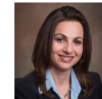
Exploring a Multi-Asset Credit (MAC) Allocation

A MAC strategy may have benefits in a volatile, low-yield world.

September 2020

Michael Connelly, CFA
Multi-Asset Credit Team Lead and Co-portfolio Manager, Global High Income Bond Strategy

Saurabh Sud, CFA
Multi-Asset Credit Team Lead and Portfolio Manager, Dynamic Credit Strategy



Anna Dreyer, Ph.D., CFA
Multi-Asset Credit Team Member and Head of Fixed Income Risk and Portfolio Construction Research

Gregor Dannacher, CFA
Portfolio Specialist, Global Credit

KEY INSIGHTS

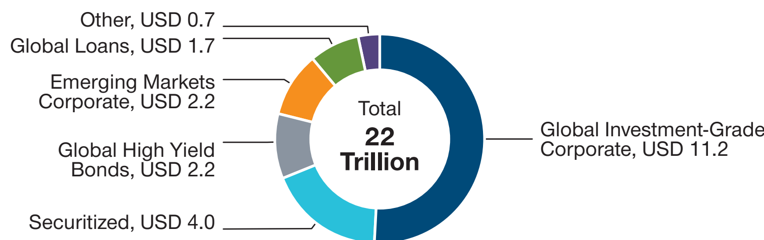
- The longer-term goal of MAC portfolios is harnessing attractive risk premiums across global credit sectors and instruments.
- MAC portfolios have the potential to harness alpha through sector rotation and security selection as well as diversification benefits as part of a broader portfolio.
- We believe that MAC portfolios should not simply invest in the highest-yielding opportunities but should focus on harnessing credit market inefficiencies.

The market turmoil of March 2020 demonstrated that volatility often creates market inefficiencies, and harnessing these dislocations in credit markets requires a combination of tactical and demonstrated global analytical capabilities. While many of the initial market dislocations generated by the onset of the coronavirus pandemic have dissipated, we anticipate that the ongoing volatility and uncertainty will create longer-term opportunities for multi-asset credit (MAC) investors.

MAC portfolios can offer the potential to harness alpha through sector rotation and security selection as well as diversification benefits as part of a broader portfolio. MAC portfolios can be designed to meet

Global Credit Opportunity Set

(Fig. 1) Credit segment size, in USD trillion



As of June 30, 2020.
Sources: Credit Suisse, J.P. Morgan, and Bloomberg Barclays (see Additional Disclosures).

USD 22 trillion

Size of investible universe for MAC portfolios

various return and risk objectives for adroit managers who have the depth and breadth of global credit capabilities. In the current volatile, low-yield fixed income environment, investors may benefit from a more opportunistic, dislocation-oriented MAC portfolio in terms of risk level.

The investible universe for MAC portfolios is about USD 22 trillion across the range of global credit sectors, providing the flexibility to make sizable, high-conviction allocations to sectors that offer relative value or pricing dislocations.

Search for Total Return and Income in Low-Yield Environment

With interest rates likely to remain at low levels for the foreseeable future, the search for total return and income from a fixed income allocation has become a top priority for many investors. MAC strategies that allow investors to target higher fixed income returns with lower volatility—albeit with higher credit risk—are in demand. The unprecedented amount of global stimulus in response to the pandemic will likely affect different credit sectors, industries, and issuers in different ways, creating an ideal environment for a strategy designed to harness dislocations.

Sector-Specific Knowledge Is Essential

The key for generating alpha in a MAC portfolio is expertise in fixed income sectors, such as high yield, leveraged loans, investment-grade corporate, securitized,[1] convertible, and emerging markets credit securities. A MAC portfolio requires strong, fundamental credit analysis for effective security selection within the sectors, allowing managers to recognize and have exposure to names that are priced inefficiently. Particularly when investing in high yield, emerging market, and securitized sectors, rigorous credit analysis is essential for selecting credits where the chance of default is remote over the investment time horizon.

Sector-specific knowledge is also essential for recognizing dislocations and relative value among those segments. This allows MAC portfolio managers to tactically rotate exposures to credit sectors that are dislocated or that offer compelling relative value or attractive absolute value as markets fluctuate.

Robust quantitative capabilities are a key component of MAC portfolio efficiency enhancement. Tools such as quantitative simulation across various market scenarios can create more risk-aware portfolio construction, assist portfolio managers with timely sector shifts, and keep overall portfolio risk within desired parameters.

MAC Return Objective

Typically, the longer-term goal of MAC portfolios is aiming to harvest attractive risk-adjusted returns across a range of fixed income credit markets and instruments. In the current environment of elevated volatility and dislocations across sectors, we believe that MAC portfolios may have the potential to deliver equity-like returns with lower volatility.

In our MAC portfolios, we do not simply invest in the highest-yielding—and riskiest—sectors and issuers. Rather, we focus on finding and harnessing inefficiencies across credit markets that ultimately can deliver more optimal outcomes. T. Rowe Price already offers strategies specializing in key credit sectors, giving us the ability to leverage our extensive experience in credit and equity analysis to manage portfolios across sectors and regions.

[1] Securitized credit includes non-agency mortgage-backed securities (RMBS), commercial mortgage-backed securities (CMBS), asset-backed securities (ABS), collateralized loan obligations (CLOs), and enhanced equipment trust certificates (EETCs).

Close Collaboration Characterizes T. Rowe Price MAC Capability

T. Rowe Price's global fundamental research platform is at the core of our MAC capability. The close collaboration among T. Rowe Price's global credit, equity, and quantitative analysts enables our MAC capabilities to take advantage of credit market dislocations like those created by the market turmoil in March 2020. We empower and encourage our analysts to think as investors and to provide conviction ratings on their ideas.

We believe that there are two key components of MAC alpha generation. The first is credit selection at the issue level, which entails identifying credit premium in addition to just credit beta. The second is the flexibility to rotate among credit sectors and subsectors to source relative value opportunities while also seeking to provide portfolio diversification benefits. We think that implementing relatively concentrated, "highest conviction" MAC portfolios could provide the optimal portfolio construction to help enhance portfolio efficiency.

Extensive Application of Quantitative Tools

The MAC team and our credit analysts work closely with our quantitative analysts, using proprietary tools to screen for relative value at the sector, industry, rating class, issuer, and security levels. The quantitative team also provides insight for enhancing optimal sector allocations and general portfolio construction, including developing return and risk expectations, measuring factor exposures, creating risk scenarios, and assessing portfolio liquidity. This work is also essential to portfolio risk management and helps ensure that the portfolio meets client constraints.

Look for our upcoming series of monthly Insights detailing our views on particular credit sectors.

Key Risks—The following risks are materially relevant to the strategy highlighted in this material:

General Portfolio Risks

Capital risk—the value of your investment will vary and is not guaranteed. It will be affected by changes in the exchange rate between the base currency of the portfolio and the currency in which you subscribed, if different.

Counterparty risk—an entity with which the portfolio transacts may not meet its obligations to the portfolio.

Geographic concentration risk—to the extent that a portfolio invests a large portion of its assets in a particular geographic area, its performance will be more strongly affected by events within that area.

Hedging risk—a portfolio's attempts to reduce or eliminate certain risks through hedging may not work as intended.

Investment portfolio risk—investing in portfolios involves certain risks an investor would not face if investing in markets directly.

Management risk—the investment manager or its designees may at times find their obligations to a portfolio to be in conflict with their obligations to other investment portfolios they manage (although in such cases, all portfolios will be dealt with equitably).

Operational risk—operational failures could lead to disruptions of portfolio operations or financial losses.

INVEST WITH CONFIDENCE℠

T. Rowe Price focuses on delivering investment management excellence that investors can rely on—now and over the long term.

T. Rowe Price®

Additional Disclosures

© 2020 CREDIT SUISSE GROUP AG and/or its affiliates. All rights reserved.

Information has been obtained from sources believed to be reliable but J.P. Morgan does not warrant its completeness or accuracy. The index is used with permission. The Index may not be copied, used, or distributed without J.P. Morgan's prior written approval. Copyright © 2020, J.P. Morgan Chase & Co. All rights reserved.

Bloomberg Index Services Limited. BLOOMBERG® is a trademark and service mark of Bloomberg Finance L.P. and its affiliates (collectively "Bloomberg"). BARCLAYS® is a trademark and service mark of Barclays Bank Plc (collectively with its affiliates, "Barclays"), used under license. Bloomberg or Bloomberg's licensors, including Barclays, own all proprietary rights in the Bloomberg Barclays Indices. Neither Bloomberg nor Barclays approves or endorses this material, or guarantees the accuracy or completeness of any information herein, or makes any warranty, express or implied, as to the results to be obtained therefrom and, to the maximum extent allowed by law, neither shall have any liability or responsibility for injury or damages arising in connection therewith.

Important Information

This material is being furnished for general informational and/or marketing purposes only. The material does not constitute or undertake to give advice of any nature, including fiduciary investment advice, nor is it intended to serve as the primary basis for an investment decision. Prospective investors are recommended to seek independent legal, financial and tax advice before making any investment decision. T. Rowe Price group of companies including T. Rowe Price Associates, Inc. and/or its affiliates receive revenue from T. Rowe Price investment products and services. **Past performance is not a reliable indicator of future performance.** The value of an investment and any income from it can go down as well as up. Investors may get back less than the amount invested.

The material does not constitute a distribution, an offer, an invitation, a personal or general recommendation or solicitation to sell or buy any securities in any jurisdiction or to conduct any particular investment activity. The material has not been reviewed by any regulatory authority in any jurisdiction.

Information and opinions presented have been obtained or derived from sources believed to be reliable and current; however, we cannot guarantee the sources' accuracy or completeness. There is no guarantee that any forecasts made will come to pass. The views contained herein are as of the date written and are subject to change without notice; these views may differ from those of other T. Rowe Price group companies and/or associates. Under no circumstances should the material, in whole or in part, be copied or redistributed without consent from T. Rowe Price.

The material is not intended for use by persons in jurisdictions which prohibit or restrict the distribution of the material and in certain countries the material is provided upon specific request. It is not intended for distribution to retail investors in any jurisdiction.

Australia—Issued in Australia by T. Rowe Price Australia Limited (ABN: 13 620 668 895 and AFSL: 503741), Level 50, Governor Phillip Tower, 1 Farrer Place, Suite 50B, Sydney, NSW 2000, Australia. For Wholesale Clients only.

Canada—Issued in Canada by T. Rowe Price (Canada), Inc. T. Rowe Price (Canada), Inc.'s investment management services are only available to Accredited Investors as defined under National Instrument 45-106. T. Rowe Price (Canada), Inc. enters into written delegation agreements with affiliates to provide investment management services.

DIFC—Issued in the Dubai International Financial Centre by T. Rowe Price International Ltd. This material is communicated on behalf of T. Rowe Price International Ltd. by its representative office which is regulated by the Dubai Financial Services Authority. For Professional Clients only.

EEA ex-UK—Unless indicated otherwise this material is issued and approved by T. Rowe Price (Luxembourg) Management S.à r.l. 35 Boulevard du Prince Henri L-1724 Luxembourg which is authorised and regulated by the Luxembourg Commission de Surveillance du Secteur Financier. For Professional Clients only.

Hong Kong—Issued in Hong Kong by T. Rowe Price Hong Kong Limited, 6/F, Chater House, 8 Connaught Road Central, Hong Kong. T. Rowe Price Hong Kong Limited is licensed and regulated by the Securities & Futures Commission. For Professional Investors only.

New Zealand—Issued in New Zealand by T. Rowe Price Australia Limited (ABN: 13 620 668 895 and AFSL: 503741), Level 50, Governor Phillip Tower, 1 Farrer Place, Suite 50B, Sydney, NSW 2000, Australia. No Interests are offered to the public. Accordingly, the Interests may not, directly or indirectly, be offered, sold or delivered in New Zealand, nor may any offering document or advertisement in relation to any offer of the Interests be distributed in New Zealand, other than in circumstances where there is no contravention of the Financial Markets Conduct Act 2013.

Singapore—Issued in Singapore by T. Rowe Price Singapore Private Ltd., No. 501 Orchard Rd, #10-02 Wheelock Place, Singapore 238880. T. Rowe Price Singapore Private Ltd. is licensed and regulated by the Monetary Authority of Singapore. For Institutional and Accredited Investors only.

South Africa—T. Rowe Price International Ltd ("TRPIL") is an authorised financial services provider under the Financial Advisory and Intermediary Services Act, 2002 (FSP Licence Number 31935), authorised to provide "intermediary services" to South African investors.

Switzerland—Issued in Switzerland by T. Rowe Price (Switzerland) GmbH, Talstrasse 65, 6th Floor, 8001 Zurich, Switzerland. For Qualified Investors only.

UK—This material is issued and approved by T. Rowe Price International Ltd, 60 Queen Victoria Street, London, EC4N 4TZ which is authorised and regulated by the UK Financial Conduct Authority. For Professional Clients only.

USA—Issued in the USA by T. Rowe Price Associates, Inc., 100 East Pratt Street, Baltimore, MD, 21202, which is regulated by the U.S. Securities and Exchange Commission. For Institutional Investors only.

© 2020 T. Rowe Price. All rights reserved. T. ROWE PRICE, INVEST WITH CONFIDENCE, and the bighorn sheep design are, collectively and/or apart, trademarks or registered trademarks of T. Rowe Price Group, Inc.

ID0003425 (09/2020)
202008-1304102