



Study at a Glance

Invesco Global Fixed Income Study 2020

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Introduction

This summary presents highlights from Invesco's third annual Global Fixed Income Study, part of a suite of thought leadership studies including the Global Sovereign Asset Management Study and the Global Factor Investing Study. These are all data-driven studies based on face-to-face interviews that add depth and context to the findings.

The Study offers insights into asset allocation decisions, strategies, and methods of implementation, as well as future intentions of investors within the fixed income asset class, and reveals how they were positioned in the lead-up to the market turmoil arising from the COVID-19 pandemic.

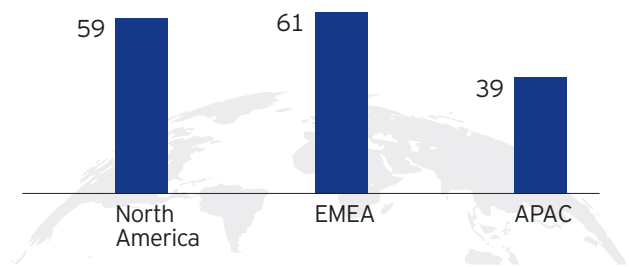
Sample and methodology

The fieldwork for this Study was conducted by an independent, full service advisory firm integrating consulting, insights and analytics exclusively in asset management, wealth management and protection. Invesco chose to engage a specialist independent firm to ensure high quality objective results. Key components of the methodology include:

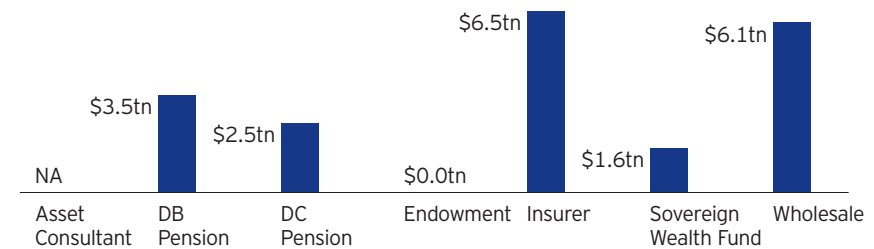
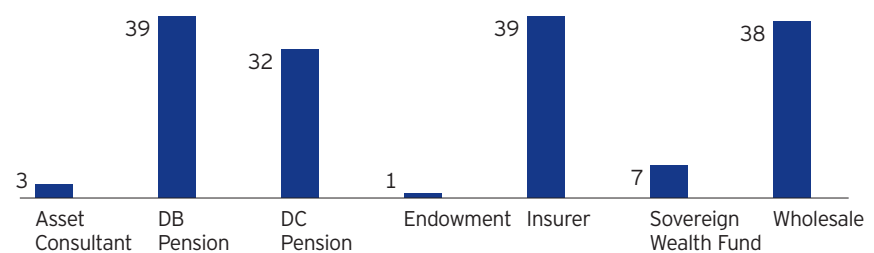
- A focus on the key fixed income decision makers within institutional investors and wholesale investors (including private banks, diversified fund managers, multi-managers and model builders), conducting interviews using experienced consultants and offering market insights rather than financial incentives
- In-depth, face-to-face interviews (typically 1 hour) using a structured questionnaire to ensure quantitative as well as qualitative analytics were collected

159 respondents across three regions covering US\$20 trillion in assets

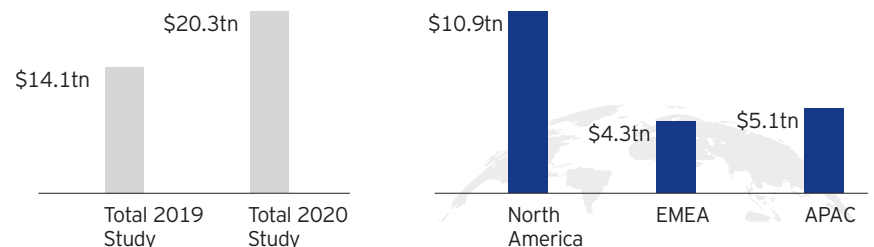
159
Total Sample



Segment Splits



Sample AUM



Theme 1

Greater caution in advance of market turmoil

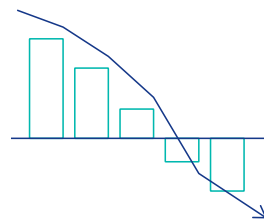
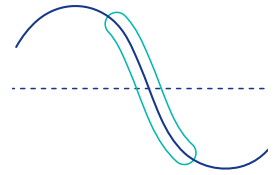
The Study's interviews, conducted before the appearance of COVID-19, revealed a strong sense of caution among fixed income investors prior to the turmoil unleashed by the pandemic.

Almost half (43%) believed the end of the record-long economic cycle was a year or less away, with the consensus for a soft landing. 23% identified a bond market bubble with just 29% fearing a major collapse in bond prices. Central bank easing had led to low and negative yields encouraging some to take on additional risk to bolster returns and meet objectives. This was a market plagued by fear: fear of losing but also fear of losing out. Despite some late cycle risk-taking, the confluence of end-of-cycle concerns and fears of trade wars may have translated into portfolios that were better protected from an unprecedented exogenous shock than otherwise may have been the case.



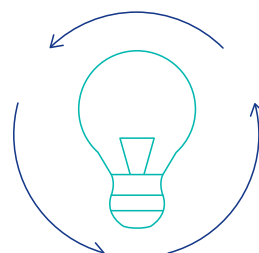
The increasing risk aversion exhibited by many investors prior to the COVID-19 crisis will have potentially positioned them better for an unprecedented exogenous shock than may have otherwise been the case.

Investors were more cautious than a year earlier. In addition to trade war concerns, nearly half thought the cycle would end in a year or less, truncating the assumed runway to the end of the cycle, pointing to economic softening and lack of monetary flexibility.



However, few were positioned for rates to fall much further, with only 8% predicting negative rates in the US.

Tumbling yields are particularly problematic for funding levels of defined benefit (DB) pensions straining to match the duration of their liabilities. Most defined contribution (DC) pensions and insurers were responding by moving up the risk spectrum and exploring new asset classes; wholesalers were doing likewise.



Investors were mindful of high levels of volatility and a breakdown in the negative correlation between fixed income and equities that has existed since the 1990s, prompting some to rethink the role of fixed income within their portfolios.

Contrast between cautious and yield-seeking investors grows



54%
cautious



46%
adventurous

Investors reacted to concerns about the end of the cycle in different ways based on their risk tolerance, with 54% of investors identifying themselves as 'cautious' and 46% as 'adventurous'.

63%
of cautious investors have been retrenching in core assets



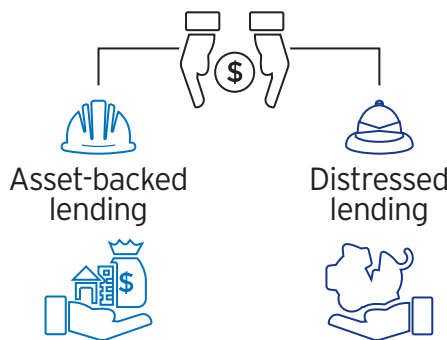
Some 63% of cautious investors were retrenching in core asset classes, particularly well-funded pension funds and insurers. Those experiencing greater pressures on returns were increasing yield through lowering credit requirements, especially North American insurers.

US investors were selling out of high yield, motivated by concerns over rich valuations and being late cycle. Non-US investors, hungry for yield and attracted by the strengthening dollar, increased their allocations.



Low yields have led to steadily increasing allocations to alternative credit, despite the strong sense of caution highlighted in Theme 1.

Among those migrating to higher yielding credit, some asset owners remain more defensive than others, particularly those identified as having a more 'cautious' risk profile. They have been more selective than peers with a more adventurous risk profile and are more likely to be increasing allocations to assets such as asset-back securities (ABS) (12%) and Real Estate Lending (15%), while maintaining higher core fixed income allocations. More adventurous investors are more likely to have been utilizing the full range of alternative credit securities to increase allocations to less liquid sub-asset classes in greater numbers: direct lending (26%), high yield debt (24%) and emerging market (EM) Debt (29%).



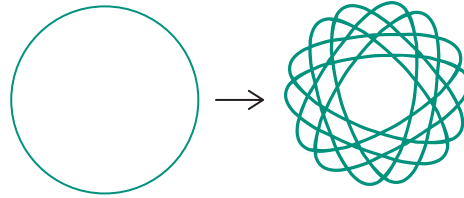
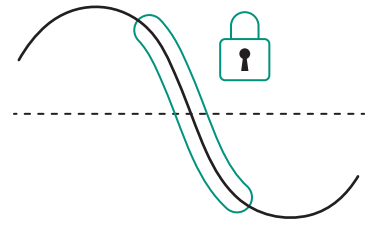
Both cautious and less risk-averse investors were reaching for alternatives. Lower-risk investors were boosting asset-backed lending, such as real estate debt (RE debt) and ABS, as they offer diversification and low correlations with US Treasuries. For the more adventurous, sub-asset classes such as distressed lending offered enhanced yields.

Emerging Asia is the place to be - a third of investors have increased allocations over the past three years. We address this trend in depth in Theme 4.



New approaches help to address a bond market liquidity paradox

Even as investors highlighted liquidity as one of their biggest concerns, many continued to make late-cycle bets for return by increasing allocations to more illiquid securities.



Fixed income markets have evolved significantly since the GFC, shaped in part by the retrenchment of traditional market makers and the rise of block trading directly between customers via ETFs and credit portfolio trading (CPT), and wider adoption of fixed maturity investing strategies.

Some 59% of investors use fixed income ETFs. They are valued for providing liquidity alongside the convenience of instant diversification. This is facilitating a range of new strategies, with just under 40% of investors using ETFs for tactical trading.

59%
of investors use fixed income ETFs



Just under **40%**
of investors use ETFs for tactical trading



Asset owners were extending allocations to illiquid asset classes late in the cycle.

Yet the majority (51%) expressed concern around bond market liquidity, uncertain how bond markets would behave during more challenging periods with the introduction of regulations such as Dodd-Frank and the retrenchment of traditional market makers that followed the GFC. The response in part has been increased interest in strategies that can help improve liquidity and reduce market risk, such as block trading directly between customers via ETFs (used by 59% of investors), credit portfolio trading (used by 30%) and wider adoption (56%) of fixed maturity strategies.

30%
of respondents use



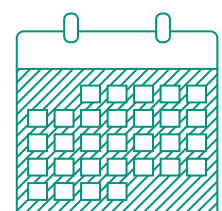
rising to **42%**



Credit portfolio trading is used by 30% of respondents, rising to 42% for the largest investors. This approach is valued for the ability to reduce market risk exposure and improve liquidity in harder-to-target parts of the market.

Investors see fixed maturity strategies as a good way of harnessing additional illiquidity premiums as well as reducing costs and generating more predictable returns. Some 56% of investors are using this approach, which accounts for around 40% of the portfolios of these investors.

Some **56%**
of investors are using fixed maturity strategies

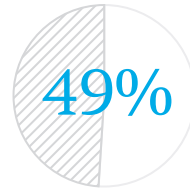


Being picky in emerging market debt – investors abandon broad mandates for country allocations

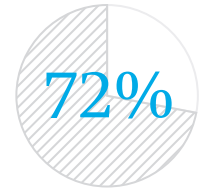
This year's Study finds another year of rising interest in emerging market (EM) debt.

72% of investors now have an allocation versus the 49% observed in our 2018 Study. Specialisation is also on the rise, especially among investors attracted by returns (rather than diversification), who prefer country-specific allocations (63%). One such discrete allocation, China, is of interest to the 42% of investors that now have an allocation, emboldened by the belief that the Chinese economy and political system offers unique diversification benefits and the lowering of barriers to investment. 62% of investors believe access is less challenging than two years ago.

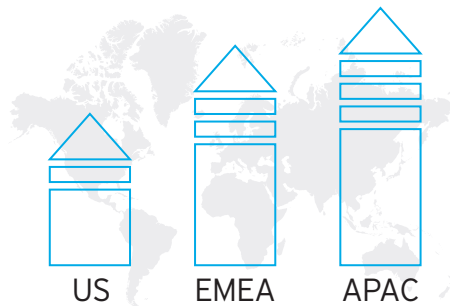
EM debt's strong run has generated rapidly growing allocations - from 49% of investors allocating in our 2018 Study to 72% in this year's Study. This is led by investors in APAC (89%) and EMEA (80%), in comparison to just over half of those in North America.



of investors allocating to EM debt in 2018 Study

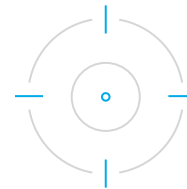


of investors allocating to EM debt in 2020 Study

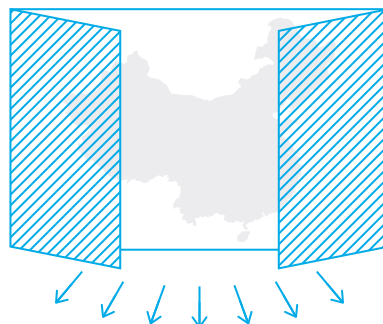


The highest growth has come from APAC, with EMEA increasing at a steadier rate. US investors lag, more motivated by diversification and benchmarks than their yield-driven EMEA/APAC counterparts.

Individual market allocations have replaced diversified mandates; return-seekers are increasingly likely to be making allocations to specific countries (63%). This approach is seen as requiring deep expertise with specialist teams that can access and understand each market.



63% of investors are making country-specific allocations



The opening up of Chinese markets is attracting foreign investors. However, almost half of US investors cited market access as a major challenge. Investors are also sceptical over pricing of default risk - again, something needing local expertise.

ESG widely seen as beneficial to returns, as focus turns to shortage of product and implementation

Investors continue to move beyond performance concerns relating to ESG, instead recognizing that managing issuer-related ESG risks has the potential to enhance returns.

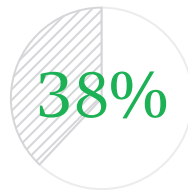
Specifically, investors who fail to address environmental and governance concerns may face higher borrowing and refinancing costs, with clear implications for the valuation of these securities for investors. 50% of investors that have incorporated ESG within their fixed income portfolios cite return enhancement as a key driver. 46% of investors that have incorporated ESG within fixed income believe that it has been beneficial to their returns with just 3% seeing a negative impact.

Investors continue to move beyond performance concerns relating to ESG, recognizing that managing issuer-related ESG risks has the potential to enhance returns (50% of respondents). Only a very small proportion still believe ESG hinders performance.

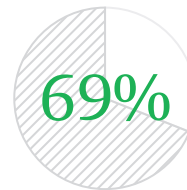
50%
of respondents recognize that managing issuer-related ESG risks has the potential to enhance returns



ESG integration in APAC

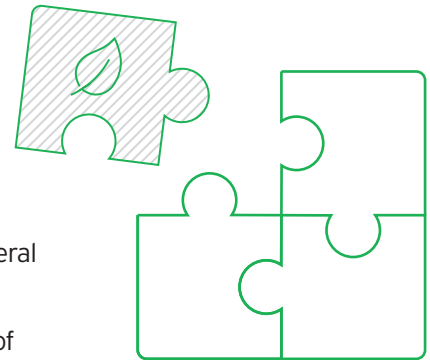


2019 Study



2020 Study

APAC is rapidly integrating ESG: now at 69%, up from 38% last year, and overtaking North America. Moves such as China's mandatory ESG disclosure and uptake by large regional asset owners such as Japan's Government Pension Investment Fund (GPIF) could see APAC leapfrog to the forefront of ESG adoption.



Availability of suitable product is the largest impediment to further implementation. While this is a general complaint, it is felt most keenly in APAC, with 40% of investors there reporting that a lack of availability of ESG bonds hinders their efforts.



This need for relevant product itself indicates that investors are becoming more specific in their ESG approach, looking for quantifiable outcomes. Some 68% now invest in ESG-specific products, 55% require their managers to integrate their ESG guidelines, and 62% have ESG factors integrated within their credit models.

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