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Multi-Asset Credit: A Non-Traditional Strategy for Unconventional Markets

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With the future investing environment likely to look very different from that of the recent past, institutional investors are looking for new approaches. At PineBridge Investments, managing directors Steven Oh and John Yovanovic discuss how a multi-asset credit strategy can provide the possibility of both yield and safety in uncertain markets.

Interest rates and inflation concerns are both threatening to emerge. Risk volatility has just spiked after a prolonged period of tightening valuations and stock prices reaching record highs. Meanwhile, the credit cycle is maturing, and central banks around the world are preparing to collectively normalize monetary policy by withdrawing excess stimulus. What can worried fixed-income investors do?

"Traditional approaches that worked very well in the past 20 years are not going to provide the outcomes that investors need going forward, and so fixed-income investors need to rethink how they're invested," said Steven Oh, managing director and global head of credit and fixed income at PineBridge Investments.

Investors today should look to non-traditional fixed income, suggested Oh. "In this type of environment, alternative fixed-income strategies such as multi-asset credit have the flexibility to better navigate shifting market conditions — and in a risk-controlled manner," he said. His colleague, John Yovanovic, managing director and head of high-yield portfolio management at PineBridge, added, "With MAC you can get high-yield returns with less than high-yield risk."

DIVERSIFYING NATURE

The reason for MAC's distinctive performance pattern, including the potential for both increased return and reduced risk, arises in part from the diversifying nature of the strategy. As opposed to traditional fixed income, MAC, as its name implies, can incorporate many different credit asset classes. The precise mix depends on the manager.

U.S. high-yield bonds and leveraged loans tend to dominate, but other components of a MAC strategy can include emerging-market debt and structured products, such as collateralized loan obligations. Both CLOs and leveraged loans are floating-rate products, making them particularly timely when interest rates are rising. However, Oh points out, "MAC is an all-weather strategy designed to find opportunities in all types of markets."

MAC strategies involve making quick shifts in allocations between credit asset classes. That is one reason asset owners should consider using a MAC manager rather than a different manager for each type of credit asset. In addition, plan sponsors typically don't have the capabilities or expertise for this dynamic approach.

Yovanovic explained that in some cases, one credit issuer might operate in different credit asset classes. An investor who uses different managers for different credit areas might not see the concentration risk this situation can pose.

"That would be invisible to an asset owner; whereas we manage that risk because we can see the entire portfolio," he said.

The asset allocation decision used in the MAC approach is based on relative valuations. Opportunities are most prevalent during times of market disruption, such as the sell-offs that accompanied the European sovereign-debt crisis that began in late 2009 or the plunge in oil prices in 2014. In today's market, however, the focus tends to be on managing risk.

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"It's much more of a defensive posturing, preparing yourself for the downside," Oh said, "because there are a lot fewer total return opportunities available in the broader market."

Despite today's defensive orientation, opportunities to capture alpha still emerge through security selection within each asset class. "We're able to add the alpha by selecting the best ideas across global credit," Yovanovic said.

According to PineBridge economists, the U.S. is in the middle of the credit cycle while the economic cycle is cresting. The result is that few securities are selling at discounts. What that means in terms of a MAC approach is that "we've moved up the capital structure to where the majority of our allocation is going to be in term loans and CLO debt, which are all senior-secured instruments," Yovanovic said, adding that MAC offers the flexibility of being able to move around the capital structure.

DECISIONS FOR ASSET OWNERS

A MAC strategy typically serves as a substitute for the leveraged loan or high-yield portion of a portfolio. It can also be used for de-risking purposes, including as a replacement for equities. Or it can be a more optimal way to manage an existing credit sleeve but "with more flexibility by combining the assets into a MAC approach," Oh said.

Asset owners should also understand that MAC is distinct from both absolute return and unconstrained strategies. All three can be classified as alternative fixed income, but MAC tends to be long-only credit in focus. MAC also can be global, though few managers have true global expertise.

MAC is also hard to benchmark. Unlike with traditional fixed-income strategies, there is no standard benchmark for investors. Nonetheless, Oh said, "this strategy needs to have better outcomes than some type of a blended discrete sleeve management, such as a 50/50 loan/high-yield index."

And MAC has risks. The credit assets in the MAC approach, such as high-yield and leveraged loans, are typically below investment grade. Additionally, these asset classes can become highly correlated during a drawdown, mitigating their diversification benefits.

"Managers with global credit capabilities across all segments – and a consistent style and investment process – can help you mitigate risk in ways that individual sleeve managers can't see," Oh said.

Oh stressed the long-term nature of a MAC strategy. "The objective for this type of strategy is generally to provide return outcomes over a market cycle or a credit cycle as opposed to a very short-term basis."

Despite these risks and limitations, the MAC approach should still capture the interest of plan sponsors, particularly compared with traditional fixed income. Though the asset allocation decisions can be complex, the intuition behind why MAC works is simple.

"With MAC, diversification comes from being able to expand the universe to buy across multiple asset classes," Yovanovic said. "The alpha comes from being able to pick only the best of each universe." ■

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