



# US BUY AND MAINTAIN STRATEGY

## OPPORTUNITY

We believe buy and maintain is a 'smart beta' strategy that employs specialist fixed income expertise to construct targeted fixed income market exposure to meet client specifications. Ongoing management of buy and maintain portfolios is focused on avoiding the cost of defaults and material loss from deterioration in credit quality, while avoiding the traditional pitfalls of unwanted sector and issuer concentration that are associated with strategies managed with close reference to an index.

We believe buy and maintain is a more efficient way to access fixed income market beta than a traditional index tracking approach. The strategy seeks to avoid the general failings of indexation such as concentrated exposure to individual issuers and sectors, allocations to lower yielding government related debt, and indiscriminate exposure. In fixed income, a heavy weighting in a market capitalization weighted index reflects a high level of issuance and greater level of indebtedness.

## SNAPSHOT

**Strategy inception:** June 30, 2009

**Strategy assets:** \$39.7bn<sup>1</sup>

**Investment objective:** Meet client specific yield, duration and credit quality objectives while maintaining portfolio credit quality and minimizing turnover and transaction costs

**Issuers:** Typically 80-120

**Turnover:** Typically under 10% pa

**Performance measurement:** Custom reporting that analyzes credit rating migration and cumulative default rates versus chosen universe. Analysis also includes the impact on portfolio credit spreads from trading activity

**Portfolio managers:** Peter Bentley (global), Jesse Fogarty, CFA<sup>®</sup>, FRM (US credit) and Craig Armstrong, CFA<sup>®</sup> (US insurance)<sup>2</sup>

**Portfolio managers experience:** 22, 25 and 26 years, respectively

**Offered by:** Insight North America LLC

<sup>1</sup> As of March 31, 2019. Insight North America (INA) is part of "Insight" or "Insight Investment", the corporate brand for certain asset management companies operated by Insight Investment Management Limited including, among others, Insight Investment Management (Global) Limited and Insight Investment International Limited. Insight's assets under management are represented by the value of cash securities and other economic exposures, and are calculated on a gross notional basis. Advisory services referenced herein are available in the US only through INA. Figures shown in USD. FX rates as per WM Reuters 4pm spot rates. <sup>2</sup>Includes employees of Insight North America and affiliates.

## INSIGHT'S EXPERTISE IN BUY AND MAINTAIN PORTFOLIOS

- Insight has a long history of managing buy and maintain portfolios for our clients
- Insight manages \$39.7bn AUM in buy and maintain strategies<sup>1</sup>
- Insight's 115-member strong Fixed Income Group has managed global buy and maintain portfolios since 2009
- Over 20 years of experience managing US dollar credit strategies with strong track records
- The team is well resourced and highly experienced. Our investment professionals are specialists in their area of focus
- The research teams have substantial expertise in the investment grade corporate and securitized sectors, which are the primary building blocks for this strategy
- Expertise in structured credit within a buy and maintain context

## INVESTMENT APPROACH

Insight's buy and maintain approach strives to deliver the smart beta of fixed income credit and securitized markets within strict issuer and sector limits. It applies the same bottom-up, fundamentally-driven credit analysis to selecting a credit portfolio as Insight's fully active strategies. Buy and maintain takes long-term views designed to avoid significant turnover and limit transaction costs.

Underlying our philosophy are key principles we aim to apply in the construction of our buy and maintain portfolios:

### Our key principles for buy and maintain

#### Starting principles

1	Invest only in companies with robust fundamentals, not biggest % of index
2	Invest for long term
3	Match sector exposure to tenor of bond
4	Diversified portfolio

#### On-going management

1	Acknowledge low market volatility
2	Seek to avoid default and material loss

Once the portfolio is constructed, the objective of maintenance and management is focused on avoiding material losses and defaults and, for most mandates, maintaining the portfolio duration within agreed bounds. Our rigorous credit investment process is designed to pre-screen for solid fundamentals, transparent reporting and access to management. Bonds are sold if the outlook for the credit materially deteriorates and if we believe that this default risk is not adequately reflected in the market price. Turnover may also occur to maintain portfolio duration.

We seek to avoid forced selling in the case of ratings downgrades if fundamentals suggest that the bond is likely to mature at par. Often a downgrade below investment grade is the most inopportune time to sell. We also seek to avoid trimming positions due to changes in market price. The issuer and sector limits apply at the point bonds are bought.

## THE TEAM<sup>3</sup>

- Insight's global Fixed Income Group numbers over 115 investment professionals with an average industry experience of 17 years.
- The US team is comprised of 35 fixed income investment professionals made up of analysts, portfolio managers and dedicated traders.
- Experienced and stable US investment team has an average of 18 years industry experience.

## CREDIT INVESTMENT PROCESS

Buy and maintain portfolios have security selection at their core. The entire global credit universe is screened for suitable issuers. To focus this bottom-up, fundamental work, issuers are excluded at this initial stage if they have poor reporting standards or there is limited access to management. This allows us to concentrate only on those issuers where subsequent credit analysis will be rewarded.

Fundamental analysis is based on an understanding of the key drivers of a business and how it is positioned within its industry. This is then combined with an assessment of balance sheet strength and cash flow modeling to derive an understanding of how credit fundamentals could evolve.

An independent Insight credit rating is then applied to each issuer. The final step in the process is to apply a 'landmine checklist' as described in the table below.

### Security selection: landmine checklist

Factor	Example
✓ Liquidity	Assuming no access to capital markets in the next 24 months, what is the impact on the issuer's liquidity?
✓ Contingent liabilities	What is the magnitude of the issuer's off-balance sheet liabilities such as pension deficits, operating leases, etc.?
✓ Regulatory risk	To what extent is the issuer's industry subject to regulation and changes in regulation?
✓ Event risk	Does the management have an appetite or need to expand the business through debt-financed mergers and acquisitions?
✓ Leveraged Buyout (LBO) risk	Is the business likely to be subject to an approach from, or a bid by private equity?
✓ Environmental, social, governance (ESG)	Is the issuer properly managing ESG risks?

Each factor scored 1 (good) to 5 (bad)

- The global Credit Team covers both corporate and structured sectors, includes 48 research analysts who are responsible for providing security and sector recommendations to our portfolio managers. The team is arranged with each analyst taking responsibility for either individual industry groups (e.g., consumer non-cyclicals) or specific sub-sectors (e.g., ABS). Where an analyst is covering an industry they will cover issuers within that industry across the entire rating spectrum from investment grade to high yield.

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The landmine checklist aims to identify the risks that can lead to a sharp deterioration in an issuer's credit quality. These are risks that could cause a sudden deterioration in an issuer's credit quality and include the possibility of an inability to access the capital markets for a prolonged period, regulatory risk and the threat of leveraged buyouts (for example, if private equity investors are particularly active in an industry).

We believe that this two-stage process has been highly successful in identifying credit deterioration early and has historically enabled Insight to exit positions before defaults or forced distressed sales.

### Multi-Sector Buy and Maintain

While the traditional strategy focuses on investment grade credit portfolios, a buy and maintain strategy is also appropriate for clients that wish to consider alternatives to multi-sector passive fixed income strategies like the Barclays US Aggregate index. The sector weights in the index are highly exposed to low-yield US Treasuries and the unpredictable cash flows of US Agency RMBS, in addition to the flaws described earlier in passive credit investing.

A multi-sector buy and maintain strategy may own:

- Modest allocation to government debt for flight-to-quality benefits (10-20%)
- Allocation to Agency RMBS securities for high quality yield and liquidity (10-30%)
- Allocations to securitized sectors such as ABS and CMBS for stable cash flows and yield benefits (10-30%)
- A corporate allocation subject to fundamental credit analysis as described (30-60%)

Asset allocation rebalancing will reflect market conditions and opportunities at the time of cash flows. An enhanced style can use modest secondary turnover to refresh the composition of issuers and sectors and may participate in attractively priced new issuance.

### Collaborative approach

Insight's approach to buy and maintain is centered upon working closely with our clients to understand their requirements and agree upon the parameters of the mandate to ensure their target objective is met. We construct each portfolio on a tailored, segregated basis to reflect each client's unique requirements.

### GUIDELINES<sup>4</sup>

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The strategy is customizable to client guidelines. Examples of client customization include:

- Maintain stable target duration or allow portfolio to mature over time
- Reinvest or pay out cash from coupon payments and redemptions
- Mix of US investment grade corporate, securitized and US government debt

### Sample Guidelines – Buy and Maintain

Typical guidelines for a Buy and Maintain portfolio:

- sectors capped at 25%
- issuers capped at 1%- 2%
- no supranationals
- no hybrid financial debt

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<sup>4</sup> Sample guidelines may not represent current or future portfolio compositions.

## ABOUT INSIGHT INVESTMENT

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Insight Investment is a leading investment manager with key operations in the UK, Germany, US, Australia and Japan. Through its predecessor companies, Insight has a 25-year history in North America and manages \$844bn globally. It is built on three main pillars: fixed income; absolute return and unconstrained investment; and risk management solutions:

- Insight's global fixed income team has a demonstrated long-term track record both for performance and innovation.
- Risk management solutions have played a significant role in the Insight story. In Europe, members of Insight were pioneers in liability-driven investment.
- Insight has been managing currency risk for two decades.
- Insight has a decade-long history of applying institutional-quality processes and governance to absolute return and unconstrained mandates.
- We understand the complex requirements of insurers through substantive team experience.

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