Enhancing Fixed Income Returns with Diversified Credit Opportunities

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Fixed income allocations of defined benefit plans are usually viewed as the anchor of the portfolio, offering protection against the volatility of equities.

But today's fixed income markets present their own unique risks, and with interest rates at such low levels, don't offer much yield as compensation. To identify the unusual challenges and opportunities, PLANSPONSOR spoke to Jude Driscoll, Head of Public Fixed Income at MetLife Investment Management, which manages global fixed income assets across the maturity and risk spectrum.

JUDE DRISCOLL

EVP, Chief Investment Officer for Public Fixed Income at MetLife Investment Management.

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PLANSPONSOR: Growth in the U.S. economy has been stable, but inflation and interest rates have been unusually low for so long—what risks does that pose for the fixed income markets?

Jude Driscoll: Globally, the geopolitical environment is unsettling—trade wars, tariffs, sanctions, and Brexit. And it looks as though the European Central Bank is out of bullets to stimulate those economies. In the U.S. we are worried about sustained low yields and challenged corporate earnings through the end of the year and into 2020.

In a market environment like this, where yields and credit spreads are low and interest rate volatility is high, it's difficult to add alpha in traditional core and core plus strategies only from a rotation among market sectors. It's also challenging to time fixed income duration and yield curve positioning.

So rather than trying to make a call on interest rates, we think investors are more likely to benefit long-term from benchmark-like durations coupled with diversification across fixed income sectors globally.

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PS: In this environment, could bad news be good news—in that disruptions in corporate earnings and the economy would bring opportunities through higher credit spreads?

Driscoll: That's a good point. The fixed income markets have all been moving together, and that's probably the most difficult time to populate a portfolio, as there are limited compelling opportunities. A shakeout in the credit universe could be helpful by widening credit spreads. We believe sometimes the best time to build a fixed income portfolio is when the market is a little upside down, and all asset classes are not moving in lock step.

PS: Is there an advantage to investing in fixed income through passive strategies?

Driscoll: We feel it is difficult to replicate the returns of the fixed income markets with passive portfolios. An index-like or passive strategy might get you some of the right bonds, but may not represent the entire market.

Additionally, a manager being able to allocate away from the index and toward spread sectors may turn up more return opportunities over the long term. For example, for the 10 years ended June 30, 2019, every manager in the eVestment Core Plus Fixed Income Universe* outperformed the Bloomberg Barclays U.S. Aggregate Index.

PS: Diversified core strategies of investment grade securities, or core plus adding separate portfolio mandates for fixed income with greater credit risk?

Driscoll: Plan sponsors who are able to expand their guidelines to allow for increased exposure to high yield, emerging market debt, non-U.S investment grade credit, and securitized credit can achieve added diversification within their portfolios. However for smaller plans this exposure may be better accessed through pooled vehicles that have the benefit of size to achieve diversified and cost efficient exposure. For either approach, a broad separately managed account or pooled vehicle, we believe manager selection should be focused on those managers with a fundamental approach to investing in these asset classes and an established history in the space.

In this market regime, we continuously search for opportunities that are consistent with our investment process and sustainable in periods of market difficulties, while leaving some powder dry to seek opportunities when the market breaks down.

*The US Core Plus Fixed Income Universe is defined by eVestment and performance returns are self-reported by participating managers and are not verified or guaranteed by eVestment. The performance returns sourced are gross of fees and represented 99% of the eVestment US Core Plus Fixed Income universe as of the date sourced. MIM has not verified and cannot verify the information from outside sources.

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MetLife Investment Management leverages a disciplined credit research and underwriting process to provide institutional investors with asset origination and acquisition opportunities and proprietary risk management analytics across public fixed income strategies, private capital, and commercial real estate debt and equity investing, among others.

For more information, visit: **metlife.com/investmentmanagement**

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