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Reassesing fixed income in a high rate, high inflation world

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5 INTERVIEW

High rates a primary pain point in US fixed income investing

Interviewer

Maya Sibul,
Reporter and Content Producer, Clear Path Analysis

Interviewee

Sean Saia,
Investment Director, Loomis, Sayles & Company

SUMMARY

- *Expected downturn coming in Q1 2023*
- *One of the biggest pain points for investors is the rate environment*
- *Emergence of private equity sponsors increased access to capital and opportunities for insurers*
- *Securitised sector may offer some of the most attractive opportunities in the market*

Maya Sibul: What are the three biggest differences you've seen over the course of your career in insurance asset management? When it comes to fixed income, what has changed most significantly?

Sean Saia: Well, I have a fair amount of gray hair now, so it's hard to hide that I have been around for a bit. When I think about changes in asset management and in the insurance marketplace, a few themes come to mind. Certainly, the emergence of private equity sponsors in the space has increased access to capital and opportunities for insurers to increase efficiency of operations, optimise capital allocation, and create new products. Tangential to this theme has been the increase in financial structures that seek to maximise the yield per unit of National Association of Insurance Commissioners (NAIC) capital and the regulators' perspective on the risk embedded in these structured vehicles. A third theme has been the continued compression of fees in the industry, despite an increase in investment complexity and desire for a high level of service.

As it relates to large changes in fixed income, the rise of ETFs and their use for immediate exposure, price discovery, and liquidity has also been impactful, however the trend that is currently having an significant impact – and may have the largest future impact – is ESG. In my view, the continued evolution of ESG will create industry winners and losers and will drive corporate strategy and investment to a certain extent.

Maya: Where do you see the most opportunities for insurers in this asset class (fixed income) over the next year-and-a-half?

Sean: Currently, in the short and intermediate portions of the curve, my team and I believe the securitised sector can offer some of the most attractive opportunities, including asset-backed securities and high-quality collateralised loan operations. While short-duration securitised bonds may not be an ideal application lifecycle management (ALM) strategy for life insurance companies, we think they potentially offer favorable capital-adjusted spread and yield and will likely continue to perform should we head into a downturn in 2023.

Maya: What are the pain points in fixed income investing, and are there any particularly attractive solutions?

Sean: In my view, the largest recent pain point for fixed income investors – particularly for insurers – has been the rate environment. The US Federal Reserve's policy has materially increased unrealised losses. While the higher-yielding environment is welcomed for new money and cash, it creates sector rotation challenges as the time associated with loss recovery has extended. Many Loomis Sayles investment teams can invest across asset classes and the quality spectrum to pursue opportunities with potential to maximise income that would seek to both offset losses and reduce the payback window.

> TECHNOLOGY SHOULD CONTINUE TO TAKE ON A BIGGER ROLE IN INVESTMENT MANAGEMENT. AN ONGOING FOCUS ON TECH DEVELOPMENT IS CRITICAL.

Maya: What role does technology play in fixed income investing? How integral is it?

Sean: Technology continues to be a driving force in the investment space, which makes me wish I had any engineering or coding skills. At Loomis Sayles, for example, the firm invests significantly in front-end investment analytics and has created a robust portfolio management ecosystem that we are beginning to share with our clients to help enhance their processes and reporting. Technology should continue to take on a bigger role in investment management. We believe an ongoing focus on tech development and integrating our systems with our clients' needs is critical.

Maya: Are there any additional trends you see developing in the near future? What is your general outlook for fixed income in 2023?

Sean: Over the past year, our proprietary strategy of creating book yield benchmarks – against which clients can both determine the income value Loomis Sayles has added as well as the appropriate yield for product pricing taking into account capital additions and redemptions – has gained traction. Insurers have grappled with this challenge for years and are interested in solutions. Our team's general market and economic outlook for 2023 calls for a downturn in Q1 2023. This would likely cause spreads to widen, with Fed funds peaking in the 4.74-5.00% range. We expect the Fed to hike rates by 50 basis points in December. In this environment, we anticipate unemployment would likely increase, equity earnings per share growth would be negative and fixed income total returns would be challenged to create positive returns.

Maya: Thank you for sharing your thoughts on this topic.


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