

***BUILDING FOR CHANGE: FLOATING-  
RATE INCOME IS THE NEW FIXED***

Schroders Securitized Products & Asset-Based Finance  
2022 Outlook

Nicholas Pont

Head of Product Strategy, Securitized Products & Asset-Based Finance

# Biography

## Nicholas Pont

Nicholas serves as Head of Product Strategy: Private Debt, Global & US Securitised Credit in addition, he also sits on the board of A10 Capital, a US direct real estate originator and servicer. He joined Schroders in 2018 from Alcentra where he was a Managing Director focussing on sub-investment grade corporate credit: Secured Loans, High Yield, Direct Lending & Mezzanine, Special Situations and Structured Credit.

Previously he was a Senior Vice-President at PIMCO where for 10 years he covered institutional clients and global financial institutions, sat on the EMEA Management Committee, the Global Alternative Credit Steering Committee as well as the Investment Committee for the PIMCO Europe Foundation. He started his career at Western Asset Management (WAMCO). He has 19 years of investment experience, and holds an undergraduate degree in Economics and Politics from the University of Exeter. Before embarking on a career in asset management, he was a professional cricketer.

# Schroders Securitized Products Platform

Experienced, proven team with a long history together through cycles

Pioneer and founder of the securitized credit markets:

- 1988** – Hyperion Capital, formed by **Lewis Ranieri**, father of the securitized credit market. Buyers of the first non-agency MBS b-piece and one of the first b-piece buyers in the CMBS market.
- 2005** – Business bought by **Brookfield Asset Management** forming Hyperion-Brookfield.
- 2016** – Business acquired by Schroders, retaining all client relationships including Brookfield sub-advisory.
- 2018** – Sourcing agreement with **A10 Capital**, a US commercial real estate (CRE) loan originator and servicer.
- 2020** – Loan acquisition agreement with Lionheart, an affiliate of **Fisher Brothers**, a 100+ year old owner/operator of US real estate.
- 2021** – Loan acquisition agreement with **Grant Street**, a US CRE loan originator.

First offering by strategy:



Experienced team

Managing securitized strategies since the inception of the non-agency market.  
Team of 18 led by Michelle Russell-Dowe:



Michelle Russell-Dowe



Anthony Breaks



Jeffrey Williams



Christopher Ames



Nicholas Pont

Over \$18 billion in AUM

Across a range of strategies: bespoke solutions provides through fund structures and segregated mandates.

Strategies cover a continuum from low duration, liquid securitized to private credit

Securitization is term financing of debt contracts. We have a broad investment tool kit, allowing incorporation of the full range of senior and subordinate securities, short-term and longer-term financing, risk transfer and direct lending on assets.

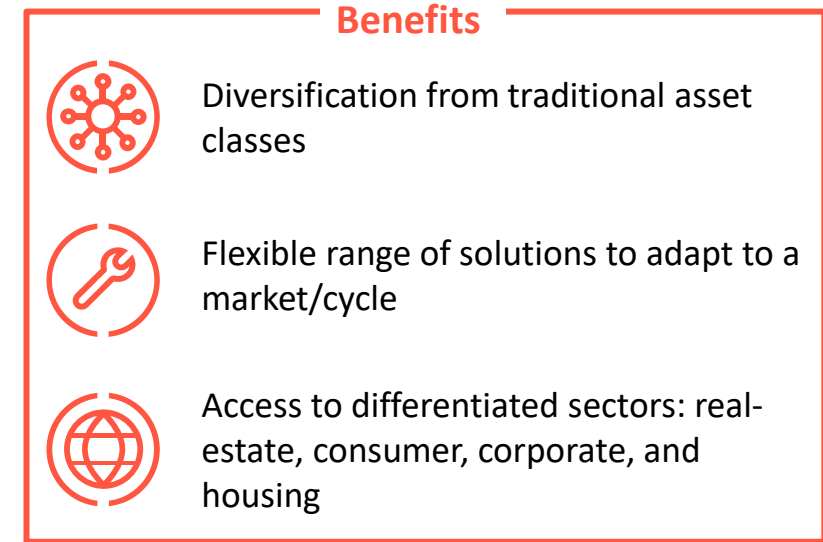
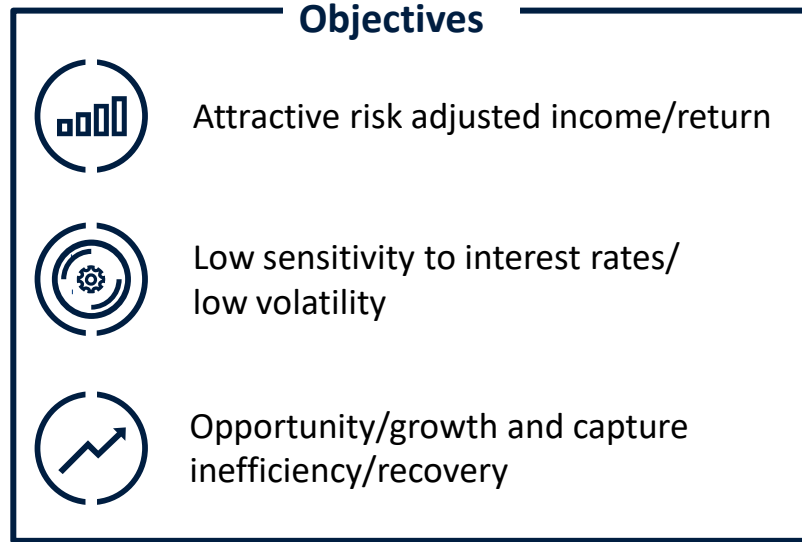
Flexible best ideas within a proprietary framework

Proven process incorporating proprietary models, data and analytics built to address the opportunities and mitigate risks of higher income securities in an ESG framework.




Source: Schroders, as of December 2021. Past performance is no guarantee of future results. Not all funds will be registered for distribution in the UK and Luxembourg.

# Schroders Securitized Products

Spanning alternative fixed income to private debt



## Credit cycle intelligence

-  Wide range of underlying assets creates opportunity to benefit from asynchronous asset cycles. We can emphasize specific **fundamentals** as opportunities develop
-  Use **structure** to enhance return potential or create a level of downside protection by moving between loans and private or public securities
-  Earn alpha in inefficient sectors as **valuations** appreciate with a recovery in assets and securities

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

# Building for change: perspective is everything

Perspective is everything – our views are less controversial today than at year-end

- We believe the Fed Funds rate will reach much higher levels by year end 2022, with the likely range being 1.25%-1.50%
- This is not a new view for us, given we have been seeing **higher, AND more persistent inflation, as well as a healthier and more resilient economy** than the expectations priced into markets
- Our focus had a broad and unique range through consumer, housing, real estate and business; this informs our views on inflation inputs (food, fuel, wages and shelter)
- We see inflation more likely to end 2022 well above the market expectations. A 4%-5% level is likely, with risks skewed to higher levels. Persistent is the new transitory... *“transitory was a bad choice of words” – Janet Yellen*
- We also believe the economy is on solid footing, perspective is everything, deceleration from high growth does not mean recession or weakness (Corporates, Consumer, Banks)
- With changes in policy the US 10-year could end 2022 in a 2.50%-3.0% range



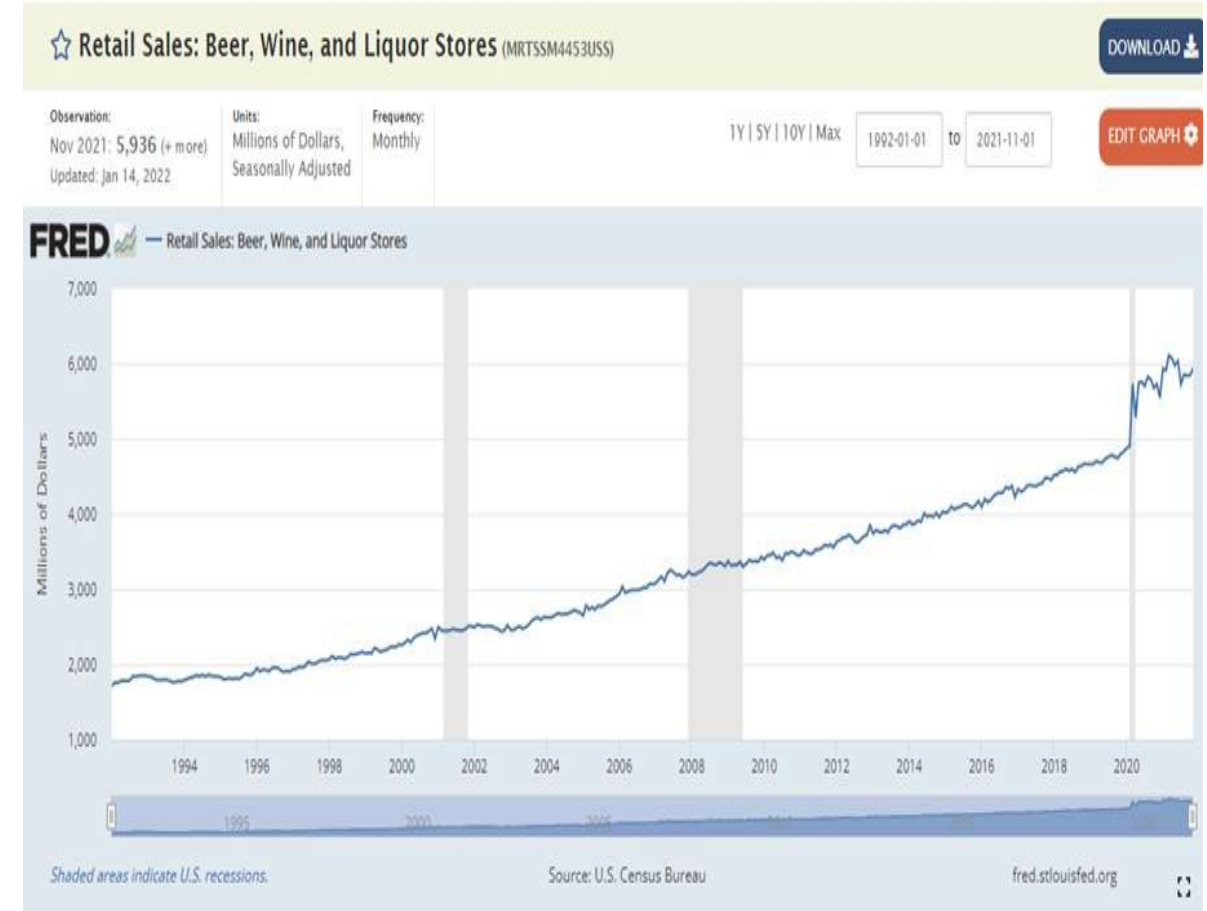


# *INFLATION, FUNDAMENTALS, VALUATIONS*

Perspective from the consumer, housing and real estate  
seat

# Building for change: from transitory to persistent

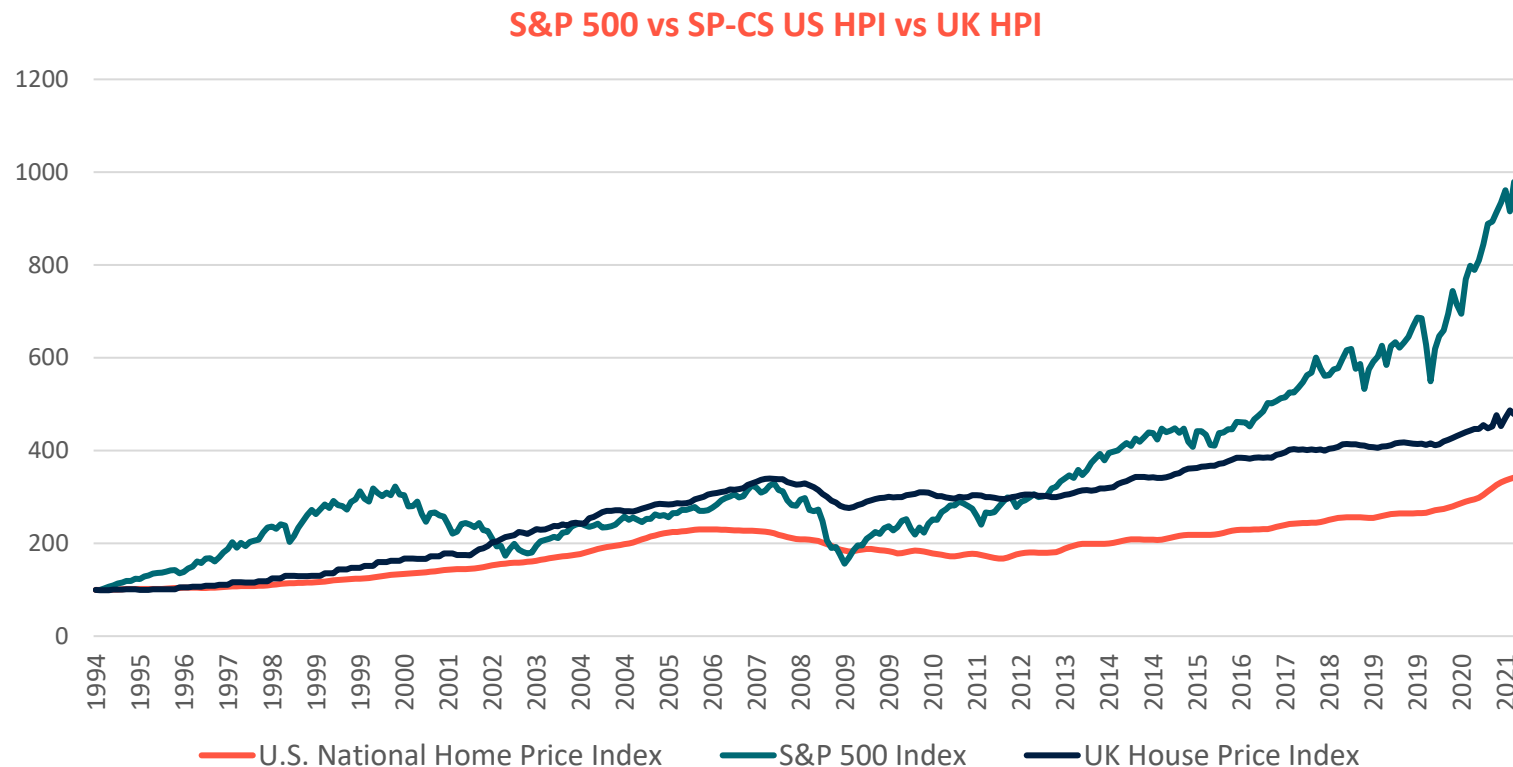
Perspective in pictures – bacon & beer, hits to consumers shopping basket is critical to their vote



Source: US Federal Reserve. Shown for illustrative purposes only and should not be viewed as investment guidance.

# Home prices have risen, but perspective is everything

Perspective in pictures: home price versus S&P 500 since 1995, financial assets have been the ultimate beneficiary...



*Important note:  
In a world where few  
remember real inflation,  
housing may be one area  
where we may observe the  
impact of inflation on behavior*

*Momentum is a critical  
component in price projection*

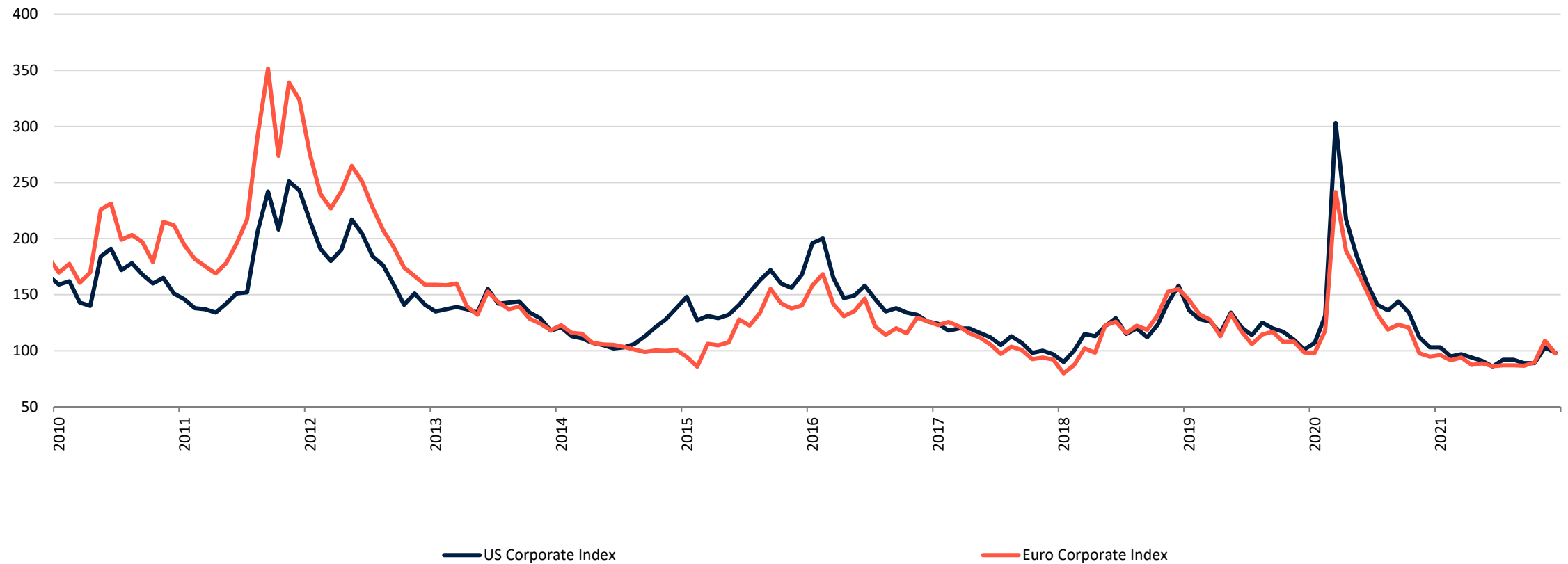
Source: Bloomberg. Schroders Capital. The views and opinions contained herein are those of Schroders Capital Securitised Products and Asset-Based Finance Team and may not necessarily represent views expressed or reflected in other communications, strategies or funds.



# Building for change: globally fixed income returns will be negative

When duration is long (7+ years), spread can offer cushion against only a small increase in rates

## Investment grade corporate spreads



Source: Bloomberg. Past performance is no guarantee of future results.

# Building for change: what does good look like?

## Changes – a kick in the technicals

Uncertainty will result in increase volatility and decreased liquidity

- QT: US Treasuries, Agency MBS, and Corporates... technical factors look weak
  - Demand: Treasuries and Agency MBS will see material change when the Fed is no longer absorbing supply. Corporate bonds will face headwinds if non US buyers return to home markets
  - Supply: Continued needs to issue UST and, watch out, Agency mortgage originations are at their seasonal low right now...
  - BOE is unwinding their corporate bond purchases, they maintain a huge Gilt position
- Many owners of fixed income look for capital preservation
- Few markets have seen periods of persistent rate increases
- While market prices in concerns that the Fed will move too fast. They have not shown that bias... and inflation is ahead of them

# Building for change:

## When risk mitigant becomes risk

### Focusing on the consequences

- We are in a period of historically low rates and historically low volatility. The central banks are responsible for this “out of sample” period and we expect to see
  - Increase in volatility – “options” are more valuable
  - Decrease in liquidity – choose the source wisely
  - Change in correlation – some tools may stand out as more useful (read: necessary)
  - Models will not work well – history and models do not work well out of sample
- Better “options” include those that avoid timing and that offer a risk premium for “identifiable risk”



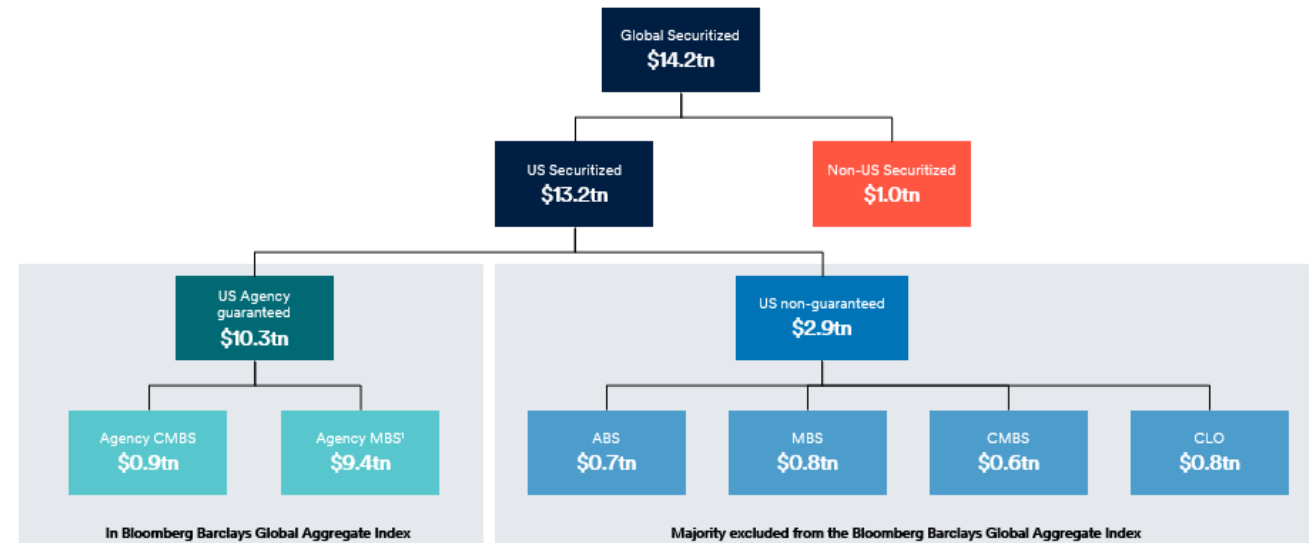
*THERE IS AN ALTERNATIVE:  
WHAT DOES GOOD LOOK LIKE?*



# Secured income: start from the diverse securitized sector exposure

## Outcomes benefit from the flexibility of a broad universe

- Securitisation takes a group of assets (a loan, a lease or a debt contract) and uses term financing to create several securities of different risk and return profiles
- Securitisation offers flexibility across many sectors with different fundamental factors structuring both senior and junior exposures
- The flexibility of the sector / structure combination creates a wide range of solutions across geography, assets, credit quality, maturity and risk premiums
- Our strategy is a diversified across sectors and across geographies, across structure and quality creating opportunity for
  - Return
  - Risk mitigation (rates and credit)
  - Diversification
- Securitised is an alternative to traditional 'core' allocations like intermediate corporate credit, or to 'plus' allocations like high yield, leveraged loans or emerging markets
- The natural barriers to entry and more limited government support make this an asset class that still offers additional return and income while avoiding the crowds



Source: Schroders, SIFMA, JPM, ECB as of October 2021. SIFMA data as of Q2 2021. The views and opinions are those of Schroders Securitised Credit team and are subject to change. Diversification cannot ensure profits or protect against loss of principal.

¹Agency MBS outstanding includes Agency CMO.

Source: Schroders. The views and opinions are those of the Schroders Securitised Credit Team and are subject to change. There can be no guarantee that any investment objectives or outcomes will be achieved. Diversification cannot ensure a profit or protect against loss of principal.

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

We build attractive solutions by looking across secured markets and a diverse set of risk premia

	Schroders Securitized Products			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–Cash+200	Rep Account–Cash+350	Rep Account–Cash+500	Global Aggregate Credit 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)	0.08	0.03	0.00	7.25	12.90	7.95	7.07	6.69	8.60	4.04	9.39	5.68	3.45	7.00
Credit quality	A+	BBB	BBB-	A-	AA-	A	AAA	AA	A-	B+	AA-	A-	BB-	BBB-
YTW (%)	2.43	3.19	6.39	1.75	0.94	1.86	1.23	1.75	2.33	4.33	0.46	0.74	2.88	4.31
1Y volatility	0.57%	0.69%	0.86%	2.89%	9.49%	4.67%	3.49%	2.84%	4.06%	2.60%	4.73%	2.21%	1.65%	3.80%
3Y volatility	5.44%	6.86%	6.53%	5.53%	7.79%	5.89%	4.38%	3.40%	7.03%	9.27%	4.57%	5.77%	9.60%	8.33%

Source: Schroders and Bloomberg as of December 31, 2021. For illustration only. Duration, credit quality and performance may differ across representative accounts within any composite. Yields are subject to fluctuate over time. Past performance is no guarantee of future results. Index returns are unhedged.

# Securitized strategies work well in today's market

Increasing inflation and increasing interest rates



## Rising rates

- Higher income on floating-rate debt
- Lower interest rate exposure
- Lower rate sensitivity (Lower interest rate volatility)



## Wage inflation

- Wages paid by corporations to consumers
- Consumers benefit from wage inflation
- Affordability improves with higher wages



## Increasing asset prices

- Values of assets rise and loan to value ratios improve, creating potential for credit promotion (upgrades).
- Consumer wealth and equity improves
- Housing and RE assets /real assets with fixed rate debt become a more desirable investment



## Prepayment risk declines

- Increasing interest rates and increasing mortgage rates reduce prepayment risk
- Higher quality mortgage cash-flows become more attractive as relative compensation for risk increases and selling volatility is more attractive

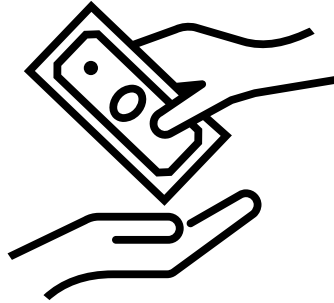
# Trends in client needs and where our products align

Flexible, diversifying income, low interest rate exposure & ability to capture dislocation



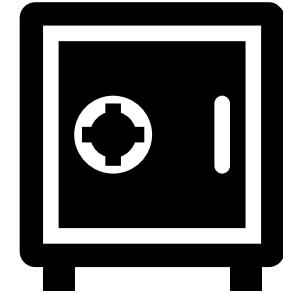
**Rising interest rates and  
inflation**

**Strategic allocation to  
floating-rate income**



**Alternative to direct lending**

**Diversification from crowded  
markets**



**Pension fund de-risking**

**Pension funding ratios at all  
time highs, need for flexibility  
and income**

Floating income is the new fixed...



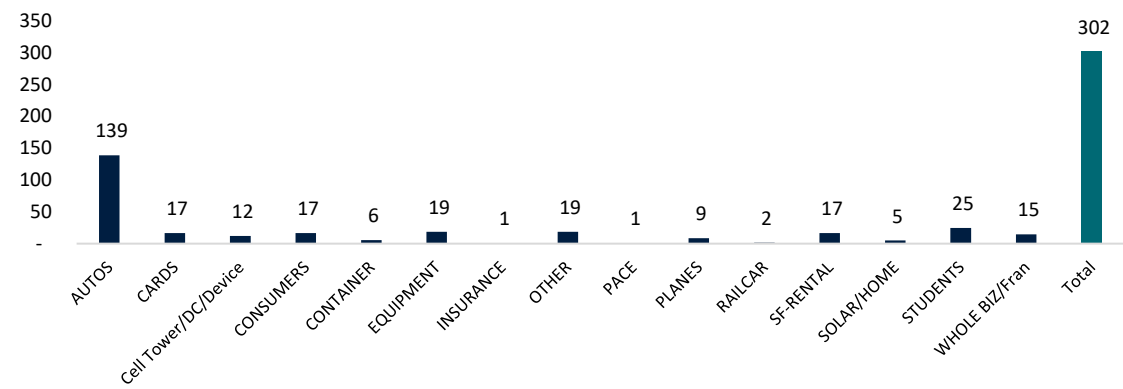


*QUESTIONS?*

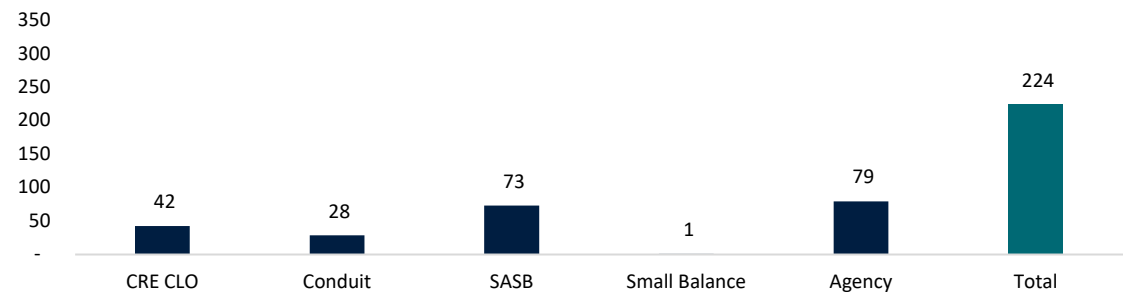
# The U.S. through the 2021 issuance lens

US 2021 full year (USD, in billions)

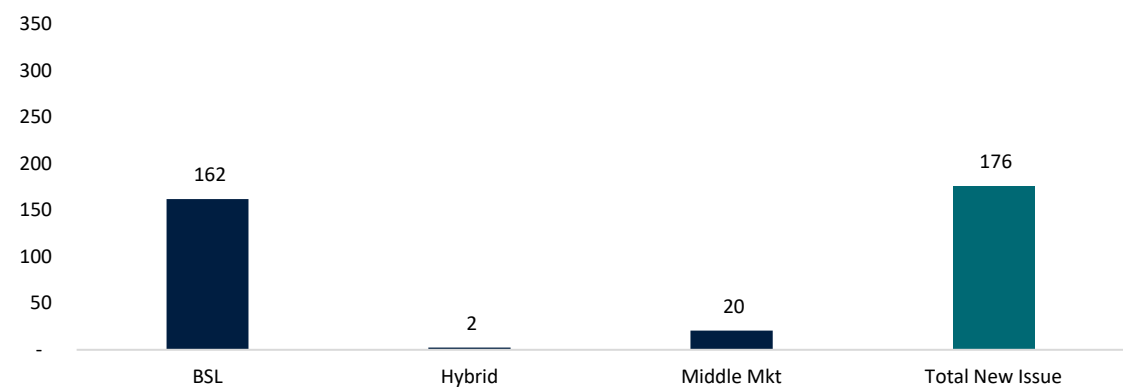
## ABS



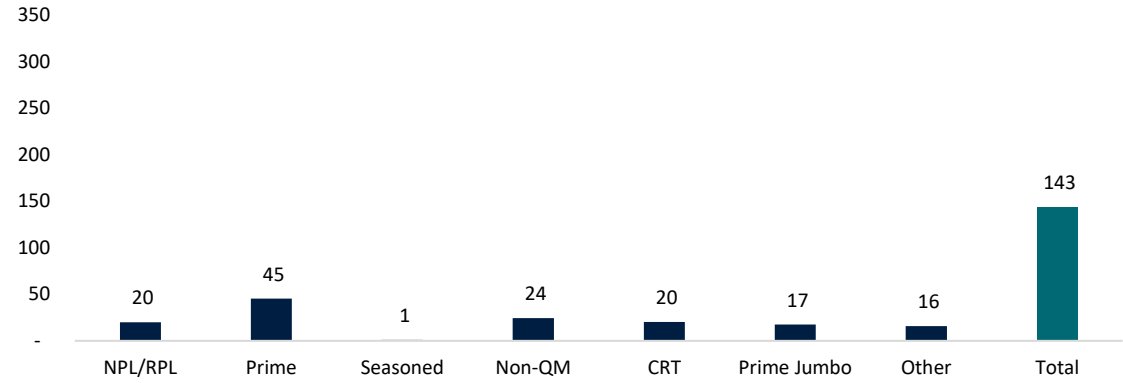
## CMBS



## CLOs (new issue, excludes refi/resets)



## Non-Agency RMBS

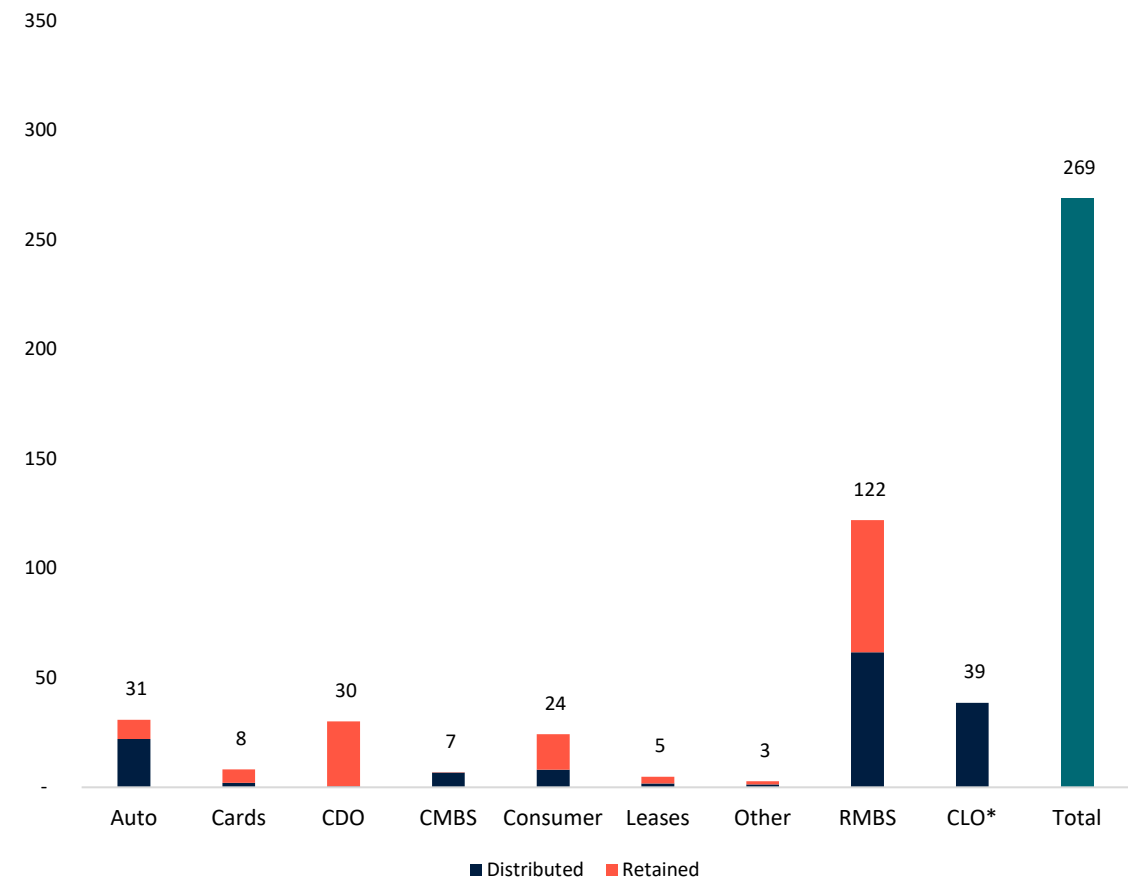


Source: Bloomberg as of 12/31/2021. Shown for illustrative purposes only and should not be viewed as a recommendation to buy or sell.

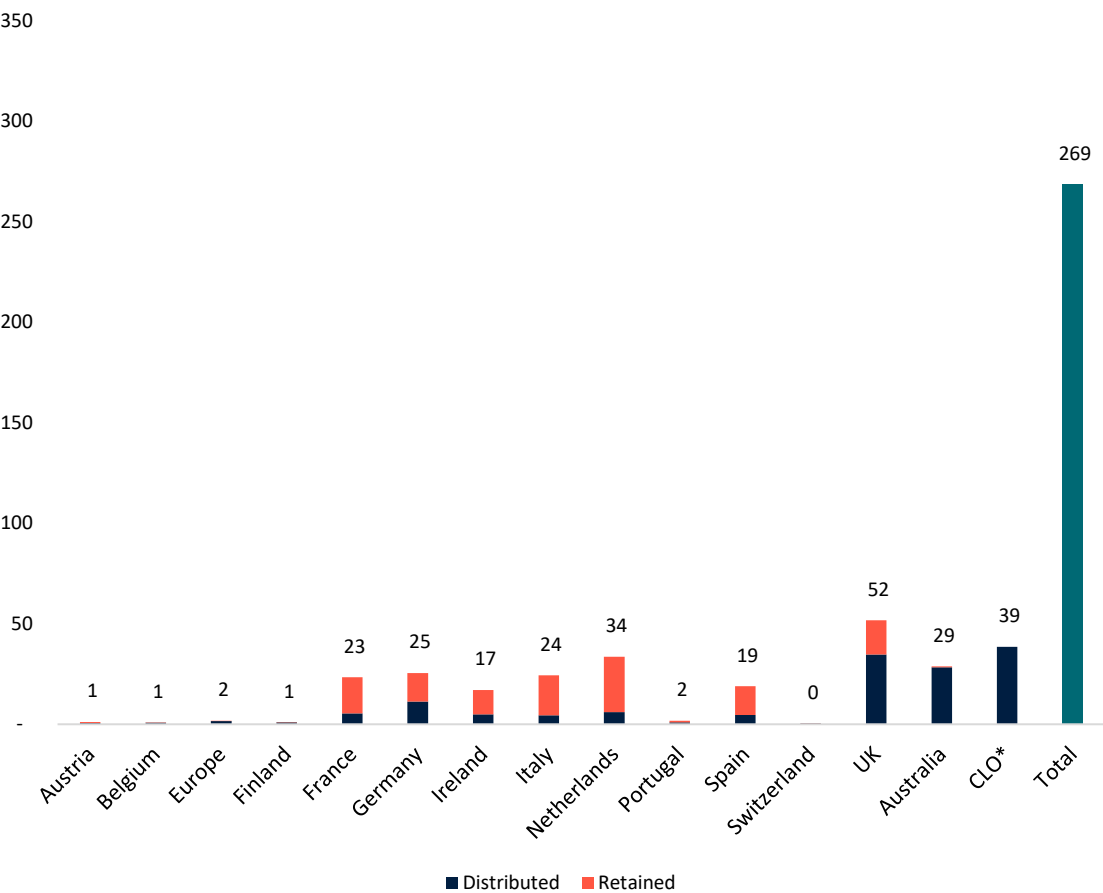
# Non-US, through the issuance lens

Non-US 2021 full year (€, in billions)

## By sector



## By country



Source: Bloomberg, JP Morgan as of 12/31/2021.

\*CLO reflects new issue, excludes refi/reset. Shown for illustrative purposes only and should not be viewed as a recommendation to buy or sell.





## *ESG DETAILS*

Sustainable cash flow profile is the cornerstone of our flexible best-ideas framework



# Environmental, Social and Governance Philosophy

We look to price for externalities and their impact to risk adjusted cashflows

## Philosophy

- **Social or public goods are those that benefit all people: examples are clean air, clean water, public safety, healthcare, literacy**
- We recognize that the world is beginning to move in the direction of accounting for the use of, or provision of, social goods
  - We want to incorporate this into our investment assessment to ensure that we correctly price for risk and/or benefit from changes in relative risk premium
  - We seek to create incentive for others to value these social goods
- This means we must gather information to understand:
  - Where these risks and benefits are present
  - To what extent they are appreciated
  - How we should adjust our assessment of cashflow outcomes to incorporate the facts
- The end goal is differentiation, and through differentiation, we can drive behavior that *more correctly prices* for use and provision of social goods

# Assessment, cashflow and scoring

We look to price for externalities and their impact to risk adjusted cashflows

## Scoring

- Securitized products and secured finance do not have public third-party scoring, and without guidance these sectors can appear opaque
- There is no required reporting for issuers, and disclosure is non-standard, we have dubbed it “50 shades of green”. It is our intent to rigorously and objectively assess facts
- Within the securitized sectors, social impact, environmental impact and governance are not subject to “corporate management”
  - There is a defined pool of assets and clear rules and roles within an ABS
  - One need not “wonder” where management will be deploying proceeds from issuance
  - Use of proceeds is discrete and observable and not subject to change over time
- At purchase, a score is established; the score is 1 (lowest) to 5 (highest) and the score is specific to a sector
  - Residential mortgage
  - Commercial real estate
  - Consumer unsecured
  - Consumer secured
  - Equipment
  - Leverage loan/CLO
- Each of the three areas (factors) – E (Environmental), S (Social), G (Governance) – are also evaluated based on how sensitive the asset-sector is to that factor (5 highest sensitivity, 1 lowest sensitivity); the scorecard weights the score by the sensitivity

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

# Sustainability of cashflow and scoring

We look to price for externalities and their impact to risk adjusted cashflows

## Complete assessment

- Our “security analysis” is a cashflow risk profile. This profile looks at the variation of a securities potential cashflow across a range of economic outcomes
- This analysis is performed using current characteristics on owned assets and assets we are newly evaluating
- This analysis reflects a current assessment of cashflows and counterparties for the current pool / structure
- Our scenario analysis also incorporates adjustments for basic fundamentals, characteristics and valuations, and the **ESG score**
  - If collateral was graded higher risk from a transition risk perspective, the range of stresses on collateral value would include more downside testing, due to this higher risk score, as a higher risk of collateral obsolescence could drive greater value declines in the asset pool
  - Likewise, collateral with higher exposure to social risk would see a wider range of stresses on both default and on recovery value. In this way, the ESG score, which reflects the characteristics of the assets when financing was provided, impacts the updated assessment of the security risk and return

# Building for change: Floating-rate income is the fix

New environment, new questions

## Key contacts:

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