IAPF WEBINAR
Securitised Credit – removing the uncertainty and capturing the opportunity for pension schemes

Schroders

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WELCOME

Jerry Moriarty, CEO, IAPF

Securitised Credit – removing the uncertainty and capturing the opportunity for pension schemes

Nicholas Pont, Investment Director, Fixed Income

Schroders

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Fixed Income strategy continuum – Schroders view

The Ask

- Target stable income
- Preserve capital
- Maintain liquidity to take advantage of dislocations
- Range of return/volatility profiles
- Range of liquidity

The How

- Diversification of return sources and risk premiums (Broad global opportunities)
- Core income where credit/fundamentals are strong
- Idiosyncratic risk for excess return
- Add liquidity through senior securities in large, deep markets or shorter spread duration

Source: Schroders.

The yield hunger games

With the central banks moving to ‘insure’ that financial conditions remain loose to prolong the economic expansion

- Yields are low
- Returns are expected to be low
- Credit quality has deteriorated: increasing risk and leverage
- Compensation for risk has declined as buyers hunt for yield by taking more exposure to:
  - Interest rate risk
  - Currency risk
  - Maturity risk
  - Volatility risk
  - Credit risk
  - Liquidity risk

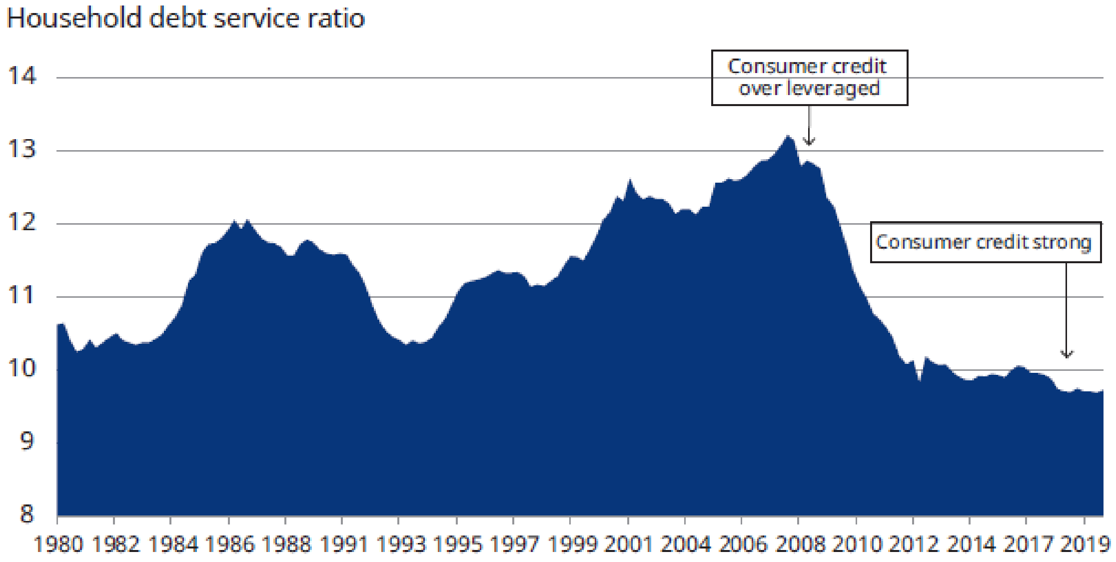
It may now be the time to re-evaluate compensation for risk, and potentially to de-risk to points where you receive a fair compensation for the risk you take

Source: Schroders.

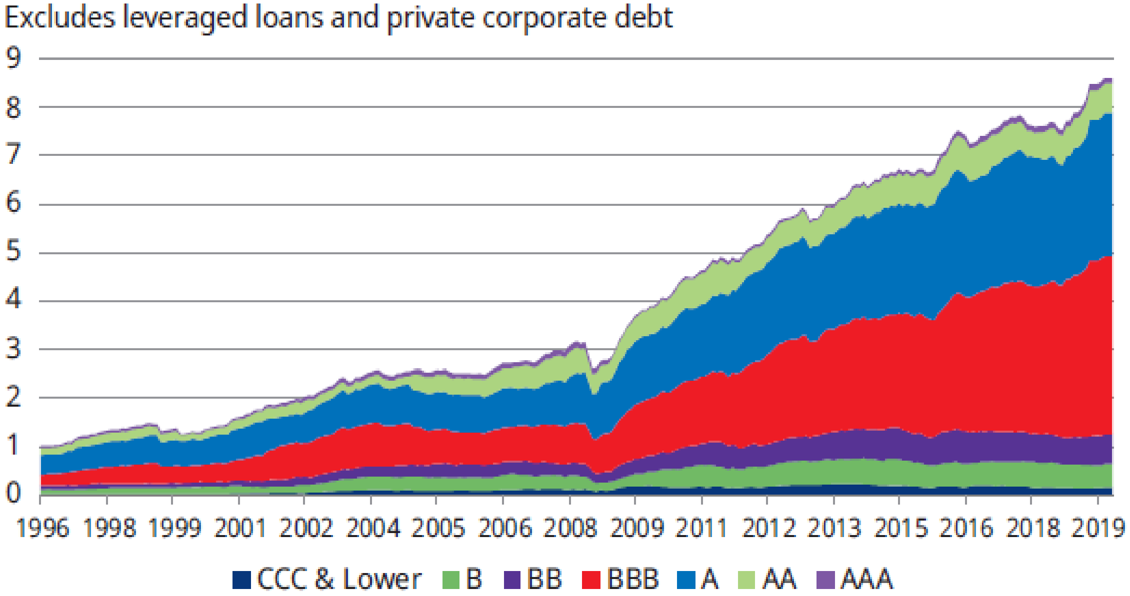
Back to the past?

This time around the average consumer leverage is lower…

Current consumer debt to income at 40-year lows



The value of corporate debt by rating ($ trillion)



Corporate debt build up seems to be the hot spot

Source: Federal Reserve Board as of December 31, 2019, left side graph. Source: Bloomberg, through December 2019, right side graph.

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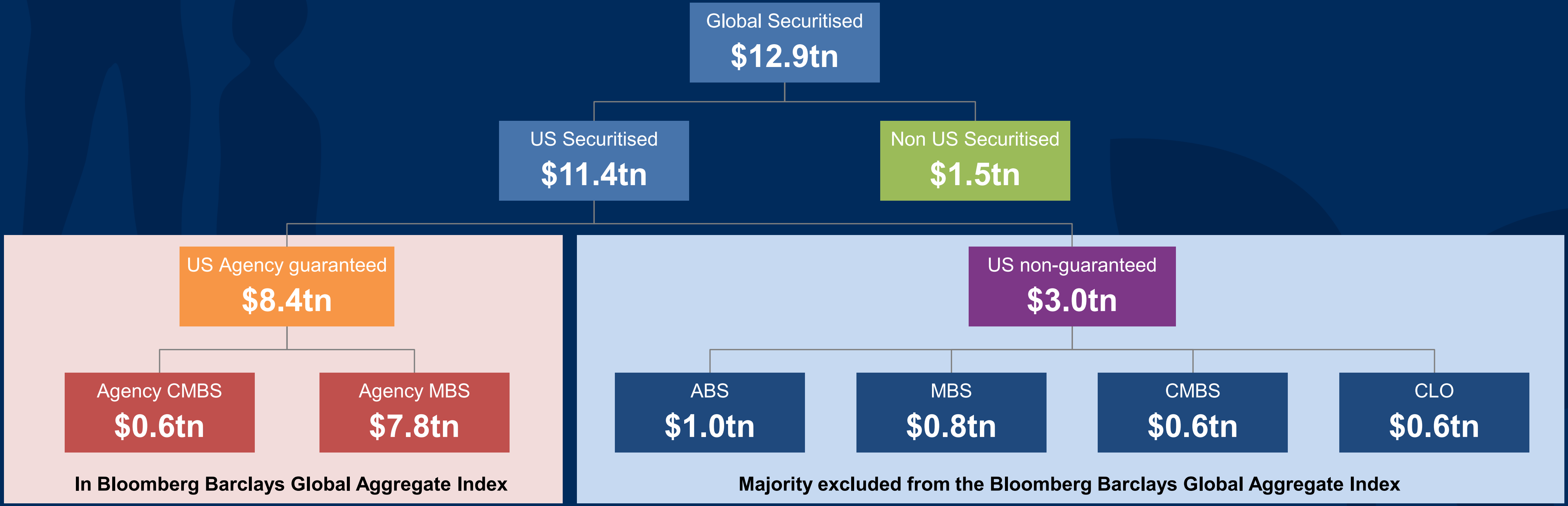
Securitisation: Sizable market, diverse asset classes

More efficient risk/reward and less tourist traffic

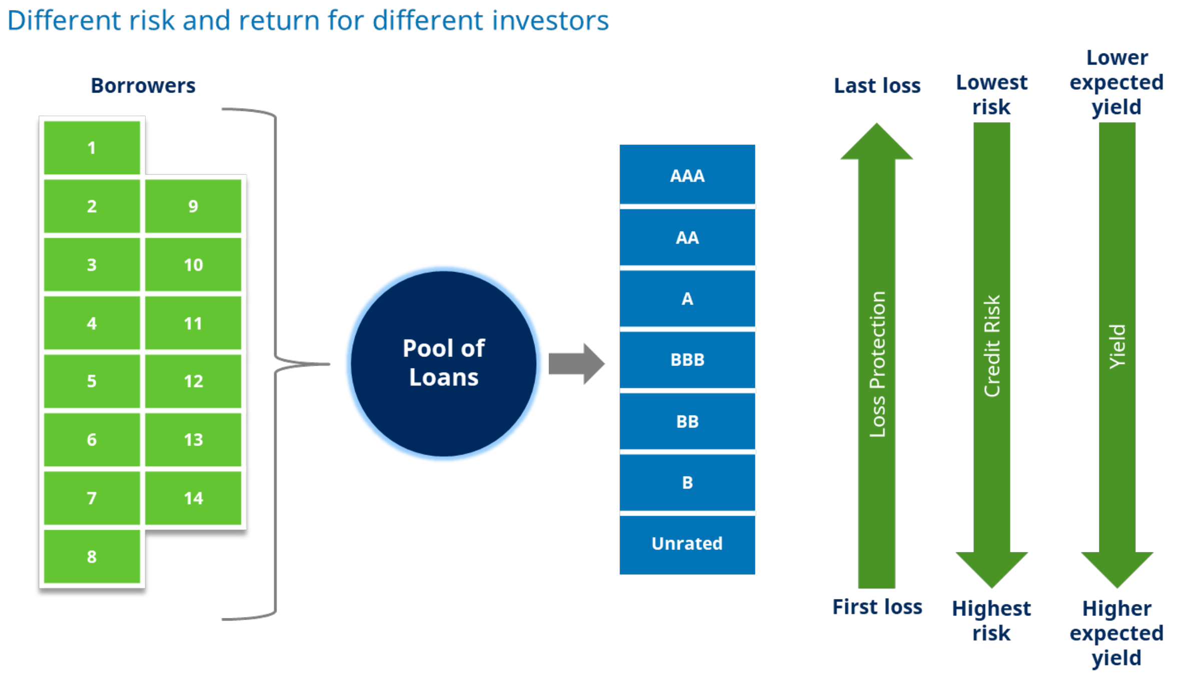


Source: Schroders, SIFMA, Fed, Barclays as of June 2019.

Putting the “Structure” in “Structured Finance”

A diagram of credit tranching

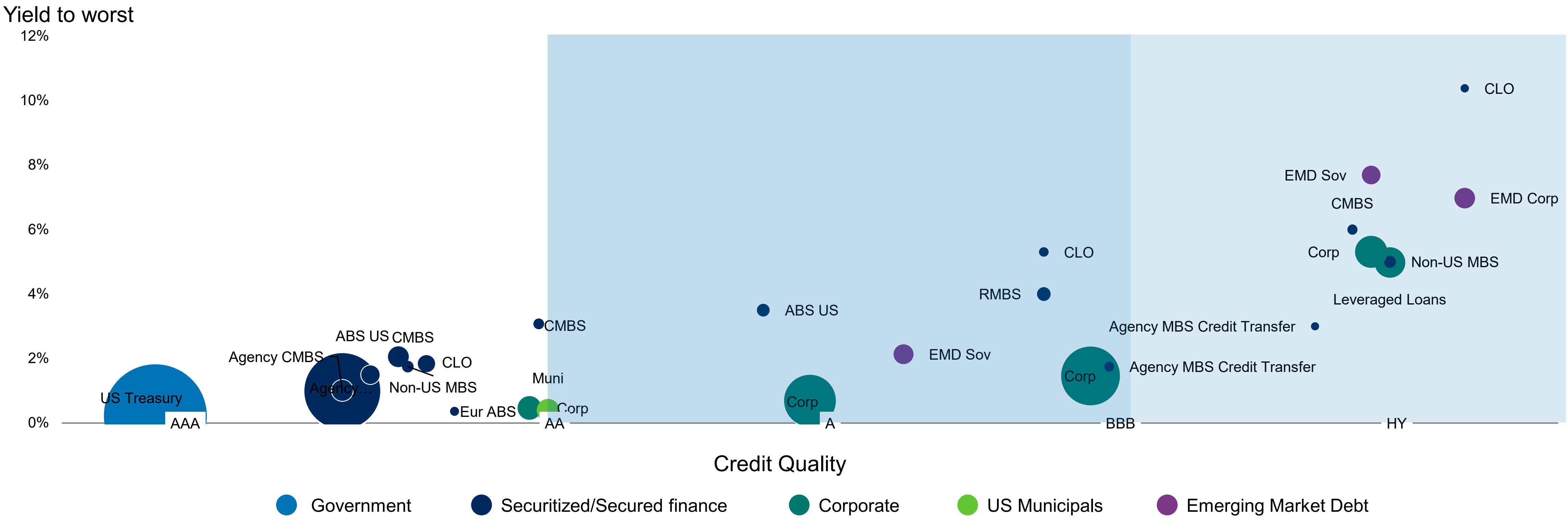
- Financial contracts are things like mortgage loans, auto loans, leases or credit card receivables
- Debts secured by the payments on financial contracts are often called asset-backed securities (ABS)
- Mortgage-backed securities (MBS) and commercial mortgage-backed securities (CMBS) are two common types of ABS, which are secured by mortgage payments
- The main risk is related to the borrower’s ability to repay the debt obligation, on time
- If the borrower fails on his obligation to pay, there may be collateral which can provide a secondary source of repayment for the debt



Source: Wikipedia (https://en.wikipedia.org/wiki/Tranche), Schroders.

Securitised is not being bought by the government directly

Superior return (yield) per unit of risk relative to many traditional credit sectors



Circle size represents size of market.
Source: Bloomberg, SIFMA, as of August 7, 2020. Security types are mentioned for illustrative purposes only and should not be viewed as a recommendation to invest.

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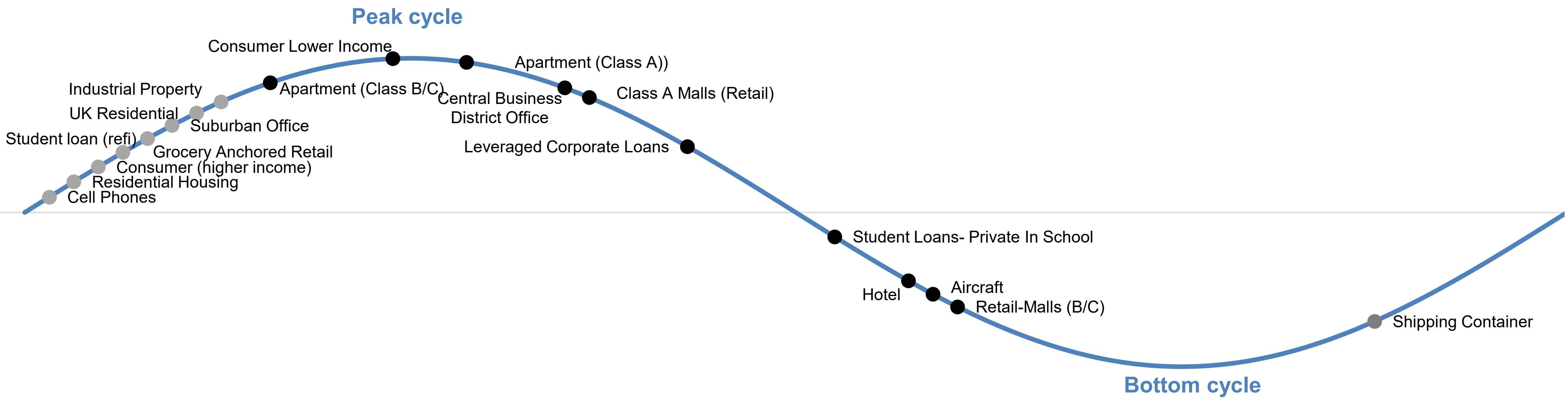
Flexibility: emphasize opportunities as they change

Variety of asset classes at different points in the credit cycle

- Enhance exposure where fundamentals are strong
- Benefit from opportunities as markets re-price

Current sector assessment



Source: Schroders, as of March 2020. The views and opinions are those of the Securitized Credit Team and are subject to change.

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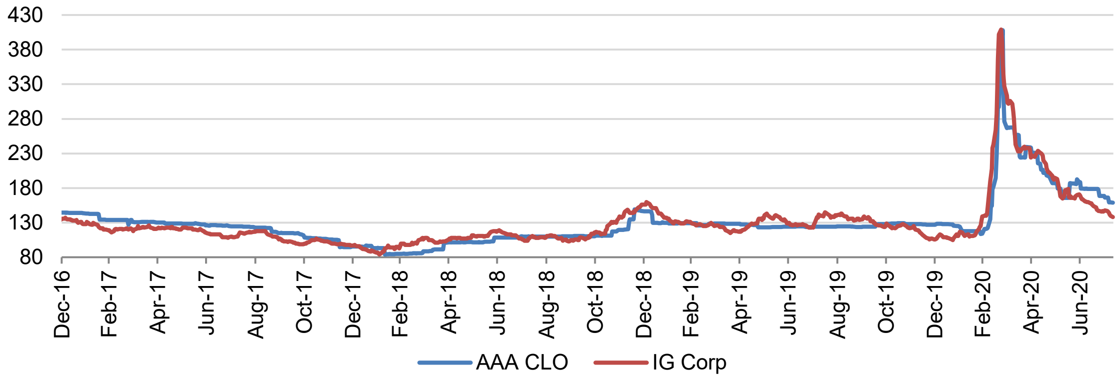
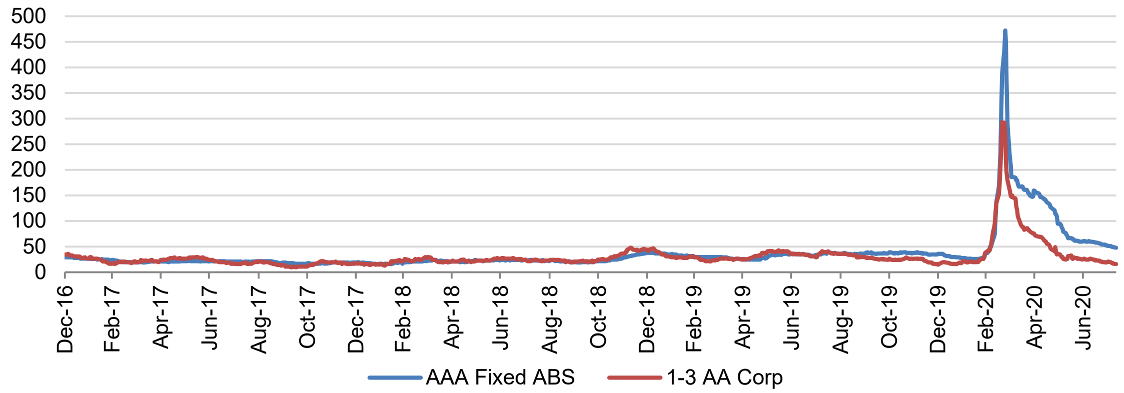
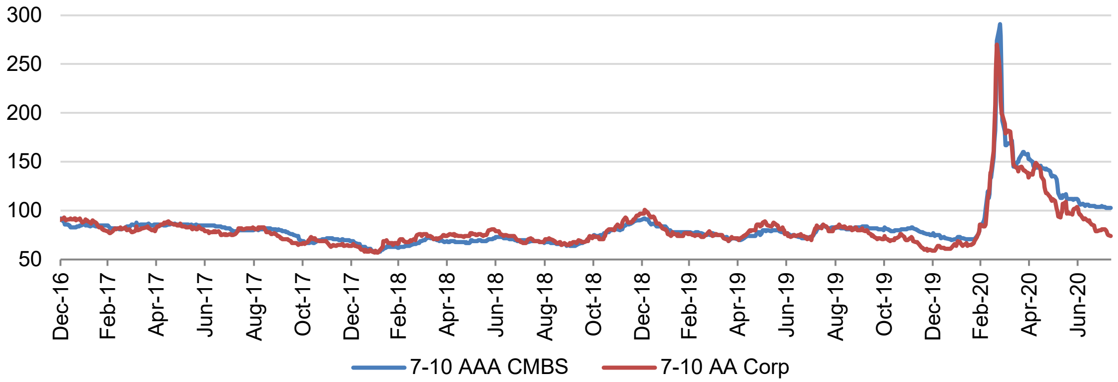
Securitised not directly bought, and offers more risk compensation today

Spreads vs. LIBOR

(bps)





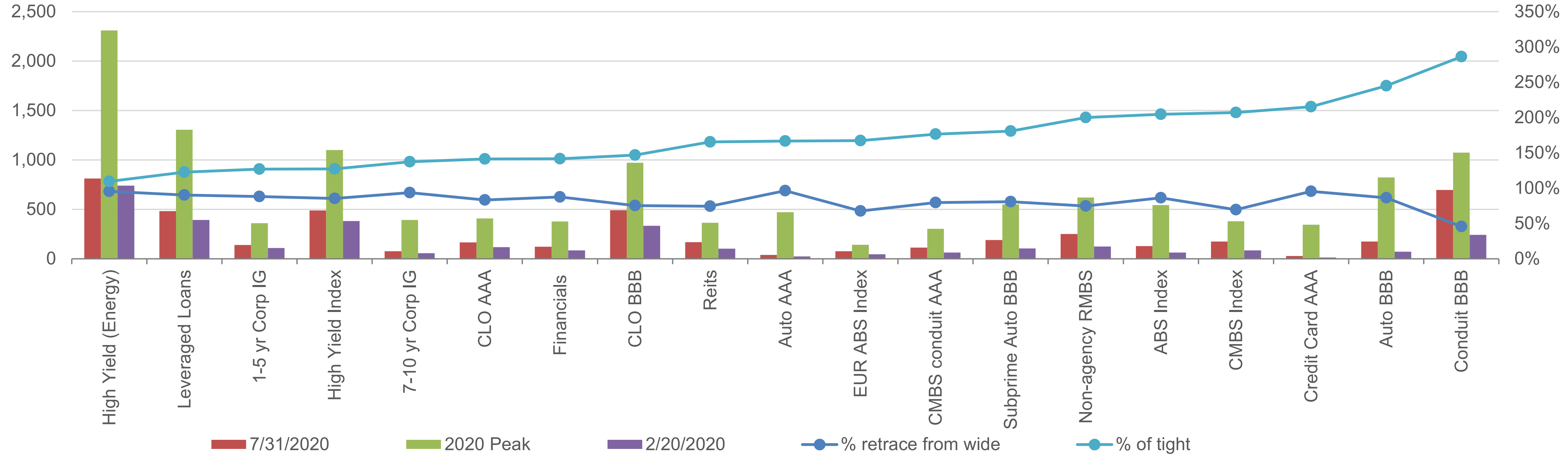


Source: Schroders, as of March 2020. The views and opinions are those of the Securitized Credit Team and are subject to change.

Markets where there is direct government buying have retraced more and are near their tights

Securitised (non-guaranteed markets) have no direct buying and offer more risk premium

Yield spread comparison



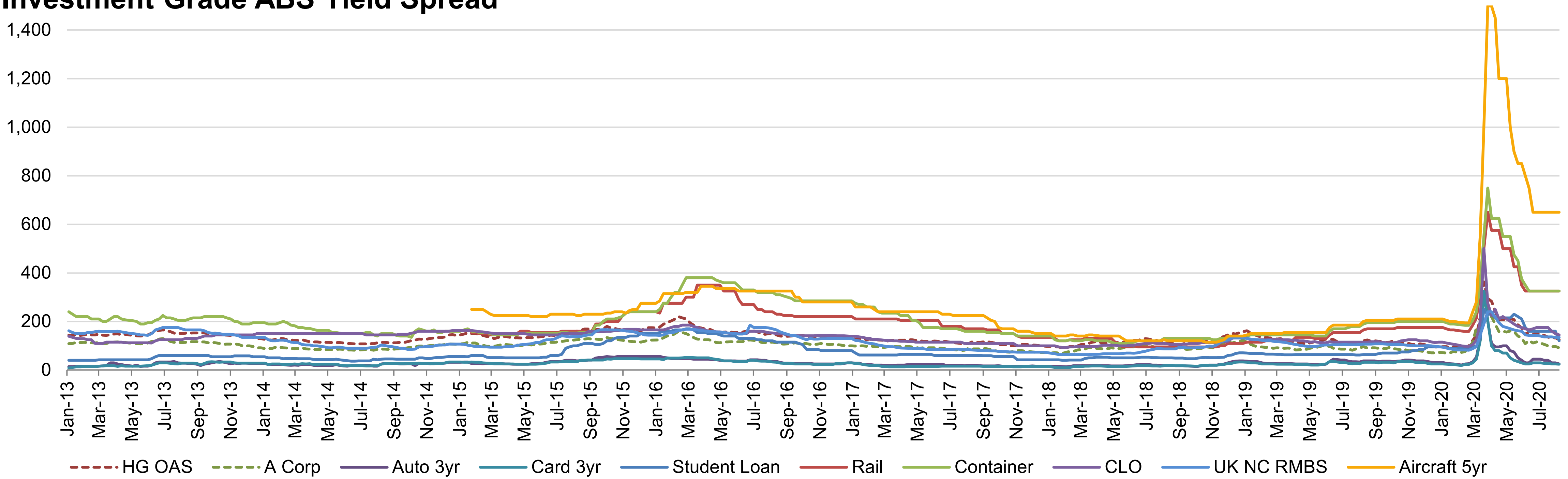
Policy and liquidity support through direct buying have distorted markets and crowded out investors

Source: Schroders, as of July 2020.

Investment grade comparisons

Esoteric spreads reflect COVID-19 risks, Vanilla ABS recovered

Investment Grade ABS Yield Spread



Policy and liquidity support through direct buying have distorted markets and crowded out investors

Source: Bank of America Merrill Lynch, JP Morgan as of 8/7/2020.

Investing across the credit universe, returns are: low, low, low

Is the compensation fair for the type/level of risk we are taking?

	Schroders Securitised Credit			Global	UK Bond Market		US Bond Market				European Bond Market			Emerging Market Bonds
Sector	Global ABS/MBS	Global ABS/MBS	Global ABS/MBS	Global Fixed Income	UK Gilts	UK Investment Grade	US Treasuries	US Fixed Income	US Investment Grade	US High Yield	European Government	European Investment Grade	European HY	EMD
Index	Rep Account– L+200	Rep Account– L+350	Rep Account– L+500	Bloomberg Barclays Global Aggregate Index	Sterling Gilts Index	Sterling Non Gilts	US Treasuries Index	US Aggregate Fixed Income	US Investment Grade	US High Yield Constrained Index	European Government	European Investment Grade	European Currency High Yield Index	EMD Hard Index
Duration (yrs)	0.25	0.25	0.24	7.23	13.81	8.16	7.15	6.04	8.54	4.2	9.36	5.84	3.91	6.52
Credit quality	AA-	BBB+	A-	A-	AA	A+	AAA	AA	A	B+	A+	A	BB-	BBB
YTM (%)*	2.64	4.8	5.13	1.71	0.31	1.68	0.5	1.25	2.15	6.98	0.16	1.06	4.71	4.66
1Y volatility	9.67%	12.11%	10.62%	8.76%	6.89%	8.48%	5.33%	3.65%	10.17%	14.09%	5.41%	9.46%	15.82%	12.93%
3Y volatility	5.45%	6.88%	6.93%	5.78%	6.08%	5.56%	4.20%	3.27%	6.17%	8.86%	3.79%	5.61%	9.49%	8.00%

Source: Bank of America Merrill Lynch, JP Morgan as of 8/7/2020. *YTM = Yield to Maturity.

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Uncertainty and economic shock play out in phases

Structural protection is a unique tool in this environment

1. Cash hoarding/ Selling
2. Overshooting
3. Government intervention
4. Regulation
5. Deleveraging
6. Recovery

- Financial markets have had a speedy decline driven by an unusual shock
- It's important to recognize what is an opportunity with protection
- Liquidity and credit are different ills, not cured by the same medicine

- Government programs like TALF can be positively asymmetric
- Flexibility to chose the best opportunity is key
- Providing capital to inefficient markets generates true excess return

- Winners and losers will come down to leverage
- Opportunity with conviction is framed by an interaction of fundamentals, structure and valuation

In a dynamic market you need flexibility to move through phases of opportunity where you build high conviction

Strategy and outlook

Bond math has changed – meet the FOCRs

- ✓ Bonds used to offer yield or coupon income that could offset some spread widening
- ✓ Today **YIELD** on intermediate duration corporates can be 50–75bps, these yields will not offset much spread widening.
- ✓ **CARRY** in a no carry environment is a challenge
- ✓ Zero is a challenging return environment
- ✓ We believe every portfolio holding should serve a purpose
  - ✓ **FAST LIQUIDITY** – ready for potential redeployment if opportunity arises
  - ✓ **OPPORTUNITY** – inefficiencies that generate excess return and develop over time
  - ✓ **CARRY** – the source of steady return, that offers safe income
  - ✓ **RECOVERY** – assets that are mispriced

Source: Schroders. The opinions stated in this presentation are those of the Schroder Securitized Credit team and are subject to change.

Strategy and outlook

Bond math has changed – meet the FOCRs

- ✓ Today it is important to have ready, fast liquidity as all opportunities do not occur at once and because there is very mixed pricing of uncertainty across markets
- ✓ Themes
  - ✓ Short-term – markets are reliant on liquidity support, maintain **FAST LIQUIDITY** in agency guaranteed securities for future opportunity
  - ✓ Short-term – securitized has recovered less as it has less direct government intervention and less crowding out – **CARRY** is attractive
  - ✓ Medium term – quality of life is changing the payment structure for housing – **OPPORTUNITY** sits in housing related securities
  - ✓ Medium term – uncertainty is can be found priced in in certain affected sectors like travel and real estate – **RECOVERY** trades sit here, but are very early stage

Source: Schroders. The opinions stated in this presentation are those of the Schroder Securitized Credit team and are subject to change.

Outlook: #death of optimism and new evolution of bond math

Near-term themes highlight uncertainty

- US elections
- Covid-19
- Policy dependence
- Data

Source: Schroders.

Outlook: #death of optimism and new evolution of bond math

Longer term trends – the lost decade

- Isolationism
  - Reversal of globalization
  - Quality of life
- Fiscal/monetary policy – the debtor's economy
  - Financial repression
  - High debt, low rates, low inflation
- Inequality
- Demographic shift, generational change
- Disruption/technology
- Investing for good or for your own good (ESG, climate)

Source: Schroders.

Assessing the current market

Accelerating positively and negatively

Positive

- Online
  - Industrial properties
  - Shipping container
  - Cell phones
- Quality of life // work from home
  - Suburban
  - Residential housing (US and UK)
  - Housing inputs
  - Cars
- Inequality
  - Asset owners
  - Higher income

Negative

- Technology
  - Malls (shopping)
  - Business travel /airlines, hotels, car rental
  - Education
- Quality of life/work from home
  - Urban
  - B&C apartments
  - Low quality office
  - Trains
- Inequality
  - Borrowers/higher debt
  - Lower income

Source: Schroders. The opinions stated in this presentation are those of the Schroder Securitized Credit team and are subject to change.

Navigating the Zero

Objectives

- Attractive income
- Low sensitivity to interest rates
- Opportunity/growth

Benefits

- Diversification from traditional asset classes
- The right tool at the right time
- Access global opportunities across public/private

The right tool at the right time: opportunities across public securities and private debt

Source: Schroders. The opinions stated in this presentation are those of the Schroder Securitized Credit team and are subject to change. There can be no guarantee that any investment objectives or outcomes will be achieved.

Schroders Securitized Credit

Experienced, proven team

1988
Core of Hyperion Capital, formed by Lewis Ranieri

2005
Bought by Brookfield Asset Management forming Hyperion-Brookfield

2016
Bought by Schroders Investment Management, retaining all client relationships and Brookfield as a client

2018
Schroders acquired an interest in A10 Capital, a middle market, direct real estate lender, with substantial proprietary technology

First offering by strategy:

- **1993** – Enhanced Securitized
- **2007** – Enhanced LIBOR Plus
- **2008** – Opportunistic Securitized
- **2012** – Securitized Credit Fund
- **2018** – Loan Opportunities

Experienced team
Managing securitized strategies since the inception of the non-agency market and through several cycles

Over $13 billion
Across a range of strategies and bespoke solutions in fund structures and segregated mandates

Securities and secured loans
We specialize in securities and the underlying collateral, with lending and servicing resources

Research-led
Proven process incorporating proprietary models, data and analytics built to address the opportunities and mitigate risks of higher income securities

Team of 15 lead by Michelle Russell-Dowe


Michelle Russell-Dowe


Anthony Breaks


Jeffrey Williams


Christopher Ames


Nicholas Pont

Source: Schroders, as at February 2020.

Schroders Securitized Credit strategies

	Benchmark Oriented	Floating-rate	Opportunistic		Private Credit	Private Debt
Strategy name	**Enhanced Securitized**	**Enhanced Securitized LIBOR/LIBOR Plus**	**Opportunistic Multi-Sector Securitized**	**Securitized Credit Return Opportunities**	**Opportunistic Credit Funds**	**Real estate/mortgage loan funds**
Key objectives	Benchmark aware, low tracking error	Attractive return, low volatility, low/no duration	Opportunistic income, corporate credit alternative	Opportunistic return, credit alternative* uses leverage	Dislocation/ Inefficient market opportunities fund	Benefit from illiquidity premium in lower leverage loans
Income	✓	✓	✓	✓	✓	✓
Diversification	✓	✓	✓	✓	✓	✓
Capital appreciation			✓	✓	✓	
Rate protection		✓	✓	✓	✓	✓
ESG	✓	✓	✓	✓	✓	✓
Impact investing						✓
Benchmarks/alpha	Securitized Index + target	LIBOR+ 150 - 350 bps	LIBOR + 500 bps	10% total return	FOCUS II 15% net return	7%-9% IRR unleveraged
5 year Sharpe	1.9	3.6/2.8 (plus)	3	2.5	-	-
5 year volatility	2.1%	0.6%/1.2% (plus)	1.7%	2.4%	-	-
Leverage-Financial	No	No	No	Yes	Funds may use this option	Funds may use this option
AUM	$5.6 billion*	$4.7 billion*	$2.7 billion	$63 million	Target $2 billion	$235 million
Capacity/ Scale	Unlimited >25bn	Unlimited >25bn	$10.0bn	$2.5bn	>$10bn	>$10bn
Liquidity	Daily (T+3)	Daily (T+3)	Quarterly	Quarterly	None (income may be distributed)	None (income distributed)
Fees/Lock-up	35bps/none	35bps/none	75bps/varies	125bps/12 months (Carried interest)	75 bps/5 years (Carried interest)	75 bps/5-7 years (Carried intere)

Performance shown reflects past performance, which is no guarantee of future results. Performance is gross of fee.
*Includes delegated AUM managed on behalf of Schroders funds globally. Source: Schroders as of December 2019. There can be no guarantee that any investor objective or outcome will be achieved. For illustrative purposes, intended only to demonstrate the depth and breadth of the Team's investment capabilities. Capital preservation and protection references do not reflect an absolute guarantee against capital loss.

Risk considerations

- Loans, mortgage or asset-backed securities may not receive in full the amounts owed to them by underlying borrowers
- The counterparty to a derivative or other contractual agreement or synthetic financial product could become unable to honour its commitments to the strategy, potentially creating a partial or total loss for the strategy
- A failure of a deposit institution or an issuer of a money market instrument could create losses
- A decline in the financial health of an issuer could cause the value of its bonds to fall or become worthless
- A decline in the performance/ cash flow of a property could cause the value of the collateral for our loan to decline or become worthless
- The strategy can be exposed to different currencies. Changes in foreign exchange rates could create losses
- A derivative may not perform as expected, and may create losses greater than the cost of the derivative
- A rise in interest rates generally causes prices for loans or bonds with fixed coupon payments to fall
- In difficult market conditions, The fund has the right to enact 1 year extension to allow orderly liquidation or maturity of loans on behalf of our clients
- The proposed structure will lock capital for a five year period, with 1 one-year optional extension
- The base currency of the fund will be USD, any non-USD exposure would be fully hedged
- Failures at service providers could lead to disruptions of strategy operations or losses

Source: Schroders.

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THANK YOU

Nicholas Pont
Investment Director, Fixed Income
Schroders

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Q&A

Nick Pont
Investment Director, Fixed Income
Schroders

Jerry Moriarty
CEO
IAPF

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