LOOMIS | SAYLES

GETTING THE BIG PICTURE RIGHT IN MULTI-ASSET CREDIT INVESTING

WRITTEN BY

THE ALPHA STRATEGIES TEAM

MULTI-ASSET CREDIT (MAC) INVESTING IS THE PROCESS OF GAINING EXPOSURE TO A GLOBALLY DIVERSE MIX OF CREDIT-FOCUSED ASSET CLASSES AND SECTOR EXPOSURES IN A SINGLE PORTFOLIO.

At Loomis Sayles, we add value as MAC investment managers by being focused on top-down regime identification, seeking to maximize risk-adjusted return potential within these credit sectors. This paper outlines key elements of our process.

INPUTS

1. Having a global opportunity set and identifying phases of the global credit cycle
2. Measuring market fragility as a determinant of asset allocation
3. Employing a dynamic asset allocation process

MANAGER INSIGHT

Global Credit Cycle

At any time, regions, countries and sectors around the world are in different phases of the credit cycle—presenting potential credit opportunities for investors. To determine opportunities, credit cycle analysis reveals which economies are borrowing and spending, and which are saving and deleveraging. This step, along with the characteristics below, can help us identify the prevailing phase of the cycle for a given country or sector.

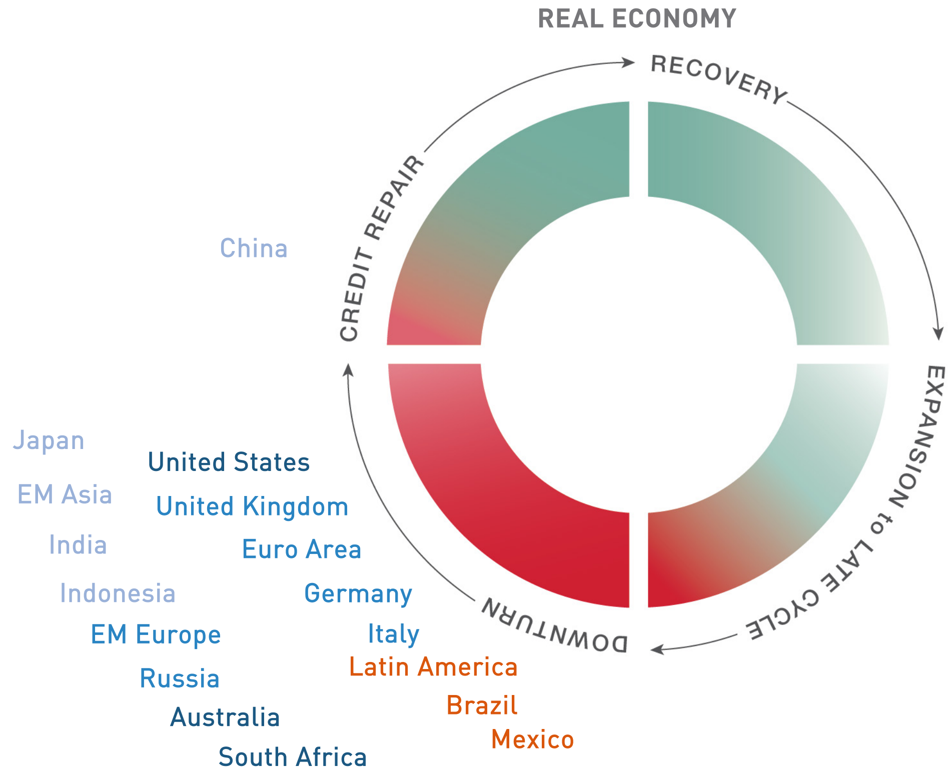
LOOMIS SAYLES' CREDIT CYCLE VIEWS

Source: Loomis Sayles.
Views as of 3/31/2020.

Chart provided for illustrative purposes only.

REGIONS:

- Asia
- Europe
- Latin America
- Other



EXPANSION TO LATE CYCLE	DOWNTURN	CREDIT REPAIR	RECOVERY
• Debt > Profit growth • Monetary policy is tight • Tight economic slack • Fading risk appetite • Liquidity tightening	• Profit contraction • Central bank is cutting rates • Recession • Liquidity and risk appetites are low	• Debt contraction • Easy monetary policy • Growth is rebounding • High liquidity • Improving risk appetite	• Profit > Debt growth • Monetary policy is about neutral • Growth near trend • Diminishing liquidity • Improving risk appetite

Measuring Market Fragility

We recognize that macroeconomic data can be significantly lagged and error-prone (subject to revision). Often, by the time the data identifies a downturn, markets have already repriced. If MAC strategies do not have a forward-looking perspective, they run the risk of unnecessary exposure to rising market stress or market crashes.

UNDERSTANDING DEGREES OF MARKET STRESS AND THEIR IMPLICATIONS

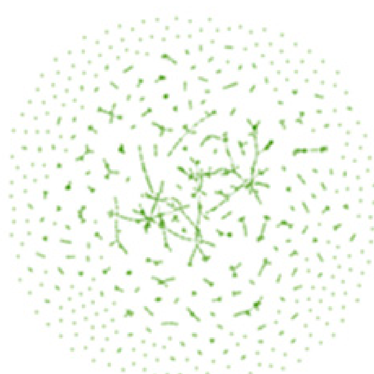
Using our proprietary Crisis Sensitivity Ratio (CSR) that attempts to highlight increasing probabilities of a crisis, we monitor market fragility across global asset classes to better understand what is driving valuations; the insights we gain contribute to decision-making and positioning.

The left-hand chart below depicts a historical snapshot of the stock market. During high-growth periods, such as mid-2006, stocks tend to exhibit low interconnectedness to each other. Conversely, in stressed regimes, stocks tend to become highly correlated (right-hand chart). When our interconnectedness measure increases, we anticipate increased levels of market volatility.

Asset Allocation

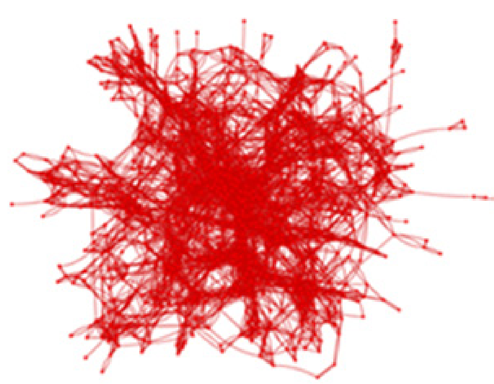
LOW INTERCONNECTEDNESS DURING GROWTH (JUN'06):

STOCK NETWORK DURING LOW CSR



HIGH INTERCONNECTEDNESS DURING CRISIS (DEC'08):

STOCK NETWORK DURING HIGH CSR



We apply this same quantitative approach to assessing the fragility of global credit markets. When degrees of market stress shift, we use these signals as inputs to guide our tactical portfolio allocations.

Our MAC strategy draws from a global opportunity set that spans investment grade, high yield, bank loans, securitized and emerging market issues. Risk premia associated with these sectors are constantly shifting. Therefore, a robust approach to allocating to what we see as the most attractive sectors is an essential source of alpha potential. "According to well-known studies by Brinson and Colleagues, more than 90 percent of the variability in a typical plan sponsor's performance over time is the result of asset allocations policy."[i]

The following table shows how different sectors behave in different phases of the credit cycle, a critical component of cross-asset risk premia. Forward-looking analysis of credit cycle regimes, combined with our analysis of market fragility, underpins our approach to harvesting credit risk premia.

Ultimately, our quantitative research informs a qualitative judgmental approach to asset allocation, based on the collective experience of an established three-person portfolio management team.

CROSS-ASSET RETURN AND VOLATILITY IN EACH PHASE OF THE CREDIT CYCLE

	EXPANSION / LATE CYCLE		DOWNTURN		CREDIT REPAIR		RECOVERY		ENTIRE PERIOD	
	AVG RETURN	STD DEV	AVG RETURN	STD DEV	AVG RETURN	STD DEV	AVG RETURN	STD DEV	AVG RETURN	STD DEV
US TREASURY	5.23%	3.54%	15.80%	7.23%	9.29%	4.94%	2.27%	4.04%	4.51%	4.35%
US TREASURY TIPS	5.30%	4.61%	7.94%	12.26%	16.46%	6.17%	3.68%	5.70%	5.15%	6.02%
US AGGREGATE	5.15%	3.03%	6.64%	7.81%	10.13%	3.46%	2.82%	3.44%	4.71%	3.68%
US SECURITIZED	4.85%	2.47%	7.00%	5.13%	6.51%	2.18%	2.66%	2.85%	4.35%	2.95%
US CORPORATE IG	5.39%	3.85%	-5.27%	17.40%	19.25%	5.07%	4.11%	4.67%	5.66%	5.92%
AAA US CORP IG	6.27%	4.59%	9.30%	20.93%	13.48%	6.12%	2.84%	5.70%	5.40%	7.40%
AA US CORP IG	4.99%	3.33%	3.14%	14.48%	14.52%	5.28%	2.56%	4.44%	4.93%	5.20%
A US CORP IG	5.12%	3.98%	-0.02%	17.17%	17.81%	6.01%	3.74%	4.96%	5.34%	6.14%
BAA US CORP IG	5.59%	4.03%	-9.59%	18.80%	23.61%	6.71%	4.60%	5.38%	6.11%	6.46%
BANK LOANS	3.90%	2.02%	-20.47%	17.54%	15.31%	2.53%	5.65%	1.91%	4.26%	5.45%
US CORPORATE HY	5.69%	4.39%	-24.34%	22.31%	31.34%	5.82%	9.25%	4.97%	7.27%	7.94%
BA US HIGH YIELD	5.70%	3.74%	-14.62%	21.11%	23.33%	4.70%	8.13%	4.44%	7.18%	6.75%
B US HIGH YIELD	5.67%	4.45%	-26.22%	22.58%	26.13%	5.32%	9.29%	4.77%	6.49%	8.09%
CAA US HIGH YIELD	5.82%	6.43%	-45.01%	26.75%	65.05%	9.74%	11.24%	7.11%	7.00%	10.93%
EM CORP	5.99%	2.45%	-17.05%	15.28%	27.15%	4.23%	6.57%	4.45%	6.66%	5.46%
EM CORP IG	5.70%	2.33%	-10.41%	11.95%	21.65%	4.16%	5.82%	4.19%	6.27%	4.66%
EM CORP HY	6.54%	3.77%	-31.61%	24.37%	47.94%	6.43%	10.14%	5.88%	8.06%	8.87%

Time period: 12/31/2001 - 4/24/2020. See cycle dates in Endnotes.[ii]
***Avg Return**: annualized total return, average of all cycles. **Std Dev:** annualized monthly volatility, average of all cycles.*

Summary

We believe MAC should be considered a comprehensive solution for fixed income investing. Through a deep understanding of the credit cycle, we aim to tactically re-weight fixed income assets with the goal of achieving the highest risk-adjusted return potential during each phase. By adjusting exposure to higher- or lower-quality securities, a MAC strategy can also dynamically shift the intrinsic beta of those investible assets, depending on the degree of market stress.

Once top-down asset allocation targets have been determined, special attention is given to security selection through bottom-up, fundamental credit research. We believe investing in companies and countries that are able to meet their repayment obligations, thereby minimizing the risk of suffering rating downgrades or defaults, is critical to potential success. In order to facilitate this, we utilize our credit research department with over 50 full-time credit research professionals. This group provides real-time, forward-looking information on the creditworthiness of the companies and countries they cover, both on an absolute basis and relative to other, similar companies/countries.

Holistically, the strategy's tactical nature, combined with its inherent diversification, helps enhance the portfolio's Sharpe ratio by mitigating exposure to large drawdowns during volatile markets. We believe over a full cycle, MAC strategies have the potential to achieve high yield-like returns with lower volatility, likely offering a viable substitute for those looking to diversify away from more constrained, single-asset credit portfolios, or higher-risk equity strategies for those that are on a de-risking path.

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Endnotes

i Does Asset Allocation Policy Explain 40, 90 or 100 Percent of Performance?, Roger G. Ibbotson and Paul D. Kaplan, Financial Analyst Journal, January/February 2000.

[ii] Regime periods as shown on page three are determined by the investment team based on a variety of subjective and objective factors, including past economic and asset performance metrics. Views and opinions expressed reflect the current opinions of the investment team, and views are subject to change at any time without notice. Other industry analysts and investment personnel may have different views and opinions.

STAGE	START	END
RECOVERY	6/1/2003 6/1/2011	2/28/2006 12/31/2013
EXPANSION/LATE CYCLE	3/1/2006 1/1/2014	12/31/2007 2/29/2020
DOWNTURN	12/31/2001 1/1/2008 3/1/2020	10/31/2002 3/31/2009 4/24/2020 (last date of data incorporated)
CREDIT REPAIR	11/1/2002 4/1/2009	5/30/2003 5/31/2011

Disclosure

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