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CHAIR

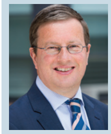
Raj Mody, Global Head of Pensions, PwC

Raj Mody is global head of pensions at PwC and also leads PwC UK's technology investments group. In his role as a pensions consulting partner, he works with companies, trustees, regulators and governments. He advises trustee boards and company management tasked with developing strategy and implementing change to their organisation's pension arrangements. Raj's areas of focus cover risk management, asset and liability strategy, including endgame solutions and insurance transactions, financing and security, benefit design and governance. He is a regular contributor to the press.

PANEL

Alex Den Braber, Principal Consultant, Aon

Alex is based in Aon's Leeds office with 16 years of experience. He is advisor to a number of pension clients, ranging from £30 million to £7 billion in size. Alex is also head of Aon's development of liquid credit solutions for pension and insurance clients, with an emphasis on helping trustees looking to de-risk, progress to an endgame investment strategy or approach buyout by building a stable of high quality, liquid and low cost cashflow-focused investments. Alex is a qualified actuary and has a master's degree in mathematics from Imperial College, London.



Noel Collins, Senior Fixed Income Consultant, Mercer

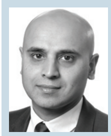
Noel is a senior consultant with Mercer Investments, based in Dublin, working in Mercer's bond boutique. He is the lead researcher for emerging-market debt and multi-asset credit strategies. Noel sits on Mercer's Global Asset Allocation Group and is a member of the International Ratings Review Committee. Prior to joining Mercer, Noel worked for seven years as a fixed-income and currency asset manager with a Dublin-based fund manager. Noel is a fellow of the Institute of Actuaries, and a graduate of Trinity College, Dublin.

Rod Goodyer, Partner, Barnett Waddingham

Rod has been with Barnett Waddingham for over 17 years, becoming a partner in 2012. He is a qualified actuary and received the Sir Joseph Burn prize for his overall exam performance within the actuarial exams. He is one of the investment team's strategy specialists, spending a large part of his time working on long-term strategy with clients. He provides investment advice to trustees and employers on small to large pension schemes. Rod has experience of a wide range of investment consultancy work including strategy reviews, investment manager selection and liability hedging.

Jordan Griffiths, Investment Consultant, Quantum Advisory

Jordan joined Quantum in 2014, having previously worked at the Office for National Statistics and OSTC. Jordan is responsible for providing investment advice to key clients. His expertise spans both DB and DC clients. He prides himself on delivering innovative and proactive advice and has extensive experience of working on a range of clients of different sizes and complexities. Recent work has included cashflow-driven investments, de-risking strategies and bespoke ESG-related strategies for DB schemes.



Azhar Hussain, Head of Global Credit, Royal London Asset Management

Azhar has 18 years direct experience of investing in an array of strategies across the global fixed income and leveraged finance arenas. He trained as a chartered accountant with Deloitte before starting his investment career as a high-yield credit analyst at Gulf International Bank. He subsequently became head of corporate debt, being responsible for IG & HY absolute and relative return strategies. He left to join Insight as head of HY & leveraged loans before joining RLAM initially as head of global high yield.

Clare James, Client Director, PTL

Clare joined PTL as a client director in January 2019, after a career spanning 24 years, acting as scheme actuary, investment consultant and corporate pensions adviser to defined benefit, defined contribution and hybrid schemes, ranging in size from £4 million to £5 billion. Clare spent the majority of her career as a principal at Punter Southall (now XPS) and previously worked at two other major pensions consultancies. During her career, Clare has advised clients in a wide range of sectors, including not-for-profit organisations.

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Multi-asset credit roundtable: More than meets the eye

Our panel of experts assesses the dynamic role multi-asset credit can play in pension portfolios today

Defining multi-asset credit (MAC)

Chair: What do we mean by multi-asset credit (MAC)?

Goodyer: I see multi-asset credit as benchmark unconstrained credit, and typically it is a spread of investment grade and sub-investment grade. I also see it as a pure credit position and the way I normally talk about it to clients is as a long-only position. I'd see absolute return as a slightly different animal. So, when I say MAC, I typically mean plain vanilla, long-only.

Hussain: I run a MAC fund and the way I define MAC is as a long-only strategy. It utilises many more of the strands of credit that have emerged over the past few years, such as loans. The main component parts for me are the sub-investment grade parts, but clearly with the flexibility to move up. That includes asset-backed securities, secured high-yield, short-duration high-yield. It's about trying to give an absolute return with lower volatility, so it's about risk-adjusted return – diversification through asset classes to give you lower volatility.

Griffiths: We see multi-asset credit as a diverse exposure to credit markets, mitigating most traditional fixed-income risks. A key point is that there is no one-size-fits-all solution. There is a large range and a broad scope in this market, providing large opportunities.

James: We have a number of pension schemes that have a MAC holding as part of a wider strategy, so I see it as something that's a diversifier to equities, and as an opportunity to get access to not just traditional bonds or high-yield bonds, but a wider range of access to different credit markets.

Den Braber: My view of MAC is that it's predominantly long-only, tapping into various core credit markets, including investment grade, emerging markets, high-yield and loans. The benefit of MAC is it's a lower governance solution where a good manager should have good stock selection and abilities in each of the markets it invests in, but also that top-down oversight from a macroeconomic perspective. So, the manager can navigate through markets, improving your risk-adjusted returns and accessing areas of the market that passive indices wouldn't otherwise get you.

Collins: I see MAC as a long-biased type of strategy, generally accessing higher-yielding areas of fixed income. So, predominantly sub-investment grade but not solely, maybe with emerging market debt (EMD), maybe without. It can be used in a growth portfolio context, so a lot of de-risking from equities, but it can also be used for people re-risking from core low-yielding fixed income markets.

The role of MAC in pension portfolios

Chair: What role do multi-asset credit strategies look to play in a pension fund portfolio today?

Goodyer: I see it as being able to do two different jobs. One is partly for de-risking out of equities, because as schemes are maturing, they want less volatility, so it's bringing them into lower-volatility solutions. At the same time, a lot of MAC funds are a good way of getting reasonably stable income generation, and as schemes are increasingly becoming cashflow hungry, taking some of your equities and moving them into MAC ticks that box.

The other way we've brought it into client portfolios has been around replacing core investment-grade credit with multi-asset credit and using LDI to fill in the duration piece. Then you almost see the MAC as a cash-plus instrument.

Also, it's a governance solution, looking for a good way to get exposures to different parts of the credit markets, accessing the different asset classes like

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loans and ABS as well as just bonds. So, you're getting a good spread of things to get your credit beta without risk constraining yourself.

The other advantage of looking at this is, if you're trying to build a sterling hedge, then you're constrained to using sterling investment-grade credit, which has some limitations. You'd rather be looking globally, which is another quite persuasive argument as to why you're now looking increasingly at MAC plus LDI plus maybe some investment-grade credit. But it's definitely part of that overall solution.

Chair: So, there are interfaces and overlays with features like LDI and other parts of the asset strategy to bring it all together?

Goodyer: Some people historically have used investment-grade credit as part of the LDI, but actually it doesn't need to be in there. So, it's about taking that out and saying, well, the LDI can typically work a bit harder, or schemes are a bit more de-risked and they can have more purely in LDI. So, it's basically an opportunity to open up your credit portfolio to more options.

DC perspective

James: We have talked already today about the DB angle, but we shouldn't forget that MAC is also used as part of the building blocks in defaults for DC funds too, where all the points that were just mentioned about volatility and that sort of thing are also important, and where MAC can do a good job there to stabilise returns.

Chair: Quite rightly we do want to cover both DB and DC. On the DC front then, the concept can be applied within DC but what practically actually happens? Are members taking this up? Do they really understand what they're getting into? Have you seen it prevalent in DC offerings for membership?

James: I haven't seen it so much as a standalone offering but more as part of a building block within a default strategy.

Collins: We're all agreed that the concept of MAC, on one level, is relatively clear with some nuances, but within that there are different sub-versions, which might or might not have varying degrees of less liquid assets within the portfolio. Loans would be the most obvious example. So, if you bring that over to a DC world, you need to make sure that you're able to fit that to the liquidity requirements, or the dealing requirements, of DC.

Sometimes that will be straightforward, sometimes it won't and what can happen is, a manager might produce MAC part two in order to make it fit for DC, but they'll have taken out some of the less liquid assets, which may mean that the MAC strategy could be less powerful as a construct than the first version. That doesn't mean that it won't work or can't work, but you just need to be mindful that those changes aren't too impactful on the overall portfolio design.

Chair: Let's explore the liquidity point. I think there would be a different perspective around the necessity and importance of liquidity in a DC environment, as part of the DC balanced pre-retirement fund, which is more about return and risk management, versus a DB context where you may be looking to shape the MAC strategy as part of cashflow matching, and you need liquidity.

Den Braber: A lot of MAC strategies are daily-dealt, although of course that doesn't negate the possibility of a lock-up if there's a run on the fund. We have however seen managers filtering out less liquid names in their portfolios, as well as incorporating some systematic trading across passive funds, to make their specific MAC strategy more nimble.

In terms of its marketing to DC, to me it feels like it's DGF part two in long only credit space, as a low governance solution. So, investors are buying into that diversification in credit, getting that higher yield compared to traditional investment grade credit, that higher expected return, with the risk protection that a DGF strategy can offer as well.

MAC strategies

Chair: Coming back to DB, what do the different strategies on offer bring to the pension fund investor?

Griffiths: The scope of the strategies lend them to being used by pension portfolios to achieve various objectives. We've already touched upon cashflows, for example, and we have talked about MAC strategies being used alongside LDI strategies. What we've seen over the past few years, due to the increase in the value of LDI assets, is LDI re-leveraging events. Such events have resulted in monies being released by the LDI strategies.

With regards to equity, many trustees may feel uncomfortable investing such money into something that is perceived as risky, and therefore, they may seek a strategy that provides them with return, albeit with lower volatility. That is where we have seen MAC preferred in that particular space.

But back to LDI, it has also been utilised as an asset to sit alongside LDI strategies, which is liquid enough to be able to allow trustees, for example, pay

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into LDI strategies if rates did rise faster than expected, and the LDI strategy require de-leveraging. Of course, there is a trade-off between how liquid an investor requires these strategies and the level of return they are willing to give up, given that less liquid strategies may be expected to possess an illiquidity premium.

Hussain: One of the real benefits of a MAC strategy is that it can evolve according to what's happening in the market. That is one of the big reasons why, as a trustee, you should be allocating to MAC, as opposed to discrete allocations to high yield and leveraged loans and investment grade, because that tactical flexibility really does make a big difference, especially in the current environment in particular.

In other words, you're delegating that investment decision across these sub-asset classes to the MAC manager, and that's a real virtue of MAC.

That's why I like running a MAC strategy, because it gives me a lot more flexibility in terms of the sorts of assets I'm buying, but it also ties back to risk, ultimately. It's all ties back to risk and return and that's what investing should be about.

Different funds are going to have different requirements, and very different risk/return requirements; you can either manage that with different allocations, or you can manage it with different types of strategies, because there are different strains of MAC.

Chair: So, there are different strategies on offer, but how do pension funds select the right strategy for their portfolio?

Den Braber: It starts with asking what's your risk and return and liquidity needs? What are your objectives? MAC is so broad it could fit into a growth portfolio, or it could be part of a matching portfolio. Of course, it's dangerous to bucket but, once you've got that risk and return agreed, the trustees then need to understand what drives that particular return. If you're looking for mid to high single-digit returns, you're going to be playing more in the high-yield space or loans. That's very different to if you're wanting something safer with a low risk and return target. That would play more into investment grade, or senior-secured credit. That's really what's driving implementation and the different strategies you would put in front of the trustee.

There's also a question to be asked around whether trustees need to understand every single asset class and sector of credit. That's quite tough for trustees, and you're delegating the allocation first and foremost when you appoint a MAC manager. But I think you do need an understanding of how those core credit markets are managed within a MAC manager's strategy.

Chair: We talked about risk and return, but no-one has mentioned calibrating that against the scheme-specific funding status, and its own funding target. Is that a key component?

Den Braber: It's fundamental, and your MAC strategy needs to complement other existing strategies in the portfolio. We can't look at MAC in isolation without thinking about correlations with other assets in the portfolio. So, you need to look at things top-down, strategically, and then start looking at the implementation.

Goodyer: You also need to consider what other fixed-income exposures you have in there, because some schemes have quite well-developed investment-grade credit portfolios, and if you've got 20 per cent of your assets already in investment-grade credit, then it's probably a different kind of MAC manager you're looking for, because you're then trying to get into the less easy-to-access areas of credit; whereas if you've got no credit exposure at all other than your MAC, you might then be looking at a much broader type of mandate that covers the investment-grade space as well.

Collins: The other area that comes into discussions is EMD. MAC, for some people, is predominantly a corporate type of portfolio, but I would say about a third of the MAC strategies on our database have EMD. That's clearly more sovereign than corporate, and there can be a discussion with clients as to whether they want it or not. Usually, there will be a relatively clear answer to that, in that they may have it already or they don't want it; and some clients might be a bit more agnostic about it. But that clearly helps you sift through the array of strategies that are available to them.

Looking further down the line, one of the things that is challenging for trustees and advisers is how they assess and measure their MAC manager, as this area tends to be benchmark-agnostic and more conceptual.

If it's going to be benchmark-agnostic, then you do have to put benchmarks to one side. But from our point of view, you wouldn't get rid of them totally, because you need to have some idea of what the markets have been offering. This is where, as advisers, it's important for us to explain things properly – you don't want to bring benchmarks into the portfolio, into the decision-making, but you do

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want managers to be held accountable.

Another way to review the manager is to ask them: "What are the main three or four things you did in the portfolio last year? Let's go through those decisions one by one to see whether, from a common sense point of view, they were good or bad decisions."

Griffiths: The multi-asset credit space is diverse, and therefore managers are required to have expertise in each area. Not only that, but the market is continuously developing, so not only do they need to have knowledge of the current dynamics, but also of future and ongoing dynamics. There is of course an argument here for looking towards multi-managers in this space, who could look underneath the bonnet, so to speak, and pick the best-of-breed managers, specific to the area they are targeting within the space. Of course, this may bring additional costs and/or governance, but that is something that has to be weighed up against the potential benefits.

Hussain: On assessing performance, for the long-term success of the strategy, you may be targeting a LIBOR-plus absolute return, but you also need to recognise you're in a long-only environment, and you've got to have a reference point somewhere.

That reference point tells you something. For example, in 2018, delivering just over LIBOR would have been a good return. You wouldn't have hit your LIBOR plus three, four that you're targeting, but just delivering above LIBOR would have been a good return given what was happening in the market. That's when MAC strategies should have proved their worth – by preserving capital when things were challenging. In 2019, conversely, delivering a LIBOR-plus four wouldn't be seen as anything special as every fixed income asset class went up. So, you've got to put it all into context.

Collins: Just on that point, 2019 was easier than 2018, and there's a lot of client concern about where we are in the cycle – the cycle will probably end sooner or later but, if or when it does end, we all hope that the MAC managers will be defensive in using whatever levers they want. With the indices, we can look at them and hopefully, if they go down, we'll be able to see that the MAC managers took the appropriate steps, and protected capital.

Den Braber: There are probably two levels of assessing a manager's performance here. First, what's the risk and return objective, so what volatility should we expect. For this we should also look at how different indices have performed in the markets the manager invests in. Second, it is informative to measure a MAC manager against peers with similar objectives and markets in which they invest. This is because there are a few peer group strategies out there. You need to ask whether other managers in the same peer group have fared better or worse and why?

Chair: Can anyone offer an example of how a MAC strategy has proved its worth given its flexibility, compared to having individual buckets of asset classes?

Hussain: With MAC strategies you've got your buckets in terms of various asset classes, but you've also got regions as well and ratings, so lots of flexibility. If you think about the summer of 2018, what were we worried about? We were worried about Brexit. We were worried that Brexit was getting closer, and even if you're investing globally, everyone has a home bias and when you're hedging back to sterling, that is one of your biases; you're going to have more sterling assets.

So, one of the things we did very consciously in 2018 was to mine our portfolio and start thinking about Brexit risks; looking ahead and thinking about the potential volatility; where it might come from. As it turned out, we did get volatility in Q4 2018 in sterling assets, more than non-sterling assets, but in 2019 that kind of faded away.

Chair: Could you go into more detail? What specifically did you do to manage the potential volatility of Brexit?

Hussain: Specifically, we asked, what does Brexit mean in terms of potential risk? It means two or three different things. Firstly, it means that any company which has got interlinked supply chains is going to be directly affected by a hard Brexit, and therefore their risk premia should increase markedly, or they may even eventually default.

An example of that to credit is Jaguar Land Rover. If you look at Jaguar Land Rover in the summer of 2018, it was priced as a BB credit. Very little Brexit risks were priced in. Six months later, that was trading 25 points lower in cash price. If you'd held that through your portfolio, that would have really hurt you. A large part of that was because people started to price in what would happen if there's a hard Brexit to Jaguar Land Rover.

Then you ask, what's my next worry? My next worry is the UK consumer, because we're going to have a lot of growth, even if it's not a hard Brexit, even if it's a soft Brexit. So, therefore, consumer-focused UK companies compared to US companies, if I've got a marginal choice, I want a US company then.

Then the third level is around the

technicals of the asset class, so sterling assets. With Brexit, anything which is sterling, and which is liquid is probably going to trade with more volatility.

So, it's about breaking it all down and asking, what are the risks in my portfolio, not just now but into the future too.

Chair: What about the interest rate impact?

Hussain: Well the other significant moment in 2018 was when the interest rate environment changed and in fact that's what 2019 was all about – the Fed pivots and then every central bank pivots equally. That happened quickly. Between December 2018 to January 2019 that environment flipped over. If you had a static allocation to, say, leveraged loans, that would have been something to consider.

In 2018 leveraged loans did well; in 2019 not so good. We were already reducing our leveraged loan exposure, not because we thought the Fed was going to pivot – I didn't think the Fed was going to pivot in Q4 necessarily, that was very hard to predict – but too many flows had gone into the asset class and so, valuation-wise, leveraged loans made less sense.

Once the interest-rate environment changed, that was a strategic point whereby we decided to actively reduce our leveraged loan exposure rather than just dripping it down.

Managing ESG as a risk

James: One of the areas trustees have been looking at is ESG as a risk, but how can trustees going into the MAC space implement their ESG beliefs and values? It's less clear cut than, say, when you are investing in equities.

Hussain: Ultimately, the equity holders own the company. Unfortunately, the way corporate behaviour has evolved over the past 20 years means that they don't necessarily always listen to the equity holders, so clearly you need lots of stakeholders to be aligned and put pressure on. That engagement from throughout the capital structure helps. Initially it may not make any difference. We've seen it for perhaps several years in terms of trying to change the structure of bonds and loans, complaining about covenants for example, which is what we do all the time, to try to get the best outcome. It doesn't mean that we always achieve it but eventually, if enough people make enough noise, you get the change. So, it's about not giving up on it, and staying engaged.

But also, you can't be exclusionary. I don't think exclusionary works until you get a huge step change in the entire industry.

We are starting to see the fruits of this. We're starting to see a change in behaviour in some companies, certainly the bigger companies, that realise the virtues of having a longer-term engagement with all stakeholders, because stakeholders are mixed. For example, I invest in credit, but as Royal London we invest in equities as well. That helps me in getting my voice heard sometimes. So, it is about everybody working together.

Equally, trustees have a part to play here, and consultants have a very important part to play, because large parts of my universe are owned by private equity companies, and who gives them the money? It's all the way through. Everybody needs to work together.

Collins: There are two parts here. One is engagement, which is harder for a bond holder but it's not impossible. You have to shout at least. You may not be able to vote, but you can shout. There's a huge industry move in that direction, so if you're not shouting, you'll be marked down. It's getting to that stage.

The other part of it is how you do your investing and how you assess companies. Clearly, you can reflect ESG criteria and concerns in terms of how you as a fund manager might value companies, and how much you'll pay for companies, and whether you'll partake in a new issue or not.

Again, if enough people decide they're not partaking in a new issue, that's a form of voting, not literally but in a general sense.

In sub-investment grade that type of ESG analysis is a little less prevalent but, again, it's growing. If you look at the ESG scores across our universes, they're lower on average in MAC than other categories. That's a fair, factual comment.

But it is getting better. People, generally, have been pretty good at assessing things like governance, and that probably was always a mainstream part of credit assessment anyway. They're becoming a lot more alive now to looking at environmental and social factors, and again that's becoming more important, because people are now wondering, for example, car manufacturer X or oil producer Y or airline Z, what will their world be like in five years' time? It could pivot and could change. So, there has to be some sort of premium built in to reflect that. So, those factors are becoming much more part of managers' creditworthiness assessments.

So, there's definitely a direction of travel which is improving this, but it is also fair to say it is at a lower level in this universe compared to other universes.

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Den Braber: I've seen similar at Aon – there is a lot more noise around this issue; and where we have come across managers that have not integrated ESG in any way, we have downgraded them, and told them we won't invest with them. In one example, after being told we would not invest, the manager then hired a head of ESG for their department, they've integrated ESG considerations into their process and it's very much a live topic and a risk that they now assess as part of their overall risk management process.

So, there's a lot of noise. There's also change, and ESG considerations are certainly being integrated in portfolios. I don't think I have seen it missed from a presentation from a MAC manager or bond manager more generally in the past six to 12 months.

James: From my perspective as a trustee, if you're investing in a MAC strategy, and especially if you're looking longer term, it's about that company still being there to be able to pay back its loan or debt. So, there's no upside you're going to get, therefore in a way isn't ESG even more critical?

Goodyer: I've heard that argument before because, particularly if you're in the less liquid parts of the credit market, then you're potentially taking a very long-term view on what you're holding; so that becomes a lot more fundamental than something you might be buying today because it's cheap, but you know you've got an out in six to 12 months' time if you want it.

Griffiths: If investment managers are ignoring ESG, they won't be able to do so for much longer. They will have to adapt to client demand and adapt to the clients' needs over the longer term. We have mostly seen this historically in equity, and over the years it has moved down through the asset classes. Multi-asset credit is certainly a place we're seeing it more and more ESG interest.

Hussain: One caveat I'd like to add is that we do see demand from our clients on this and we've embedded it in our credit process – we think it's a rating factor when we're rating companies. But in Europe, we are way ahead of the US on this, and that's important because they are still the largest credit market for us. So, as much as we're going in the right direction, it's going to take some time for the US to catch up and, at the moment, the US is not progressing at the same pace. We don't get the same response from US companies that are just issuing into the US. If they're issuing globally, yes, absolutely, you can see the change of behaviour, and that's good to see, and it will have an impact. But it will take time.

Long versus short

Chair: Are there any perspectives on the role of shorting within a multi-asset credit strategy?

Den Braber: From a risk management perspective, if the derivative exists to help manage risk, then shorting can make sense, as well as going long if that's efficient, but I think investors look at MAC as long-only and something that they understand. That is, if you invest in something money good, it will pay back. It's not looking at a relative value trade that might be most efficiently implemented with derivatives, which you see from the absolute return bond managers. So, from my perspective, alpha is alpha, and if some alpha is driven by relative value trades that's fine, but if investors are expecting MAC to be a less complex long-only strategy then it should stick to that, unless it's for risk management purposes.

Hussain: From a MAC manager perspective, it's quite nice to flip it the other way – we're quite honest in terms of what our assets are and how they're going to behave. We're long-only, we've got some risky assets, we're not going to be positive in every year. As an asset class, actually as a sub-asset class, it's therefore got a lot of virtues. I question the absolute return asset class on the flip side, though, because if you're not long/short, how can you always give an absolute return?

2018 was a great example – how many absolute return strategies gave you a positive return? Gave you a return above cash? It's a question I like to probe. 2018 was good, because it showed some cracks, and at some point this cycle is going to end, and those cracks are going to perhaps become much bigger fissures, and it's worth looking at where those are, because you can see the weaknesses in where money has flowed, and a lot of money has flowed into areas, I would say, that actually have got some real challenges. That's why I think it's worth looking at this in that way.

Collins: In relation to MAC, we do want managers to be able to manage the portfolios and use their freedom if or when the storm clouds arrive. How they do that is up to the manager, and I think the majority will stay in long space. They'll move to treasuries, they'll move to cash, they'll move to just very defensive assets, perhaps move up the IG curve. Some managers, I would say about 10 per cent of managers, will do shorting in the MAC space, typically, and we have no issue with that. If the manager has the skillset and they can see certain ways that using shorting will help them achieve or apply that protection to the portfolio in those bad times, that's fine.

So, we're okay with it, but it isn't terribly common.

Goodyer: Generally, the absolute return space has struggled a little bit more for performance on those cash-plus targets. 2018 is quite useful for highlighting the risks in both, but I would generally say to clients actually, with a pure long-only MAC, you'd probably expect a higher return over the long term, but you've got to accept those negative years will be there, because that's actually the opportunity set you're giving the manager; there's ways you could go defensive, but you're still going to be expected to have some market exposure to an extent.

Collins: You almost perhaps don't want too much protection going on, because ultimately, you're investing for a cycle, and part of the deal with higher-risk assets is there's a bit of volatility, and you're being rewarded for that over time. So, that's maybe another factor to bear in mind.

Den Braber: Allowing short positions is about time horizon as well. An absolute return manager might aim to deliver cash plus over all time periods and may use short positions to help do this. A typical long only MAC manager will say that over a three or five-year time horizon you'll ride the market waves but they'll deliver that target return, because ultimately, in the absence of defaults, it's quite a forgiving asset class. So you'll earn that yield, you'll get repaid and you'll get that return. But if you're looking at performance quarter-by-quarter, as a lot of pension trustees are, you don't always have visibility of that secondary benchmark being what the actual credit markets have done that you're participating in. Trustees can become very lost.

So, it's about the time horizon you're expecting a manager to perform over as well, which is quite key when considering MAC.

Education

Chair: Is there still a big education piece needed around MAC for pension funds to fully understand the opportunities these strategies can offer?

Collins: MAC is a much more commonplace strategy when you talk to trustees today compared to three or four years ago. Three or four years ago you'd go to a meeting, and you were starting with a blank sheet of paper, taking it from the top. Nowadays, people are familiar, certainly with the main asset classes – high-yield bonds, loans, EMD. If you've got asset-backed securities, you might get a few frowns across the table, given the history there, so you will have to explain things.

More and more managers though will be trying to bring in extra flavours to the portfolio, partly to give them an edge, because it's a very competitive marketplace. But with things like convertible bonds, for example, you might find 5 per cent or 10 per cent, and trustees will ask, what are convertible bonds? So, the more niche areas will be the areas that trustees want to know about.

Things like the asset allocation, trustees tend to get very quickly.

Den Braber: I would say the concept of multi-asset credit is easily understood by trustees coming out of, for example, investment-grade credit or reducing equity allocation, depending on whether trustees are increasing or decreasing risk. They understand they want to access global credit markets. They understand they don't want to do that themselves and appointing a well-resourced MAC manager is going to serve that purpose.

But I would say, after having implemented a MAC manager a year later, apart from that key message around delegation, the detail is lost. Trustees cannot always recall the specific details of a MAC strategy. But I think they understand the core points – dynamic asset allocation and deep resources in very different credit markets and specialist areas. The worst thing that could happen is have a manager come knocking at a trustee's door saying, 'I've got a new multi-asset credit fund', when they have no history of running an EMD book or a high-yield book, or anything like that. Trustees need to understand that those tools need to be there.

James: Typically, where I've seen MAC put in, it's a relatively small part of the overall portfolio, but you are really relying on those managers to deliver in several different areas and do their stuff. The governance burden therefore in terms of getting under the bonnet of that on an ongoing basis is something that shouldn't be underestimated, and is probably something that isn't always brought out to the fore at the outset when you're thinking about this as a possible alternative asset class.

Goodyer: The fact that MAC has become a lot more prevalent in the past three or four years means there probably is another big education piece to come when the cycle ends and we see more challenging returns, because a lot of people have had this Goldilocks scenario where everything has just gone right so

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far, and that's not going to last forever. At that point, there will be a lot of re-education of what is in these funds.

Hussain: For me, as a MAC manager, what I want to be is as un-black-boxy as possible. Markets have been incredibly benign for quite a long time, and central banks have bailed us out continuously. There's a limit to that, and we're getting to the end of that, clearly.

So, you've got to be prepared for tougher times, and as a manager you've got to articulate where you're taking that risk and what the reward is and try to price those. Illiquidity risk is important in all credit markets, even investment grade. We don't talk about it enough. We do have to think about illiquidity premiums and how markets have changed in the past 10 or 15 years. In 2007, markets were a lot smaller, so credit markets today are very different. The holders are very different, and all those factors will make a difference.

Griffiths: To bring the conversation back to the education piece, this is where the dual performance mandate becomes important. Many strategies have a cash-plus target, but if a strategy was to over or underperform this target significantly, then it would be beneficial to see how the strategy compared against its peers, especially during times of market stress, for example. Furthermore, such an approach may, dare I say it, be down to be luck, and therefore it is beneficial to compare peer group performance.

Looking ahead

Chair: Looking ahead, what are your fears? What excites you? And will we see more innovation coming into the MAC space?

Collins: Maybe the end of the cycle is coming, so that excites me and concerns me in equal measure. We will see how it plays out, but we have been experiencing a benign environment. If we hit a stormy environment, it will be fascinating to see how MAC managers play out in that, how they protect, whether they manage to protect and whether they manage to see it coming, because that's the sort of thing we really want them to do. That's one of the calling cards of MAC.

There are numerous advantages of MAC but one of the big advantages is that degree of freedom that managers have which should allow them to protect the portfolio when necessary. Clearly, if we do get a challenging event, we'll see if they meet these expectations.

In terms of innovation, some managers are trying to bring in slightly more niche asset classes, and that's a double-edged sword. They do need to have the right expertise to do these things. These things must be done properly because, if you do something at the margin, its impact may not be terribly significant one way or the other on the overall portfolio, but its impact on reputation can be huge.

As a marketplace, multi-asset credit is getting very competitive, and there's certainly another wave of entrants coming into the market. So, managers are looking at how they distinguish themselves – that's fine, but my concern would be that they overdo that type of thing to the detriment of the overall portfolio.

Griffiths: We have discussed diversification within these strategies, and there is no doubt that diversification remains key, but it's worth remembering as we head towards the potential end of the cycle that diversification can break down. This is important in credit markets where we have a asymmetry of return, i.e. the downside risk can be larger than the potential upside.

Taking a step back from multi-asset credit for the moment, it's important that the whole strategy is reviewed holistically, not just the standalone asset class. It is vital that investors consider their whole portfolios and the interaction between asset classes when making asset allocation decisions.

Den Braber: I agree. When you look at a pension scheme's portfolio, you can say: "You've got equities, you're exposed to some corporate risk there. You've got investment-grade corporate bonds, more corporate risk. Then you've got MAC, a lot of corporate risk." Perhaps they should look at some different types of credit where they will be less exposed to that corporate risk? That can be selecting a specific type of MAC strategy that complements those exposures, or coming out of MAC altogether, looking elsewhere to consumer-driven debt strategies.

The other point worth making is that, if you look at best to worst performer in 2008, it's probably about 50 per cent between investment grade and high yield that sold off. That's a massive opportunity. If you can hold something that's money good and comes back, I would want MAC in my portfolio there. So, I'm not looking forward to the end of the credit cycle, but also very much looking forward to the end of the credit cycle as there will be a good opportunity for nimble skilled managers to take advantage of that.

Goodyer: I agree. At the end of the cycle inevitably there are going to be many opportunities for people to exercise more skill to pick the right things and

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hold them when spreads do blow out.

But my concern is partly about the amount of money that's flowed into this asset class in recent years, whether everybody there actually fully understands that even if things are liquid, they could get marked down quite aggressively – if you think back to what happened in 2008/9, with a lot of loans that never really got close to defaulting, there was a point where you only could have sold them at quite significant losses, and my concern is just whether people are fully cognisant of what might happen, even if the assets are actually money good.

Hussain: The end of the credit cycle means defaults are going to go up, and companies are going to fall over. Last time it happened everything was correlated, and we'd got a great test case. This time's going to be different, but I kind of welcome it because that's what credit picking's all about. That's when you prove your worth. Ultimately, credit is all downside, very little upside, so we prove our worth when we protect the capital.

It's not going to be easy, though – default environments are incredibly tough environments, and therefore, you need skilled people. You need to have the right resource. You need to have people with some experience of those things, and to know what they're good at and what they're bad at. That's the most important thing. It's recognising your strengths and specialising on your strengths, and not drifting everywhere because that's when it will go wrong.

To your question about innovation, we shouldn't be racing ahead with innovation in a MAC strategy, because I don't think our investors want that in a MAC strategy. This isn't an equity strategy. So, there's a place for innovation, but that's in, usually, higher-risk, higher-volatility parts of the market, different pools. Absolutely, that's where you want your innovation. But at this point in the credit cycle innovation could be quite dangerous.

Collins: There's still a lot of activity in this area, so it is a very vibrant part of what's happening with clients. It does have a lot to offer. It works very well in terms of improving risk/return profiles of portfolios. MAC can fit into several places on a spectrum for clients, and a lot more clients are moving into that space. The outlook for credit markets might well give us an environment where MAC does show its worth in its best light.

Den Braber: From my side, MAC has played an important part in the de-risking journey. My argument is that low risk MAC hasn't gone far enough. MAC is still seen as quite a high risk/return credit strategy for those clients that want to delegate their credit strategy to a manager and diversify, but for a lower return. Trustees are therefore almost forced into single strategies at that lower return target. Innovation in low-return, multi-asset credit would be very welcome in the industry.

James: As a trustee, I can definitely see a place for MAC, both in DB and DC strategies. We've probably only just scratched the surface in this area. There are a lot of schemes out there that will start to look at this. I can see this really taking off as another diversifier as, with the economic backdrop, we scrabble around to find where return is going to come from. Saying that, it's important that trustees don't underestimate the governance burden required, or the selection process required. It will also be important to see how the approach to ESG evolves. We've heard some encouraging things today about the right noises being made, and I would be interested to see how that plays out in the next two, three years.

Griffiths: I think there is space for a risk-adjusted MAC allocation in both the DB and DC sectors. We are excited about the opportunities it poses. Going back to the passive/active argument, over the years investors have been spoilt with a combination of low fees and strong returns from many passive funds given the bull markets that have been experienced since the financial crisis. Now we're seeing challenging times, it might play out that active management may help investors to preserve capital and manage volatility. This becomes increasingly important as pension portfolios mature.

Hussain: Acknowledging the growth of credit markets means, in a way, MAC was inevitable and, as an investor, it just makes a lot more sense, because ultimately, I invest based on risk-adjusted returns, and having more flexibility makes that easier. Ultimately, that should give better outcomes, and that's what MAC should be about, and has been about for the past few years. Hopefully, we'll get to prove our mettle in tougher times.

Goodyer: MAC is going to play a growing part in DB and DC strategies going forward. One point where we may see innovation, where we may see growth, is around more cashflow decumulating strategies, in the way that investment-grade has already got pooled fund products out there targeting cash-flows in particular. This could be on both the DB and the DC side of things.