VIRTUAL SUMMIT **SEPTEMBER 2021**

2021 FIXED INCOME SUMMIT

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Bringing together the **leading voices** in the industry to unpack the current **fixed income** landscape

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INTRODUCTION

Asset TV's Fixed Income Summit held in September 2021 brought together the leading voices in the fixed income industry to unpack the current fixed income landscape.

Moderated by Asset TV Program Anchor Jenna Dagenhart (pictured right) this fast-paced event packed all the biggest risks and opportunities for bond investors into three hours of riveting content. Expect to gain a better understanding of where fixed income fits in a portfolio, the growing role of ESG, the municipal bond landscape, and much more.

This **Asset TV Fixed Income Summit** Key Insights publication proudly shares the highlights of this event with our esteemed audiences and the extended investment community around the globe.

A sincere appreciation and thanks for the interest from the wide audience that tuned in to this event.

For full access to the conference videos or any parts thereof, please visit the **Asset TV Fixed Income Summit** page.

ABOUT ASSET TV

Asset TV is a global video research and learning platform that provides leading edge CE and CPD accredited content. Through its specialist channels and dedicated conversation forums **Asset TV** shares the latest investment news and in-depth thought leadership by tapping into world-class expert opinion.

Over 500,000 advisors, pension funds, consultants, family offices, and wealth managers across the globe trust **Asset TV** for their due diligence, validation, research, and learning. **Asset TV** supports investment professionals with CE-accredited research and learning videos.

Fund managers film with **Asset TV,** sponsor thought leadership programs and syndicate their in-house content on **Asset TV** websites.

The company was established in 2003 and has offices in London and New York, with representation and dedicated websites for advisers in the UK, US, Canada, Europe, Asia, and South Africa.

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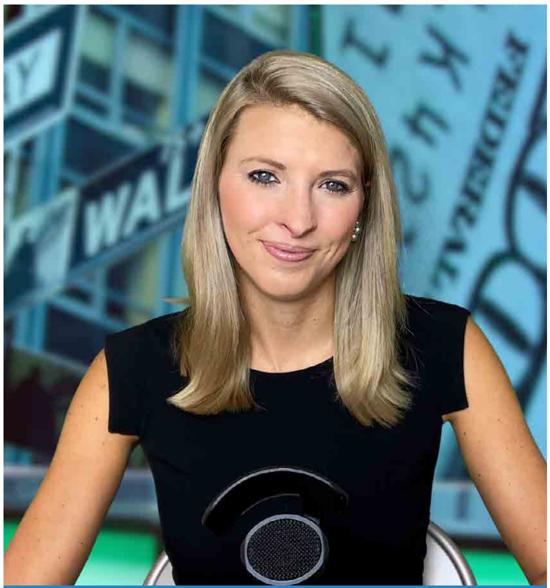

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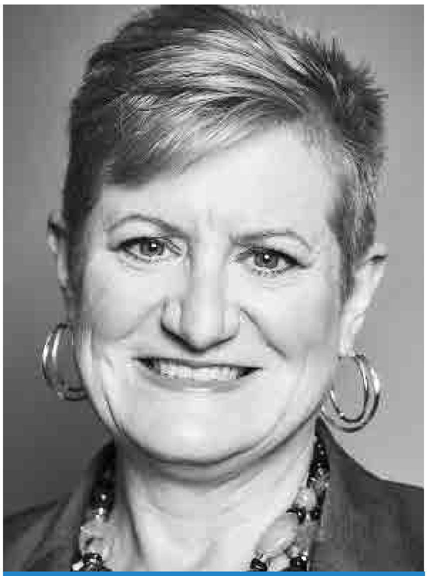
WATCH THIS SESSION

Confessions of an Active Fixed Income Manager: **Risk and Relative Value**

> *Looking to the current market environment, we are in a good place fundamentally. We have largely come out of Covid-19, and there's been a tremendous amount of fiscal and monetary stimulus injected into the system.*
>
> **- Anne Walsh**
> CIO of Fixed Income, Guggenheim Investments



While passive investing has gained huge traction in equities, it was never meant to apply to fixed income. The respective markets are not dissimilar in size ($46 trillion for equities versus $52 trillion for fixed income), but there are only around 3,500 listed equities compared to 5-million listed CUSIPs to which you can add unlisted, private securities and debt instruments. Given the extent and diversity of unlisted assets, it would be very hard for a passive approach to out-do active.

One distinct advantage of active investing in fixed income is risk mitigation. From the day you buy a bond until the time it matures, your return opportunity is really limited to income and return of principle. This means you don't have a huge upside, but you also do have a very significant risk of loss. That's where active managers come in to look at the non-indexed part of the market for opportunities.

At Guggenheim, new mandate money would be put to work in all sorts of risk on sectors and credit sectors, such as corporate credit, some real estate, structured credit - always maintaining enough liquidity in the portfolio to take advantage of credit opportunities should they arise.

CONTRASTING DYNAMICS

The active versus passive dynamic is highlighted in the composition of the Bloomberg Barclays Aggregate, the most widely used and broadest bond market index. About 75% of the Ag comprises government-issued holdings, meaning that the yield that investors can achieve in this space is very limited. Investors are also vulnerable to rates rises.

In contrast, outside of the Ag the opportunity set is far higher, including anything from high-yield security, structured credit, mortgages, leveraged loans, municipal bonds, any number of other securities, as well as private debt issuance.

FORWARD MOMENTUM

Looking to the current market environment, we are in a good place fundamentally. We have largely come out of COVID; there's been a tremendous amount of fiscal and monetary stimulus injected into the system; employment is in recovery; The Fed is accommodative; defaults have fallen in terms of actual defaults and those that are predicted; and upgrades are happening in corporate credit.

Fixed income investors need to be concerned about inflation. But inflation is really the result of the reopening of the economy post COVID. Some of the strongest inflation pressures are subsiding and we believe that inflation is likely to be transitory.

The Fed will likely start to taper their purchases from $120 billion a month of government securities, but probably not materially. Rates-wise, we believe that The Fed will not actively seek to raise rates until maybe as late as 2025 compared to market anticipation of Q1 2023.

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The Path of Fixed Income: Policy Inflection from Easing to Tightening

> *Portfolios should remain balanced. The risks are sticky inflation, demographics biting on global growth, and companies sitting on a load of debt which could lead to credit problems again.*

- Michael J. Collins
Managing Director and Senior Portfolio Manager for Core, Core Plus, Absolute Return, and other Multi-Sector Fixed Income strategies, PGIM Fixed Income

Analyzing the post-COVID recovery has been a huge macro-economic challenge for portfolio managers and analysts, because it happened so fast following one the biggest drawdowns ever. However, stimulus measures are going to wane, and growth will probably moderate again. The Fed is going to taper and will likely to be done buying bonds by middle-to late-2022. This is priced into the market thanks to the Fed's transparency this time around, so another taper tantrum is unlikely.

Some of the growth drivers have been the remarkable ability of the private sector to adapt and the fast-forward of a technological revolution that was going to happen over 10 to 20 years.

That's a step change. We see US growth normalizing back to 2% or below – with a deflationary environment driven not only by COVID but major secular forces already in place like aging workforces, challenging demographics, and improving technology.

Everyone has been surprised at how sharp inflation has gone up and how sticky it's been but at PGIM we think inflation is going to fall back to below 2%, probably starting late 2022. We also fully expect the Fed to slowly start raising the funds rate, maybe late in 2022, early 2023. As a major driver of our long-term interest rate outlook, we think the raise will be 0,75% - 1%, on average for the next 10 years (lower than the Fed's north star of 2,5%).

GOLDEN AGE OF CREDIT FOR THE BOND MARKET

A year ago, PGIM coined the term "the golden age of credit for the bond market". This has truly played out over the past 18 months with the biggest and sharpest improvement in credit quality creating an upgrade-downgrade ratio of well above one - a good sign for credit investors.

We remain positive on credit fundamentals, but we have moderated the risk and taken profits in some of the most fully valued parts of the market, including some higher-quality companies which are being downgraded. We own a lot of debt in financials like the big banks which are now benefitting as a safe play from the stiff regulations post GFC.

THE CASE FOR BALANCED PORTFOLIOS

Regarding the relative value between cash, bonds, and equities, we believe retail investors at this point in the cycle likely don't own enough fixed income, nor enough duration within their fixed income. Portfolios should remain balanced.

Our base case is constructive and benign - moderating growth, moderating inflation, kind of easy policy, rates staying range-bound, and equity and credit valuations staying around where they are over the next few years. The risks are sticky inflation, demographics biting on global growth, and companies sitting on a load of debt which could lead to credit problems again.

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WATCH THIS SESSION

Taking a closer look at
Core Bonds in Today's Markets

> *Core bonds exist to bring balance in your portfolio - to diversify against your risk assets such as equity holdings, and to generate income along the way.*
>
> **- David Braun**
> Head of US Financial Institutions Portfolio Management, PIMCO

2020 was of course bad growth-wise amid the pandemic. We believe we're now in a two-year period where growth is recovering quite strongly, but it will likely be uneven across different geographies and different sectors.

Inflation is high, fuelled by the opening of the economy post-COVID but we believe, like the Fed, that inflation will likely be transitory. Valuations-wise, the typical trade-off when you're in an early part of the recovery for growth is to overweight generic credit, but that's not wise right now given the current level of valuations and starting spreads on credit securities.

Investors want to participate in the recovery. However, with such low yield, what is the role of fixed income today, and specifically that of core bonds?

PIMCO believes the role of core bonds and fixed income hasn't really changed. Core bonds exist to bring balance in your portfolio by doing two things: diversify against your risk assets, like equity holdings; and generate income along the way. As a case in point: in 2020, stock markets were in free fall, other risk assets were under attack, yet core bonds hung on in and delivered positive returns.

ACTIVE MANAGEMENT IN THE TIME OF COMPRESSED ENVIRONMENT

There is some anxiety among investors about the impact of rising rates. We believe rates are going to be relatively range-bound for the next year or so. Nonetheless, one needs to be positioned defensively.

As an active manager, you can hopefully manoeuvre yourself around a rising rate environment and generate positive alpha to offset that bond price decline due to the rising rates.

We would argue that active management is the only prudent way to run a bond portfolio – especially in an environment like this, where the low level of returns and compressed generic credit spreads create an environment where the broad market beta returns are likely to be low for a while.

SEEK OPPORTUNITIES, DIVERSIFICATION BEYOND GENERIC SECURITIES

Our style regarding core bonds is centred on diversification, seeking out the opportunities in the market and building diversified portfolios that both reduce the downside risk and increase the upside return potential.

We want to build a portfolio that is currently diversified outside of generic securities. On interest rate risk we are defensive, slightly underweight duration versus a generic benchmark. In terms of credit, security and industry selection remain important.

Our current focus is on financials, such as the big banks; bonds of issuers who are directly related to the COVID reopening; and US housing markets, especially private-label securitized product backed by home mortgages.

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ESG Integration and Investing in Securitized

We're excited about the future of ESG. From the Securitized perspective, the best-case scenario would be to have more ESG factors readily available across the market, with cooperation from more asset managers to make best practice the norm.

Moderated by **Jenna Dagenhart**, Presenter, **Asset TV**

Liza Crawford
Head of Securitized Research
TCW

Jamie Franco
Head of Fixed Income ESG
TCW

Despite the Securitized market still in the early stages of adoption, ESG integration is an inevitable market evolution and actively asset managers should evolve their Securitized platforms to support ESG integration and ultimately ESG investing to meet growing demands of their clients.

TCW defines ESG across three categories: ESG integration, ESG investing, and ESG investments:

- **ESG integration** is the integration of what have historically been non-traditional factors into the investment process, applied systematically across asset classes.
- **ESG investing** is where we would design tools and strategies to target ESG characteristics or ESG outcomes for clients; no one size fits all, so this is a perfect opportunity for active asset managers to design the tools that clients are looking for.
- **ESG investments** refer to the labelled bond market or the thematic market where bonds are issued where they have use of proceeds, targeting, or objectives for green, social, and sustainable outcomes.

ENVIRONMENTAL

There are some real opportunities in Environmental space - for one, energy efficiency which we see in the residential mortgage market where there is lending focused on financing and energy improvement at the property level, in the commercial mortgage market.

Furthermore, in the asset backed securities market, we can see energy efficiency being financed through installation of solar panels, for example.

As we aim to become increasingly aligned with climate change and the Paris Agreement, emissions data is another important focus area, but it is a challenge to get data in the Securitized space.

SUSTAINABILITY

The Sustainability factor in the Securitized space presents equally great opportunities. We currently use census data and our analytics partners to help provide additional information about the local area population, education levels, etc. We are particularly focused on seeing more data and transparency around borrower diversity and inclusion.

GOVERNANCE

ESG was pioneered in Equity, but it is a lot more complex in the fixed income space. In terms of Governance in the Securitized market, you're looking at elements such as bankruptcy, remote vehicles, issuing bonds, looking at the quality of the underlying collateral, origination practices, servicing practices, cashflow waterfall, bond structure, and then ultimately bankruptcy remoteness.

HOW DO WE ENGAGE ON ESG?

First and foremost, we are active with issuers. Then we engage with Wall Street; we are a signatory to the PRI and sit on their Securitized advisory committee. We also published our ESG dashboard in their more recent Securitized white paper.

There are other interesting discussion points beyond the scope of this summary, such as data retrieval and management and the differences between negative screening, positive screening, and impact investing.

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The Role of Bonds in Multi-Asset Portfolios

> *We have learned a lot about the Fed's willingness to seemingly do almost anything to stabilize markets, such as massive monetary stimulus via purchases of US treasuries and MBS, but also at the corporate bond level.*

- Andy Sparks
Managing Director, MSCI Research

As tragic as the COVID-19 crisis has been, it has been a huge learning opportunity for financial market participants. The question going forward remains: will inflation be tame, and will the bond-equity correlation remain negative?

Liquidity was a major factor that was underscored - not just in equities and corporate bonds, but also in the US treasury market, a market normally regarded as one of the most liquid in the global capital market.

Inflation is a major factor to watch. Having hit its highest level in 30 years, the current market expectation is that it will drop to close to the Fed's 2% target.

NAVIGATING DIVERSIFICATION AMIDST VOLATILITY, INFLATION

The reality is that after adjusting for market inflation, expectation yields on US government bonds are negative. Bond investors ideally want a continued 60:40 classic portfolio allocation with 60% to equities and 40% allocation to bonds.

But if inflation volatility rises and the Fed seems to lose control, the correlation would turn positive. In this scenario, the insurance/hedging value of bonds in a multi-asset portfolio would diminish, as would the ability to diversify portfolios.

From a bond portfolio construction perspective, there's emphasis on finding ways to improve the liquidity profile, for example with innovation around ETFs as trading vehicles.

We're also likely to see quantitative strategies based on factors in fixed income. Prompted by COVID, we are doing various stress tests as a way of looking at potential economic scenarios, to see how portfolios would behave.

CLIMATE INVESTING: A NEW HORIZON

Turning to climate-aware portfolios, a huge amount of education is still needed. There has been an upsurge in interest, with some commentators even comparing it to providing financing for the next industrial revolution. This could of course be a huge development for the capital markets.

We continue to research climate investing from the perspective of bond investors. We compared corporate bonds to equities to try to better understand the climate risks. In our modelling, newly rebalanced portfolios had similar yields and spreads as the original portfolios which suggests that climate investing does not yet appear to have had a major impact on bond market pricing. But policy will be crucial, especially once new regulations start to be enforced.

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Municipal Bonds: The Infrastructure Opportunity

> *One of the biggest concerns when the pandemic first hit was around credit quality in a market such as munis, which is mainly retail owned. However, this has turned into an increasingly positive narrative as investors are much more comfortable with the credit landscape which is partly driven by the American Rescue Plan.*

Panel discussion by Build America Mutual (BAM)
Moderated by **Michael Stanton,** Head of Strategy and Communications, BAM

Seán W. McCarthy
Chief Executive Officer
BAM

Grant Dewey
Chief Executive Officer
BAM

Nisha Patel
Director
Portfolio Management
PARAMETRIC

Elizabeth Mossow
Senior Managing Director
INVESCO

Suzanne Finnegan
Chief Credit Officer
BAM

Despite several challenges and trends set to influence the market, the muni market is generally structured to be very resilient. On a relative basis, munis have performed very well year-to-date, outperforming other taxable fixed income asset classes. On an absolute basis, however, it's not nearly as compelling.

The primary driver is flow: in the year-to-date roughly $85 billion, or some $200 million per day, has been pouring into the market and it's been difficult to find supply to meet that demand. According to current estimates some $500 million is expected to flow in by year-end.

Looking at separately managed accounts for individual retail investors, one of the biggest concerns about 18 months ago when the pandemic first hit was around credit quality in a market like munis, which is mainly retail owned. However, this has turned into an increasingly positive narrative as investors are much more comfortable with the credit landscape in munis, which is partly driven by the American Rescue Plan.

PREVAILING VALUE, HIGH YIELD POTENTIAL AND GROWING DEMAND

Turning to inflation and tax risks, investors are cautious about the negative impact on fixed income, but munis still make the most sense relative to other fixed income asset classes. That said, there may be some weakness in Q4 but nothing that could trigger a big sell-off. The value is still there. Investors and managers are actively managing portfolios, minimizing some of that downside risk in a higher rate environment.

The high-yield municipal market tends to be very heavily concentrated in a few sectors, with Puerto Rico's court-supervised bankruptcy being a case in point. After the court hearing in early November. there is potentially $6.6 billion that will go back to current high-yield investors, creating a new, huge source of demand.

INCREASED RISK APPETITE AND LEGISLATION TO DRIVE OPPORTUNITIES, MOMENTUM

Regarding credit spreads, going into COVID, there were record lows, then they widened out and they've come back full circle, with new lows of 58 basis points, indicating a lot of appetite for risk right now in the market.

Turning to the current infrastructure discussion in Washington DC, the muni market is probably going to play a significant role. Legislation has been introduced that would bring back a version of the old Build America bonds.

There might be more activity to help finance investments such as into roads, water, and sewer systems, perhaps even schools. But there's a lot to unpack in the recent proposals, both on the tax side, which would affect demand and on the issuance side.

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IN CONCLUSION

The Asset TV Fixed Income Summit covered wide-ranging topics and included presentations by experts from some of the best-known players in the fixed income space. Analyzing the post-COVID recovery has been a huge macro-economic challenge for portfolio managers and analysts because it happened so fast following one of the biggest drawdowns ever. Given low interest rates and increased inflation, how should investors think about bonds? The Asset TV Fixed Income Summit covers this key question on investors' minds and many more.

TOP TAKEAWAYS

Active management is the best way to maneuver around a changing environment.

The municipal bonds market is structured to be very resilient and could play an important role in the national and local infrastructure pans.

The Fed is going to taper and will likely to be done buying bonds by middle to late 2022. Another taper tantrum is unlikely.

Inflation was a hot topic with speakers generally agreeing that it will probably settle down into the Fed's range of 2%, probably starting late 2022.

Liquidity was addressed including in the US treasury market. There is some innovation in this space, for example ETFs being used as trading vehicles.

There has been an upsurge in interest regarding climate-aware portfolios, with some commentators even comparing it to providing financing for the next industrial revolution. This could be a huge development for the capital markets.

At the same time, with ESG increasingly coming to the fore to meet the growing demands of clients, the big focus going forward is likely to be on Governance.

> *We believe the role of core bonds and fixed income hasn't really changed. Core bonds exist to be a balance in your portfolio, to do two things: diversify against your risk assets, like equity holdings; and generate income along the way. In 2020, stock markets were in free fall, other risk assets were under attack, yet core bonds hung on in and delivered positive returns, proving the point*
>
> **- Asset TV Fixed Income Summit, September 2021**

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Asset TV wishes to thank the esteemed speakers, panelists and moderators who participated in the 2021 Asset TV Fixed Income Summit, as well as to our Asset TV community members who tuned into. We value your ongoing association and valued contributions.

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SPEAKER PROFILES

Anne Walsh
CIO of Fixed Income, Guggenheim Investments

Michael J. Collins
Managing Director and Senior Portfolio Manager, PGIM Fixed Income

David Braun
Head of US Financial Institutions Portfolio Management, PIMCO

Liza Crawford
Head of Securitized Research, TCW

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