Summary
• Low yields have become the normal state of play, which leaves pensions with a challenge; how can they meet their liabilities going forward?
• Multi-asset credit provides diversification by having a broad spread of asset allocations in the credit union that is adjusted by managers when necessary.
• A lack of correlation between assets can provide the protection from market movements that pension schemes need.
• There are a number of different strategies, but all of them aim for decent levels of diversification.
• The appetite for alternatives to traditional fixed income is likely to grow, as interest rates are predicted to remain low.

Credit where it's due?

Long-term low yields have left pensions looking for new ways to invest. Sandra Haurant asks whether diversification through multi-asset credit can hold the answer

A low-yield environment has become the new normal in the world of investment, but the news that almost a third (30 per cent) of all investment-grade securities are now offering yields at below zero still makes for surprising reading. In August 2019, according to Bloomberg, the global stock of negative-yielding debt had reached $17 trillion; so if an investor buys into that sub-zero fixed income debt now, and holds it until maturity, they can only make a loss.

For institutional investors, and perhaps pension funds in particular, this means a significant rethink is in order. Things have changed so significantly that the traditional approach is no longer an option; sovereign debt, the 'old world' staple of pension portfolios, can no longer offer the returns that are needed in order to meet the liabilities pensions have. To come good on the promises made to savers, they need to make some big changes to the way they invest.

Investec's head of developed market credit, Jeff Boswell, explains: "If you look at any investor's portfolio, the core building block of their portfolio was a government bond portfolio, which generated attractive yield, but then also had a defensive element to it, in terms of acting as a defensive anchor in choppy markets." Now that the defensive element has essentially gone from portfolios, pension funds are obliged to look elsewhere for attractive yield with enough of a defensive element to offer sufficient protection. This, says Boswell, is where multi-asset credit can be a useful tool. "It's a means of generating what is an attractive yield in a world which is certainly yield challenged," he says.

Flexible funds

Hermes Investment Management's head of fixed income, Andrew Jackson, believes that, while finding yield may be difficult, the scope for returns and illiquidity premium is out there. But, he says, navigating today's tough landscape is not always an easy task. A balance must be struck. "Against a backdrop of lower yields and at a late stage cycle, investors are aware that traditional approaches may be insufficient to generate good-quality return for risk," says Jackson. "Multi-asset credit provides a non-siloed, flexible approach that can be tailored to the exact needs of pension funds, particularly those able to be flexible and tolerate some illiquidity."

According to Jackson, the diversified approach available through multi-asset credit has multiple benefits for pension schemes. From flexibility to risk management, he suggests, they have plenty to offer: "Multi-asset credit solutions can be tailored to deliver minimum risk for desired return, or maximum return for desired risk," he says. "Traditional solutions could currently be deemed 'uninvestable', with central banks' asset purchase giving rise to $17 trillion of negative yielding assets. Opportunity to generate alpha is much more valuable in markets where beta pays so little. Multi-asset credit provides the flexibility required to maximise alpha opportunities; pension funds can optimise their risk-adjusted returns through strategies that dynamically invest across the credit spectrum, and throughout the capital structures of companies, thereby diversifying the means of identifying opportunities."

Matters of size

The role of multi-asset credit within a portfolio can vary, depending on the size of the fund and its requirements. Boswell explains: "For smaller pension funds, *[multi-asset credit]* can be a fixed income solution for them whereby, rather than trying to figure out when to invest in investment grade, or what the allocation to high yield should be, a multi-asset credit fund manager can effectively act as an outsource solution, giving access to a variety of different markets." At the other end of the scale, the need for larger pension funds might be different. "For bigger pension funds, we can fulfil a slightly different need," says Boswell. "I would say, typically, with the bigger pension funds, it might be that they are looking for attractive return, but they are

not willing to take too much incremental risk; so maybe they want to substitute out some of their investment grade bond allocation into a MAC solution."

Within the multi-asset credit world, there are a number of different strategies; one of the main differences, perhaps, comes down to the level of liquidity investments might offer. The one overarching theme for multi-asset credit, though, is diversity. Payden & Rygel's global credit portfolio manager Tim Crawmer says: "Pension funds are looking for creative ways to find yield, but they also want to find ways to minimise the risk in the grab for that yield. Multi-asset credit is a good solution, because it includes higher yielding asset classes, like high yield, leveraged loans, emerging markets and structured products, and by combining those in one mandate, you can get high yield-like returns, but you also get the diversification benefits of being in different asset classes that do not have a correlation of one to each other."

And when it comes to accessing multi-asset strategies, there are plenty of paths to take for pension schemes, whatever their size, says Jackson: "Hermes offers segregated accounts, funds and everything in between. We believe solutions should be tailored for specific needs and pension funds must think critically about their risk return objectives," he says. "We believe consultants have performed a very valuable service to pension funds' long-term outcomes by improving understanding and risk tolerance for both MAC and more flexible approaches to credit."

At Investec, the approach to multi-asset credit is differentiated by a combination of a diversified portfolio, dynamic asset allocation and defensive capabilities. Its investment universe is broad, with everything from high yield and loans to emerging market debt and investment grade, and area not all multi-asset credit strategies include.

Making changes

There is, then, plenty of choice, and the lacklustre environment in fixed income means that this is an area that has been growing in popularity with pension schemes, although not necessarily all over the world. "Certain areas have a greater interest in multi-asset credit," says Crawmer. "We have seen a lot of interest in the UK and Europe; not so much in the US, because the pension funds *[in the US]* like to do their asset allocation in house."

With interest rates low and expected to stay that way for a while, appetite for investments that can shift and change to capture yield is likely to strengthen. The need for pensions to match their investments to their liabilities, to protect themselves from risk and to find ways in which to best meet their obligations to members, means they must look for the most efficient and reliable approaches to hunting for yield. But what does the future hold for multi-asset credit?

"Currently, we believe that fundamentals and, importantly, company behaviours continue to support credit markets, especially at the higher end of the ratings spectrum. Now, more than ever, credit investors need to identify areas of value in the market – and allocate with conviction – while reducing exposure to fully-priced sectors," says Jackson. As for beneficial mixes of asset classes, he says: "We currently see good value in emerging markets and corporate hybrids. Within corporate investment-grade and high-yield markets, security selection is increasingly important."

The quest for yield in this ongoing low interest rate, low yield world may continue to lead investors to this, relatively new, part of the credit market, where diversification and flexibility are the key themes. Indeed, Jackson says: "Broadly, we believe MAC will continue to grow as appetite for more flexible solutions continues to rise … We remain cautious on the outlook, but continue to believe that MAC can be a product for all seasons for institutional investors."

Written by Sandra Haurant, a freelance journalist