Multi-Asset Credit Investing

By the Loomis Sayles World Credit Asset Team:
Portfolio Managers Kevin Kearns, Tom Fahey & Andrea DiCenso; Product Manager Roger Ackerman

KEY TAKEAWAYS

- MAC strategies aim to capture global credit risk premiums while simultaneously minimizing the costs associated with credit downgrades and defaults.
- A broad universe of global credit opportunities enables MAC strategies to navigate full market cycles.
- Compared to single-asset strategies, MAC strategies have the potential to lower correlations by investing in multiple credit asset classes.
- MAC can use individual credit opportunities to boost performance potential.
- MAC managers should have experience steering multisector portfolios through market cycles as well as deep macroeconomic expertise, robust fundamental research and integrated risk capabilities.

In a low-yield environment, fixed income portfolios concentrated in core assets such as Treasurys and investment grade bonds may fall short because they assume a singular risk profile and lack a yield cushion. We believe investors should consider multi-asset credit strategies for exposure to diversified sources of income and attractive risk-adjusted return potential.

What is MAC?

Multi-asset credit (MAC) is a diversified investment discipline that aims to capture global credit risk premiums by investing in a range of geographies, asset classes and credit instruments. MAC strategies can exploit broad macroeconomic trends, changing global credit conditions and individual security selections to pursue these goals.

How does MAC Work?

MAC strategies broaden the opportunity set beyond traditional fixed income portfolios and enable investors to lend across a diverse set of geographies and quality grades. MAC disciplines actively search for attractive risk-adjusted premiums above typical Treasury yields. A risk premium is additional yield that serves as compensation for assuming increased exposure to risk factors like credit and liquidity. MAC investors have the potential to earn significantly higher income and total return than they could with, for example, a government- or investment grade-only strategy in exchange for exposure to these and other risk factors. As shown below, MAC portfolios can access a range of global asset classes and investment instruments.

INVESTMENT OPPORTUNITY SET

Source: Loomis Sayles.

GEOGRAPHY	ASSET CLASS	INSTRUMENT/ SECURITY TYPE
Global	Investment Grade	Cash Bonds
	High Yield	Leveraged Loans
	Converts & Preferreds	Converts & Preferreds
	Leveraged Loans	Structured Securities
	Emerging Market Corporates	Credit Derivatives
	Securitized	Interest Rate & Currency Hedges
	Structured Securities	

MAC Investing and the Credit Cycle

MAC investing tactically allocates capital to regions, countries and sectors. Making the most of this dexterity demands a deep understanding of the credit cycle.

WHAT IS THE CREDIT CYCLE?

The credit cycle is a disciplined top-down framework used to analyze changing credit conditions over time. Credit cycle analysis tracks which economies are borrowing and spending, and which are saving and deleveraging. The cycle has four major phases: expansion to late cycle, downturn, credit repair and recovery. Regions, countries and sectors around the world are all in different phases of the credit cycle at any given time, which can create potential credit opportunities over a full credit cycle.

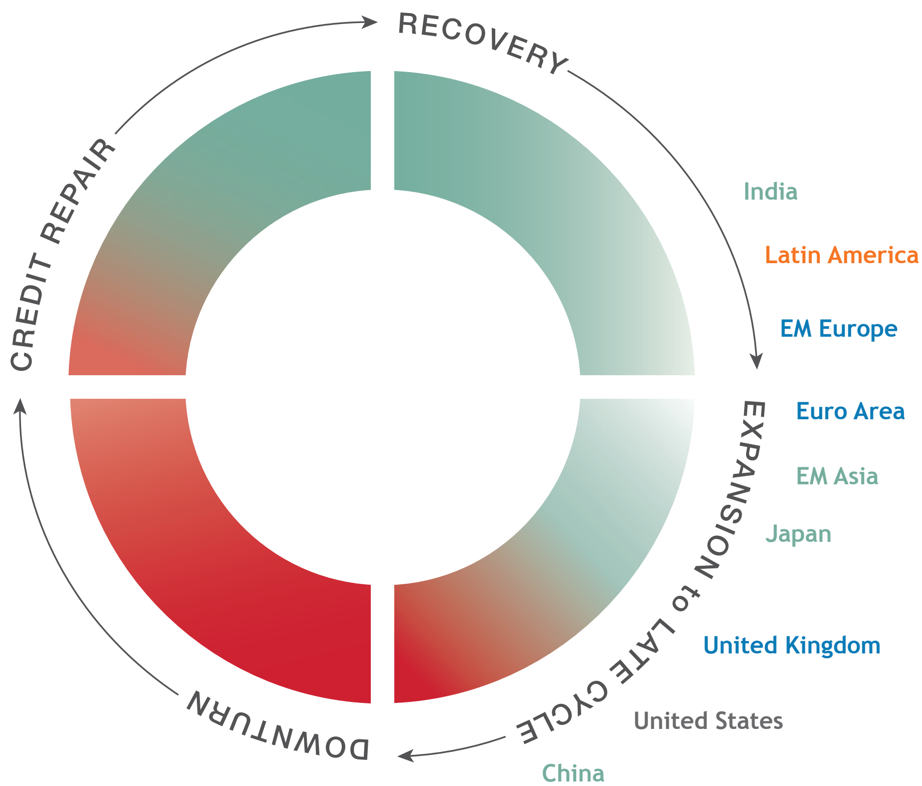
LOOMIS SAYLES CREDIT CYCLE

Source: Loomis Sayles. Views as of 12/31/2017.

Chart provided for illustrative purposes only.

Regions:

- Asia
- Europe
- Latin America
- Other



EXPANSION TO LATE CYCLE	DOWNTURN	CREDIT REPAIR	RECOVERY
• Debt > Profit growth • Monetary policy is tight • Tight economic slack • Fading risk appetite • Liquidity tightening	• Profit contraction • Central bank is cutting rates • Recession • Liquidity and risk appetites are low	• Debt contraction • Easy monetary policy • Growth is rebounding • High liquidity • Improving risk appetite	• Profit > Debt growth • Monetary policy is about neutral • Growth near trend • Diminishing liquidity • Improving risk appetite

MAC INVESTING THROUGH THE CYCLE

Because individual regions, countries and sectors chart their own course through the credit cycle, formulating a distinct credit cycle view for each is essential. Defaults typically begin to rise in the expansion to late cycle phase and peak during downturn, and the credit risk premium follows the same pattern. MAC strategies are designed to monitor country, sector and security default patterns; portfolio managers use their credit cycle views to assess relative value opportunities and determine optimal portfolio positioning. We consider this versatility a key advantage of MAC investing.

The figure below demonstrates our belief that sectors follow fairly dependable patterns of behavior throughout each phase of the credit cycle. In our view, a credit cycle framework combined with a deep understanding of valuations (the degree of over or under value relative to other sectors and history) and technical factors (for example, capital trends and seasonalities) can help promote strong fundamental risk management and performance potential.

CREDIT CYCLE SCENARIO	INVESTMENT GRADE	LEVERAGED LOANS	HIGH YIELD	SECURITIZED ASSETS	EMERGING MARKETS	DURATION STRATEGY
CREDIT REPAIR / RECOVERY Seek to optimize risk-adjusted returns by adding exposure to risk assets	Positive/ Neutral	Positive	Positive	Positive	Positive	Neutral/ Negative
EXPANSION Shift from higher-quality to lower-rated investments because environment for risk assets should still be favorable	Neutral/ Negative	Positive	Positive/ Neutral	Positive/ Neutral	Positive/ Neutral	Short/ Minimum
LATE CYCLE / DOWNTURN Seek to dial down risk in late cycle by increasing quality and extending duration; focus shifts to capital preservation during downturn	Positive	Neutral/ Negative	Negative	Neutral/ Negative	Negative	Long/ Maximum

Uncovering Individual Credit Opportunities

In addition to potentially harvesting credit risk premium through geographic and sector allocations, MAC strategies can take advantage of individual credit opportunities. Deep, specialized research expertise that cuts across markets is a requisite for any credit strategy. Fundamental security analysis can uncover issues trading at a discount to their intrinsic value. Individual credit selection can be particularly important during the later stages of credit cycle downturns and heading into credit repair, when widespread risk aversion tends to punish risk assets indiscriminately. Fundamentally sound credits purchased at a discount during these cycle phases may experience price appreciation as the cycle progresses, which can help boost returns.

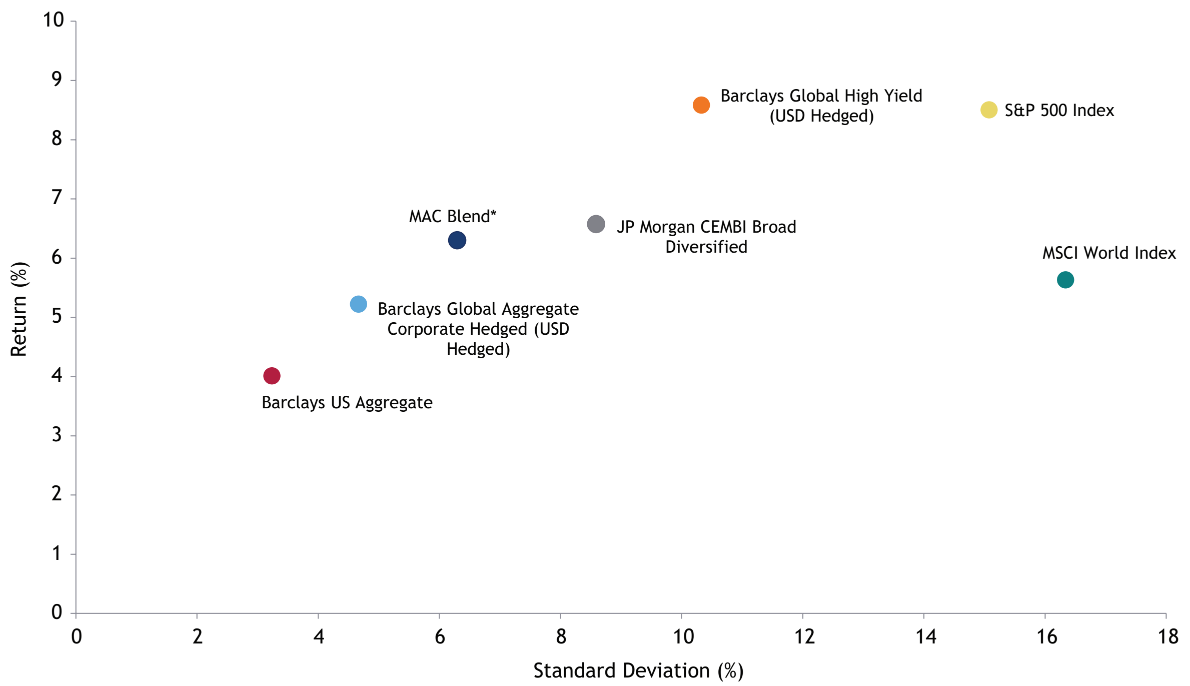
Duration Management

Duration risk, the sensitivity of bonds to changes in interest rates, is an inevitable part of credit investing. Because MAC strategies are designed with broad discretion across the credit spectrum, having the tools available to more effectively manage duration risk is critical. For example, high yield credits can sometimes increase in value during economic expansions, but an associated rise in interest rates can offset that price appreciation. To address scenarios like this, we advocate allowing MAC strategies to actively manage duration.

Why Have a MAC Allocation?

MAC portfolios can be managed to capture opportunities based on the global credit cycle, economic conditions and an investor's stated risk tolerance. MAC disciplines cast a wide net in the global search for yield, giving investors access to a mix of investment grade, high yield, convertibles, emerging markets, leveraged loans and securitized issuers. By focusing on sectors that offer an attractive risk-adjusted spread over Treasury yields, MAC investing may boost return potential. For example, diversification has helped the MAC Blend shown below achieve compelling returns with lower volatility than most major single asset classes for the ten years ended December 31, 2017. This favorable return/volatility profile also supported a strong Sharpe ratio for the same time period.

DIVERSIFICATION POTENTIAL
Data as of 12/31/2017.



Source: Zephyr Analytics, data for the 10 years ended 12/31/2017. Results are shown in US dollars. Returns are annualized. Standard deviation measures return dispersion. ***Past performance is no guarantee of future results.***

**The hypothetical MAC Blend is a blend of indexes created by the Loomis Sayles World Credit Asset team. Please see endnotes for a more detailed description of the benchmarks and the MAC Blend. This is for illustrative purposes only and does not represent any Loomis Sayles investment product. Other industry analysts and investment personnel may have different views and opinions.*

SHARPE RATIO
10-Year Annualized Data as of 12/31/2017.

	RETURNS (%)	STANDARD DEVIATION (%)	SHARPE
BARCLAYS US AGGREGATE	4.01	3.24	1.13
BARCLAYS GLOBAL AGGREGATE CORPORATE (USD HEDGED)	5.22	4.67	1.04
MAC BLEND*	6.30	6.30	0.95
BARCLAYS GLOBAL HIGH YIELD (USD HEDGED)	8.58	10.33	0.80
JP MORGAN CEMBI BROAD DIVERSIFIED	6.57	8.59	0.72
S&P 500	8.50	15.08	0.54
MSCI WORLD INDEX	5.63	16.34	0.32

Source: Zephyr Analytics, data for the 10 years ended 12/31/2017. Results are shown in US dollars. Returns are annualized. Sharpe ratio measures risk-adjusted return by dividing return in excess of the risk-free rate by volatility.
Past performance is no guarantee of future results.

**The hypothetical MAC Blend is a blend of indexes created by the Loomis Sayles World Credit Asset team. Please see endnotes for a more detailed description of the benchmarks and the MAC Blend. This is for illustrative purposes only and does not represent any Loomis Sayles investment product. Other industry analysts and investment personnel may have different views and opinions.*

For investors already deploying assets to credit, this diversification broadens the base of opportunities to include asset classes less correlated to core investments. While diversification does not protect against loss, it can help reduce portfolio risk. The dynamic nature of the strategy may also give investors a lens into the global credit cycle, potentially informing them of risks in their overall portfolio. Managing duration and, if needed, currency exposure can improve return potential and risk management. Managers can use these levers separately in their efforts to optimize overall portfolio positioning.

Conclusion

Active investing across global geographies and multiple bond sectors is complex work. Careful investment manager selection is critical to harnessing the benefits of the strategy. MAC managers should have experience steering multisector portfolios through a range of market cycles. We believe practical experience combined with a systematic investment process that is designed to identify business and default cycles can provide opportunity to effectively preserve capital and capture the credit risk premium over market cycles. Robust fundamental research and integrated risk capabilities are essential inputs that may further support return potential. Finally, MAC managers must understand a client's risk tolerance and duration objectives and tailor their approach accordingly.

This report was originally published in December 2015. We have updated the content as necessary and otherwise believe the information is current and relevant.

AUTHORS

TOM FAHEY
VP, Portfolio Manager

KEVIN KEARNS
VP, Portfolio Manager

ANDREA DICENSO
VP, Portfolio Manager

ROGER ACKERMAN
VP, Product Manager

Endnotes

Indexes shown in charts and graphs were selected to represent global credit sectors on which multi-asset credit strategies can potentially draw as well as the global and US equity markets. All indexes are unmanaged and do not incur fees. It is not possible to invest directly in an index.

The hypothetical MAC blend is a blend of indexes created by the Loomis Sayles World Credit Asset team and shown for illustrative purposes only. The MAC blend consists of 50% Barclays Global Aggregate Corporate Index – USD Hedged, 25% Barclays Global High Yield Index – USD Hedged, 15% JP Morgan Corporate Emerging Markets Bond Index (CEMBI) Broad Diversified, 10% S&P/LSTA Leveraged Loan Index.

Standard deviation measures return dispersion. Sharpe ratio measures risk-adjusted return by dividing return in excess of the risk-free rate by volatility.

This data and analysis does not represent the actual or future performance of any investment product and it is subject to change. These results do not reflect the impact of actual portfolio trading and do not reflect the deduction of fees and expenses and assume the reinvestment of dividends and capital gains.

Disclosure

Past market experience is no guarantee of future results.

Diversification does not ensure a profit or protect against a loss.

There is no guarantee that any investment objective will be realized or that the strategy will generate positive or excess return.

Key Investment Risks: *Non-US securities and foreign investments involve special risks including greater economic, political and currency fluctuation risks, which may be even greater in emerging markets. Currency risk is the risk that fluctuations in exchange rates between the US dollar and foreign currencies may cause the value of a portfolio's investments to decline. Credit risk is the risk that the issuer or borrower will fail to make timely payments of interest and/or principal. This risk is heightened for lower-rated or higher-yielding fixed income securities and lower-rated borrowers. Liquidity risk is the risk that the portfolio may be unable to find a buyer for its investments when it seeks to sell them, which is heightened for high yield, mortgage-backed and asset-backed securities. Other risks include issuer, interest rate, derivatives, leverage, counterparty, prepayment and extension risk. Investing involves risk including possible loss of principal.*

This paper is provided for informational purposes only and should not be construed as investment advice. Any opinions or forecasts contained herein reflect the subjective judgments and assumptions of the authors only and do not necessarily reflect the views of Loomis, Sayles & Company, L.P. Investment recommendations may be inconsistent with these opinions. There can be no assurance that developments will transpire as forecasted and actual results will be different. Data and analysis does not represent the actual or expected future performance of any investment product.
We believe the information, including that obtained from outside sources, to be correct, but we cannot guarantee its accuracy. The information is subject to change at any time without notice.

MALR021342