Summary

- Low yields in traditional investment-grade bonds and gilts means pension schemes are looking to different asset classes for yield.
- This must be balanced against liabilities, which are growing.
- Multi-asset credit can provide a mix of credit assets from across the globe, potentially opening access to a wide variety, which can provide yield and allow for risk management.
- But selection of the right fund is important – it needs to match the requirements of a scheme so that it does not leave it exposed to higher risk than it can safely absorb.
- The future of MAC looks bright, with increasing numbers of pension schemes considering it as an alternative – though not a clean swap – for more traditional credit investments.

MAC: A world of opportunity?

With multi-asset credit (MAC) funds rising in popularity among pension schemes in recent years, Sandra Haurant looks at how pension funds are adopting a MAC strategy as an alternative to traditional credit

Multi-asset credit (MAC) strategies have been attracting increasing levels of interest from pension funds over the past few years.

Thanks to an ongoing low yield environment in what have long been considered 'traditional' pension assets, such as investment-grade corporate bonds and government debt, pension schemes have been asking whether these funds, with their ability to invest in multiple forms of credit assets across the globe, can provide a valid alternative.

As Hermes Investment Management co-head of credit, Fraser Lundie, says: "Given the profound structural change in debt capital markets that has occurred over the past years, credit investors can no longer rely on a traditional approach to deliver the same strong risk-adjusted returns that are typically associated with the credit asset class."

But while returns are important, pensions schemes are also obliged to take into account the rising cost of liabilities; it is therefore vital that they find a way of striking a balance between the right level of yield and an acceptable level of risk.

Which, says Investec's multi-asset credit strategy portfolio manager, Jeff Boswell, is where multi-asset credit strategies can, in theory at least, come into their own. "MAC strategies typically offer a higher yield, while offering defensive qualities via risk management using several different credit asset classes," he explains. "The strategy seeks to provide a strong income element on a consistent basis that few other assets can provide."

What's in a name?

As the name suggests, these funds have a broad spread of assets. So just what comes under the umbrella of MAC? The list is long and varied: high-yield bonds, emerging-market debt, bank loans, asset-backed securities, senior-secured loans, and more, can all be found within MAC funds.

But fund managers must be canny in order to make the best of a wide range of opportunities. "The multi-asset credit investment universe is vast, encompassing around 16,000 securities," says Boswell. "It is therefore important, in our view, that managers of MAC strategies are able to be nimble and flexible in their investment approach, in order to invest opportunistically and generate the best outcomes for their clients."

Lundie agrees: "The benefit of a flexible mandate and investing in global credit markets allows the *[fund management]* team to rotate out of credit classes, regions or sectors they consider to be overvalued, therefore exploiting valuation anomalies among debt instruments, across currencies and through the capital structure." Careful management, then, can make use of the

right assets at the right times, to create the balance investors need.

Strategic thinking

There is no such thing as a 'typical' MAC fund, according to JLT Employee Benefits' senior investment consultant and head of manager research, David Will, so sorting them into different sections can help make sense of a wide-ranging area of investment.

"We believe the most expedient way of classifying these diverse and continuously evolving products is by their long-term performance target over cash, whilst also considering any secondary focus on capital protection or volatility reduction," says Will. "In addition, it is possible to differentiate between funds based on their underlying asset class exposures and the extent to which and how derivatives are used."

And while there are as many strategies as there are MAC funds, broadly speaking, explains Will, managers employ one of two main approaches: "Top down, where portfolio construction is based around the manager's macro-economic views and asset allocation to the various credit asset classes; and bottom up, where portfolios are constructed on the basis of 'best idea' stock-picking across the credit spectrum."

A question of style

The right fit for a pension scheme depends on a variety of factors, and, as Redington's senior vice president, manager research, Greg Fedorenko, says: "MAC funds vary widely in terms of target returns, risk appetite, permissible asset classes within the credit universe, and the presence or absence of non-credit risks such as unhedged foreign exchange risk and significant active interest rate exposures."

For Redington, the universe is divided into two: "Absolute-return fixed income, which we define as an investment-grade equivalent risk strategy, targeting a return of around 2-3 per cent, per annum in excess of cash, and multi-class credit, which we see as a strategic alternative to high-yield bonds and leveraged loans that is able to access a broader palette of underlying positions."

Moving on

One significant move into MAC came recently from the London Borough of Lambeth Pension Fund, which put £75 million into multi-asset credit from its corporate bonds allocation. JLT advised Lambeth on the move, and, says Will, a number of other JLT clients have also made the decision to shift into MAC.

"MAC funds are unconstrained, and therefore have a much wider opportunity set than traditional bond funds," argues Will. "They can access opportunities across different credit sectors and geographies, seeking the best risk adjusted returns wherever we are in the interest rate and credit cycle, including a low-yield environment."

And the move away from very traditional asset classes shows a significant shift, which, according to Boswell, is occurring with increasing frequency, and for a variety of reasons: "From de-risking core equity holdings to re-vamping vanilla credit portfolios, through to addressing low-yielding government bond portfolios," says Boswell. "Not to mention those DB schemes that are facing the threat

of becoming cashflow negative and struggling to pay pensions without selling down assets."

And for Lundie, a move to MAC is an opportunity that offers "a flexible and dynamic credit allocation through the cycle that provides a solution for investors seeking to either outsource their full credit exposure or enhance existing fixed allocations". This transition, he says, marks something bigger, a move away from traditional 'siloed' allocations to MAC, "a structural shift to better reflect the holistic, global debt markets we now have".

The future of MAC

But MAC is not always the right choice – and it is not a direct swap for traditional, investment-grade bonds. Indeed, the nature of these funds means that they can present a completely different proposition to pension schemes, so selecting well is important.

"It very much depends on the risk profile of the MAC fund relative to the corporate bonds being used as a funding source," Fedorenko says. "Many MAC funds include sizeable weightings to higher yielding, below investment-grade corporate bonds, which clearly offer higher risk in terms of potential exposure to default than is the case in investment grade corporate bonds."

Nonetheless, this is an area that looks set to continue to attract the interest of pension schemes. Low interest rates may have helped to encourage investment in MACs among those seeking higher yields than they have been able to achieve from what was once the bread and butter of pension fund investment, but, argues Lundie, that ought not be the only reason for selecting these funds.

"The low interest rate environment has helped catalyse the move to MAC allocations, but it should not revert course as and when interest rates normalise," he says. "The fundamental rationale for such an allocation holds true, regardless of underlying interest rates."

And according to Will, MAC strategies are already taking their place for the long run. "We believe MAC will become increasingly popular, not just for pension schemes that are contemplating rising interest rates, but also for those schemes that utilise liability driven investment strategies, which require investments to produce a return in excess of cash over time to finance the derivative exposures driving these solutions," says Will.

"Over time, more pension schemes will see the benefits of MAC and make allocations to MAC strategies, regardless of whether interest rates remain lower for longer or move higher." After all, he adds: "A well-managed MAC fund should be able to generate meaningful, risk-adjusted returns and provide valuable diversification to fixed income allocations, irrespective of the yield and 'spread' environment."

Written by Sandra Haurant, a freelance journalist