls and differentiation of outcomes. Long-term valuations certainly do suggest equities have considerable value. The premium offered by risk assets over government bonds is attractive. However, a quality bias, for example in terms of balance sheet strength and ability to resist dividend cuts, makes sense in the next phase. In terms of styles, then given the very low bond yields, equity income from quality stocks is, and we suspect will become, more valuable.

Aberdeen Standard Investments head of multi-asset research, Richard Dunbar

When the world eventually recovers from the Covid-19 induced recession then equities will be a sensible asset class for investors seeking returns that exceed the yield on high-quality bonds.

A consequence of the Covid-19 crisis is that investors will focus much more on important issues such as business resilience, in terms of supply chains and balance sheet strength; and management's ability to demonstrate strong leadership and culture during challenging conditions. This is likely to further push investors towards companies with strong sustainability characteristic, further strengthening a shift that was clearly occurring prior to this crisis.

We believe that there is a strong investment rationale for focusing on businesses with strong sustainability characteristics.

A company's 'strategic positioning' is strongly related to the sustainability of its products or services. Strong or poor



environmental, social and governance (ESG) practices are a good proxy for 'management effectiveness'.

Investing in such entities should have positive risk and return characteristics. From a return perspective investors should benefit from many of the sustainability-related shifts that are taking place globally. From a risk perspective this should reduce the likelihood that they suffer from unintended ESG-related events and risks.

Kames diversified growth fund co-manager, Colin Dryburgh

The natural response to this crisis is to panic and sell. However, we are actively allocating to, and recommend our clients invest in, low volatility equities – maintaining equity allocation close to target, while limiting downside risk.

We believe this approach gives the best risk/return trade-off over the medium term because equity markets can reverse direction very quickly, and being out of the market on big 'up' days can be more harmful than staying the course through volatility. At the same time, the arithmetic of drawdowns means that a 50 per cent drop needs a 100 per cent rebound to recover, whereas a 30 per cent drawdown is made whole through a 43 per cent bounce. Low volatility equities give some exposure to the up days, while limiting drawdowns on down days.

You can't have it both ways, so such a portfolio will naturally lag the market on the way up but should protect more on down days. To express this quantitatively,

the portfolio's beta on up days might average 80 per cent, but 60 per cent on down. Given the arithmetic of drawdowns, it will 'win by not losing'.

Over the medium term, such portfolios have proven their ability to deliver close to market returns with lower than market volatility. We don't think we're out of the crisis yet, but over time a low-volatility approach will prove prudent but proactive.

State Street Global Advisors EMEA head of investment strategy and research, Altaf Kassam

A relatively quick 'V-shaped' recovery in an economy could see assets at the higher end of the risk spectrum, for example equities, perform relatively well. Longer-term return expectations for equities are attractive, as valuations across markets are currently depressed, but significant risks remain. During these uncertain times, cashflow becomes a critical component for any company. Higher-quality value stocks offer investors potential to rely on persistent financial strength and stability, providing the potential for outperformance. Furthermore, given the relative weakening of sterling versus major currencies, currency-hedged equities may also be favoured.

Quantum senior investment analyst, Stefano Carnevale

One particular asset class pensions schemes should explore is synthetic equity. Using synthetic equity has two key benefits for pension schemes today. It enables schemes to efficiently capture the potential upside from equity markets with explicit downside protection from near-term falls. Secondly the scheme can still hang onto their collateral assets, i.e. cash and gilt, to support liability hedging and short-term liquidity needs.

River and Mercantile Solutions co-head, Ajeet Manjrekar