

Don't write off fixed income just yet

The webinar will begin shortly



Russell Investments

New Zealand Investment Forum

Adam Smears

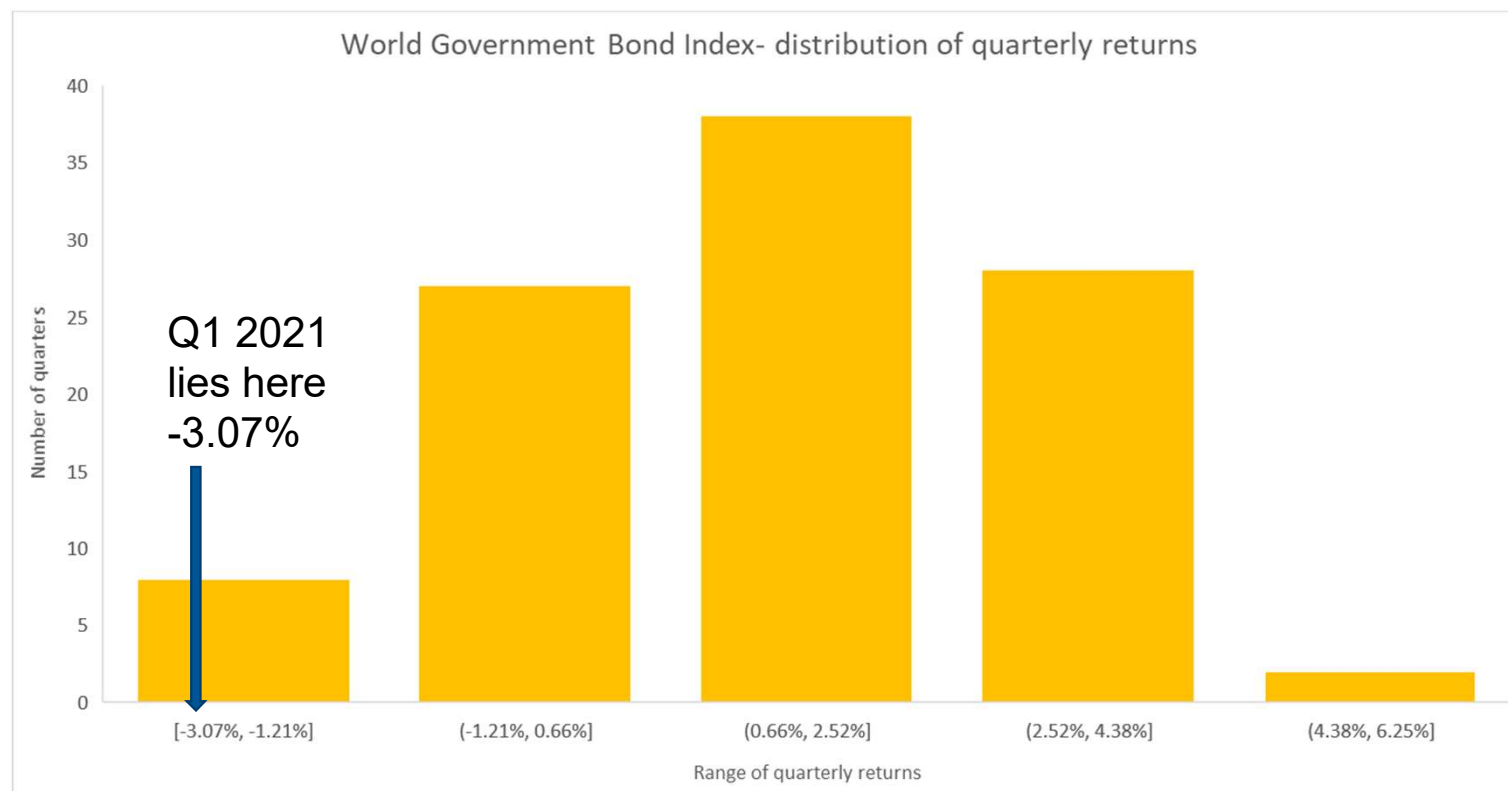
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May 2021

Q1 21 - Global government bonds have worst quarter on record



Source: FTSE World Government Bond Index USD Hedged 6/30/95 to 3/31/21

The low yield world – is it over for bonds?

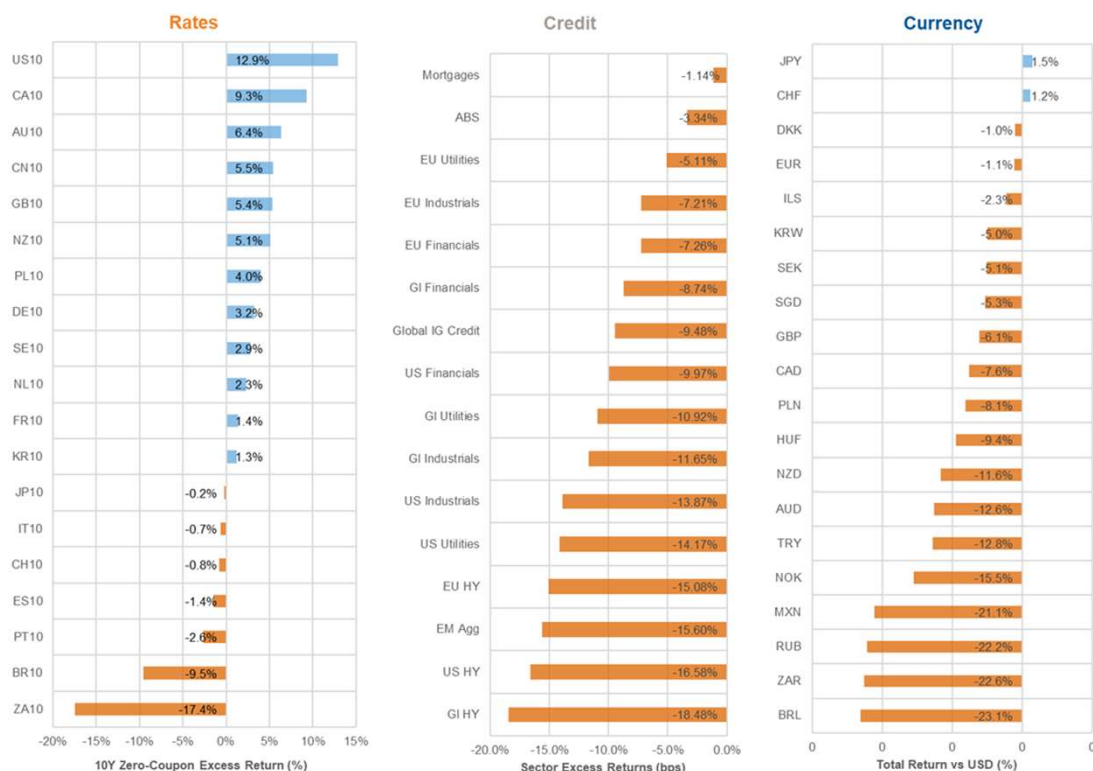
A multi decade fall in yields post the 70's oil crisis



Source: Bloomberg. 10 year US treasury yield 01/01/1962 to 3/31/21

Reminding ourselves why we own fixed income..

There are very few instruments that can protect you when the market is in crisis.



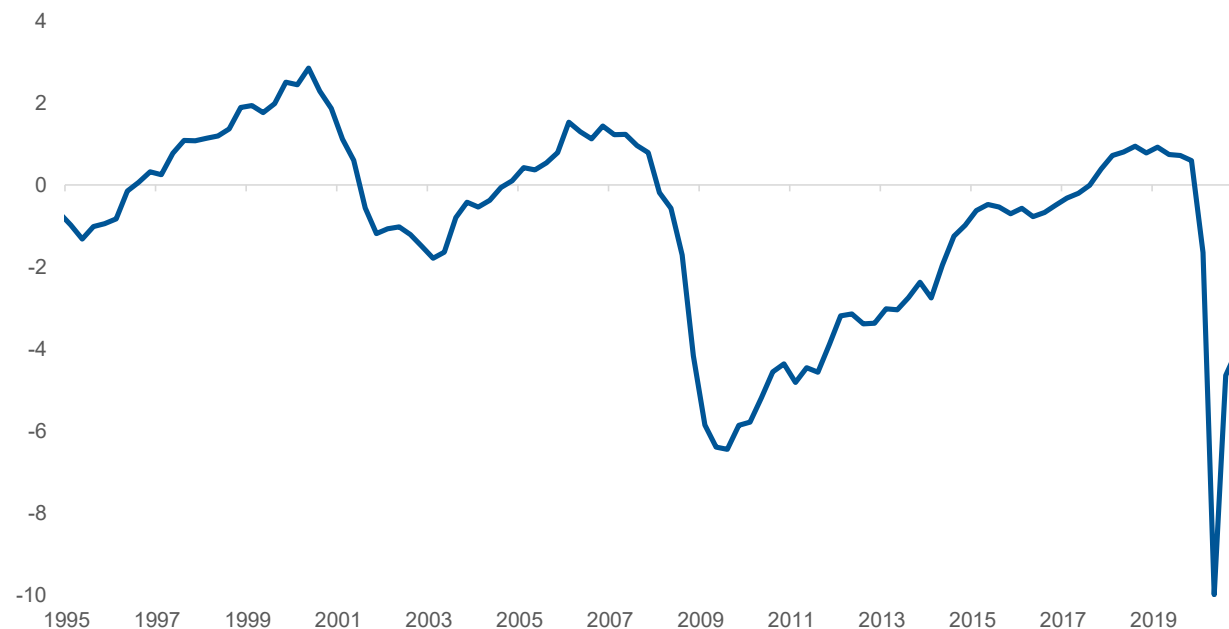
Correlation Table	US 30Y	US IG Credit	US High Yield	US Bank Loans	EMD Hard Currency	EMD Local Currency	Convertibles
US 30Y		0.381	-0.226	-0.361	0.006	-0.086	-0.233
US IG Credit	0.381		0.743	0.655	0.830	0.594	0.635
US High Yield	-0.226	0.743		0.914	0.862	0.666	0.851
US Bank Loans	-0.361	0.655	0.914		0.802	0.568	0.764
EMD Hard Currency	0.006	0.830	0.862	0.802		0.787	0.751
EMD Local Currency	-0.086	0.594	0.666	0.568	0.787		0.674
Convertibles	-0.233	0.635	0.851	0.764	0.751	0.674	

Source: Bloomberg as at 31 March 2020. Any past performance is not necessarily a guide to future performance. Any reference to returns linked to currencies may increase or decrease as a result of currency fluctuations. Notes: Rates: Derived from Bloomberg zero-coupon yields. Credit: Bloomberg Barclays excess returns. Currency: All TR indices except for RUB (JGENFXRU) and ILS (ILSUSD). Source: Bloomberg.

The strong recovery still hasn't repaired the damage

The output gap is substantial and must close before inflation becomes a problem

Spare capacity suggests inflation is unlikely until 2022 or 2023
US output gap, % of potential GDP



Source: Historical output gap is an average of model-based estimates from the Congressional Budget Office and Federal Reserve Board (FRBUS model). Data as of 2020:Q4.

What does that mean for bonds?

A steep yield curve means bonds offer some value if risks are symmetrical...

Probability	Change in Yield	10 Year Yield	1Y expected returns
40%	+100bps	2.62%	-5.27
50%	Same	1.62%	2.48
10%	-100bps	0.62%	11.11
Blend			0.24

With a Zero Interest rate policy, bond yields have a lot of carry that helps to insulate against price declines..

Assuming over the next year the 10 year ends somewhere between today's level and 100bps higher, with a 10% chance of market collapse, there is some value.

Source: Russell Investments. Data Bloomberg April 28th, 2021

However, the FED has created the ingredients for inflation..

More money has been created than any time since being measured and the treasury will need more

More money being created now that any time in current investors memory

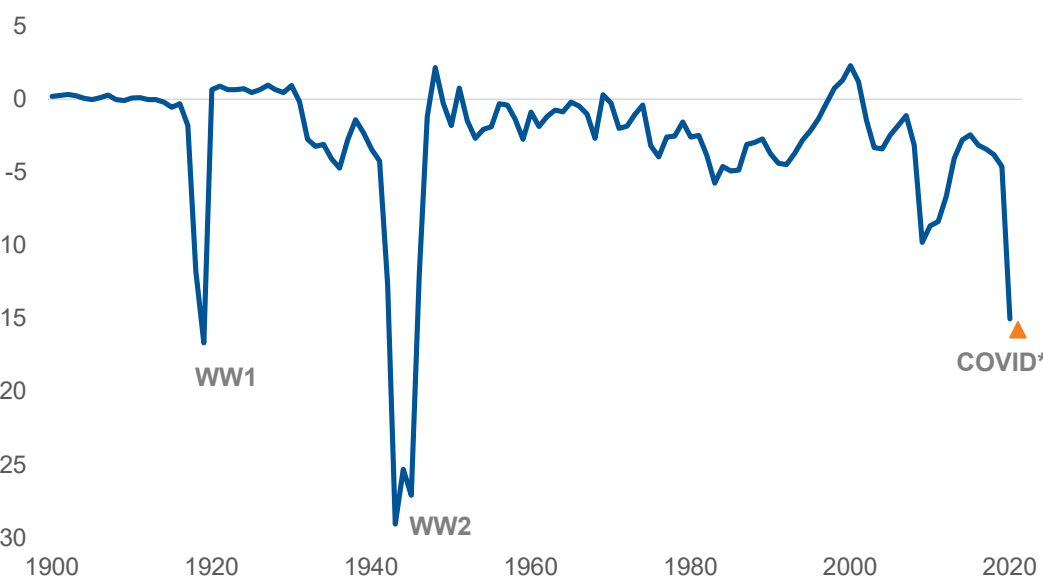


Source: Bloomberg Federal Reserve M2 – 12 month change. 4/1961 to 4/2021

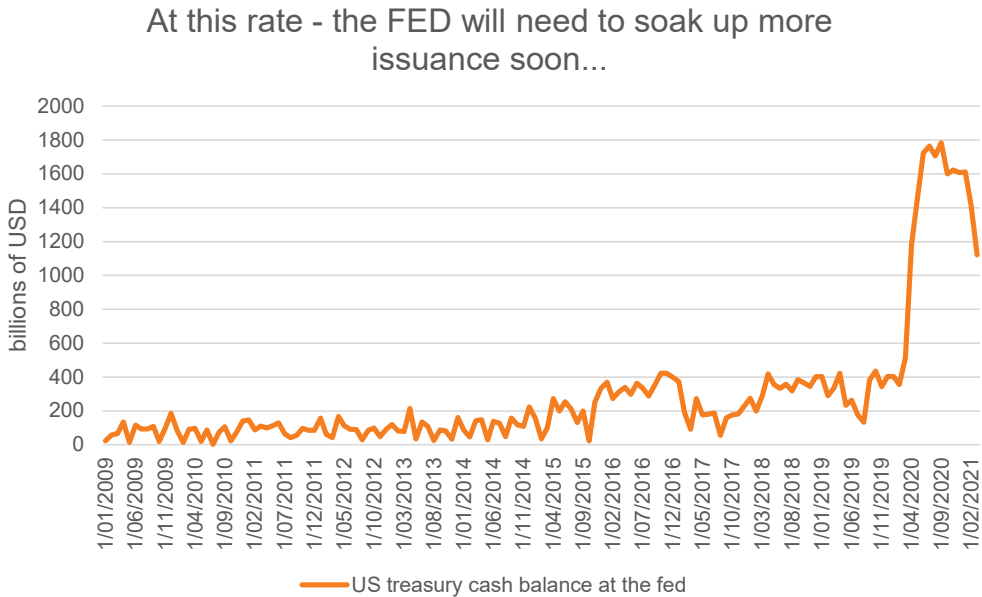
And the treasury is happy to cook with them.

Deficits only rivaled by the World Wars

US federal budget balance, % of GDP



Source: Historical Statistics of the United States, CBO. *Denotes the consensus estimate for 2021 as an average of forecasts from JP Morgan and Goldman Sachs as of March 5th 2021.



Source: Bloomberg – US Treasury deposits held at the Federal Reserve. 01/01/2009 - 03/31/21

Working your portfolio harder is more important than ever

Strategies especially relevant for today's tricky market

Targeted Risk Premia:
Prepayment

Diversify: Intelligent Credit

Alpha: Securitised

Source: Russell Investments. For illustrative purposes only.

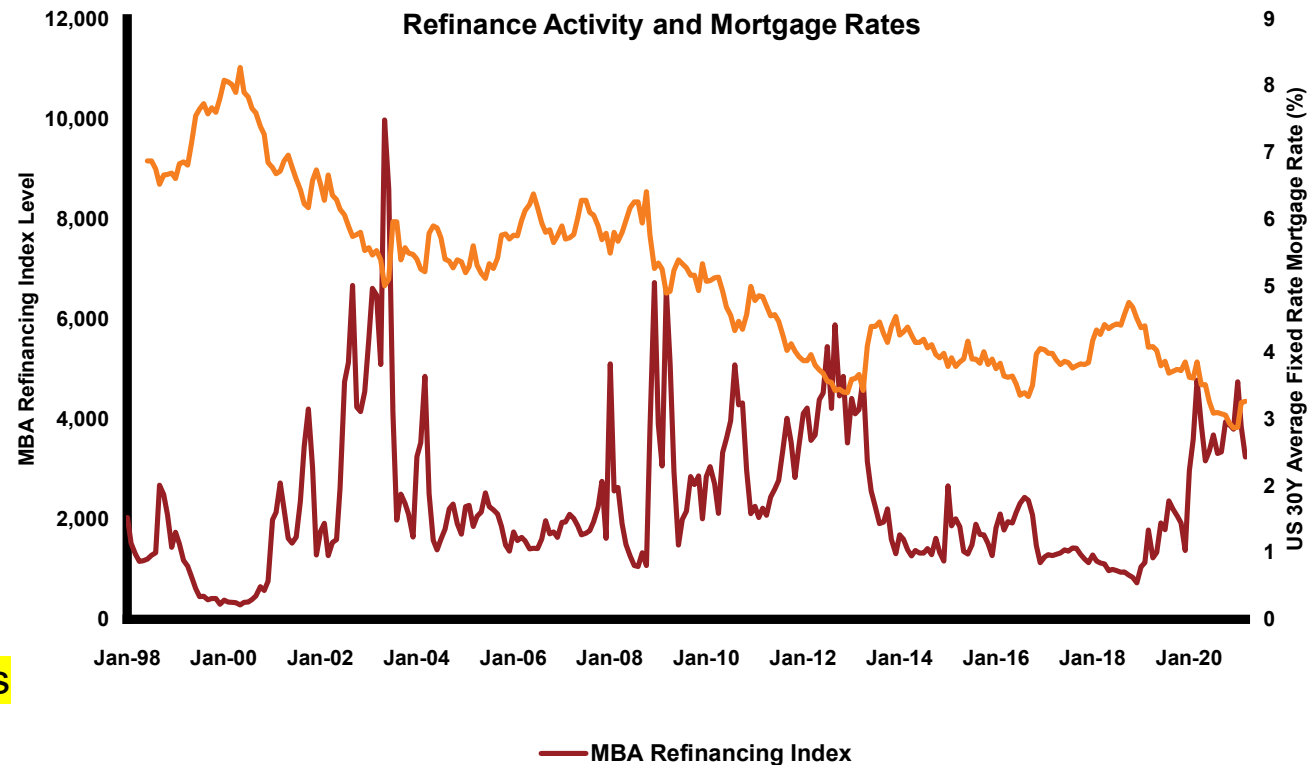
Diversifying risk premia - prepayment

Higher yields without duration or credit risk

Prepayment

- > Interest only strips of US Agency mortgage-backed securities.
- > **AAA** credit quality
- > Higher spreads – **3-6%** spread.
- > Performs well when homeowners are refinancing their mortgages less. Performed poorly if homeowners are increasing the rate at which they refinance their mortgages.

Performs well when yield curve steepens



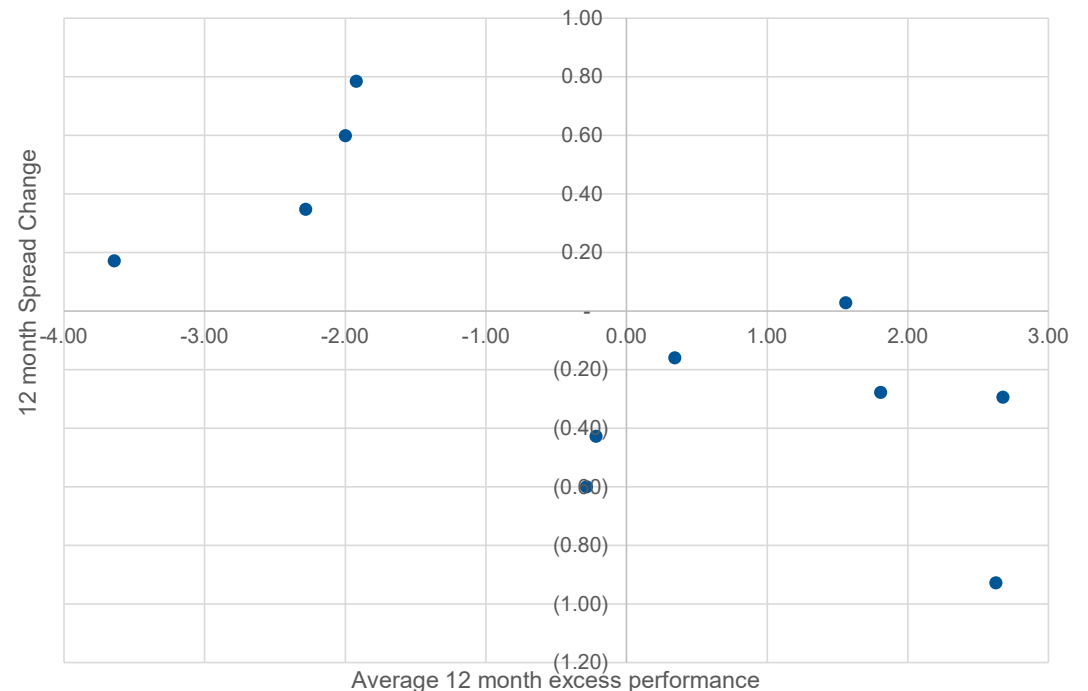
Source: MBA – Mortgage Bankers Association of America Refinancing Index
Indexes are unmanaged and cannot be invested in directly. 6/30/98 to 3/31/2021

Diversify manager biases with factor strategies

Adding factors that diversify manager biases

- > Many investment grade corporate bond managers generate excess returns by buying credits that are lower quality than the benchmark, and ensuring their research minimises the possibility of credit losses.
- > This results in active strategies having biases to low quality bonds and being more sensitive to risk.

Global credit managers outperform during bull markets

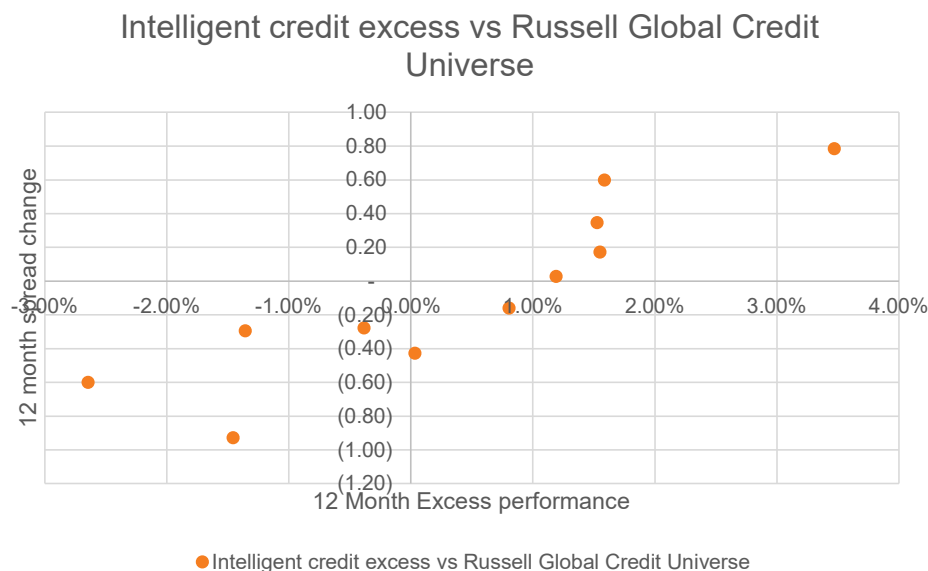


Source: Evestment – Global Credit Universe 12/31/2009 to 12/31/2020

Solution: Intelligent Credit

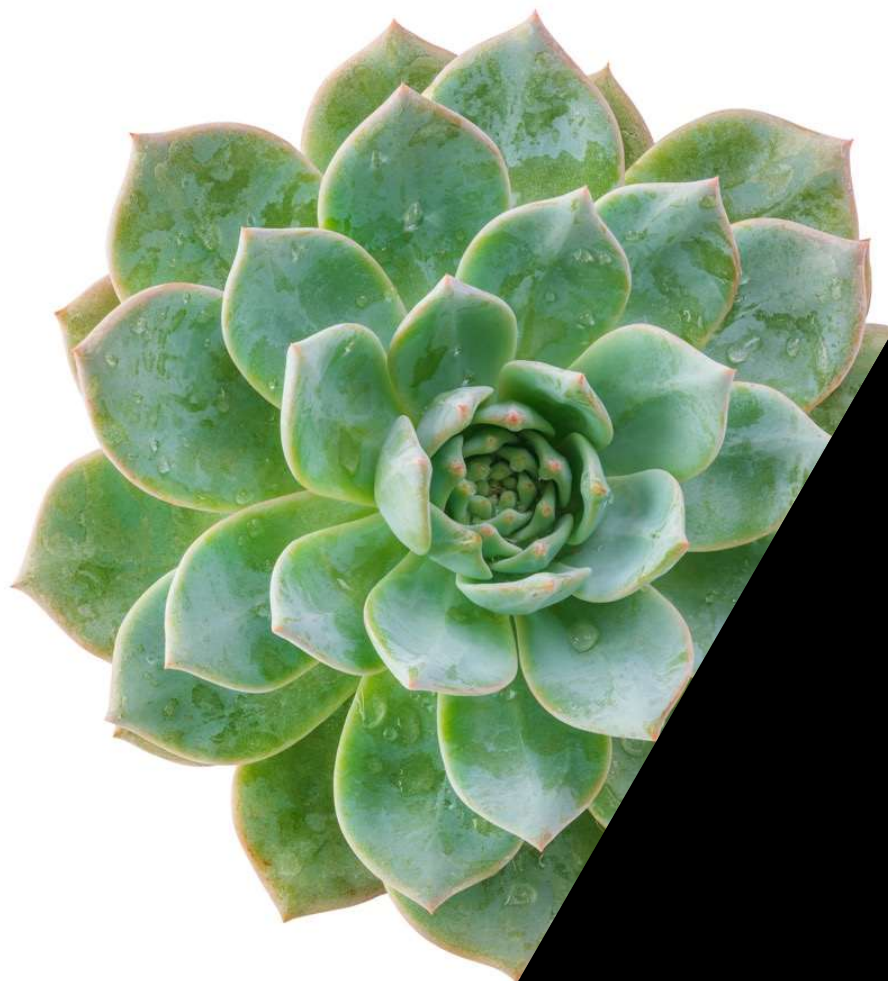
A credit value factor that complements active managers

- > Partner with Moody's KMV
- > KMV uses a merton based model and their historical default data to quantify a fair value spread.
- > Systematically overweight credits trading cheap to Fair Value Spread.
- > The strategy overcomes behavioural biases by staying more defensive in tight spread markets while buying into weak markets.



Source: Spreads Bloomberg Barclays US Investment Grade credit index. Intelligent Credit returns relative to Russell Investments Global Credit Universe - live from October 2017 to December 2020, backtest from Oct 2017 to 12/31/2010.

Alpha – Securitised





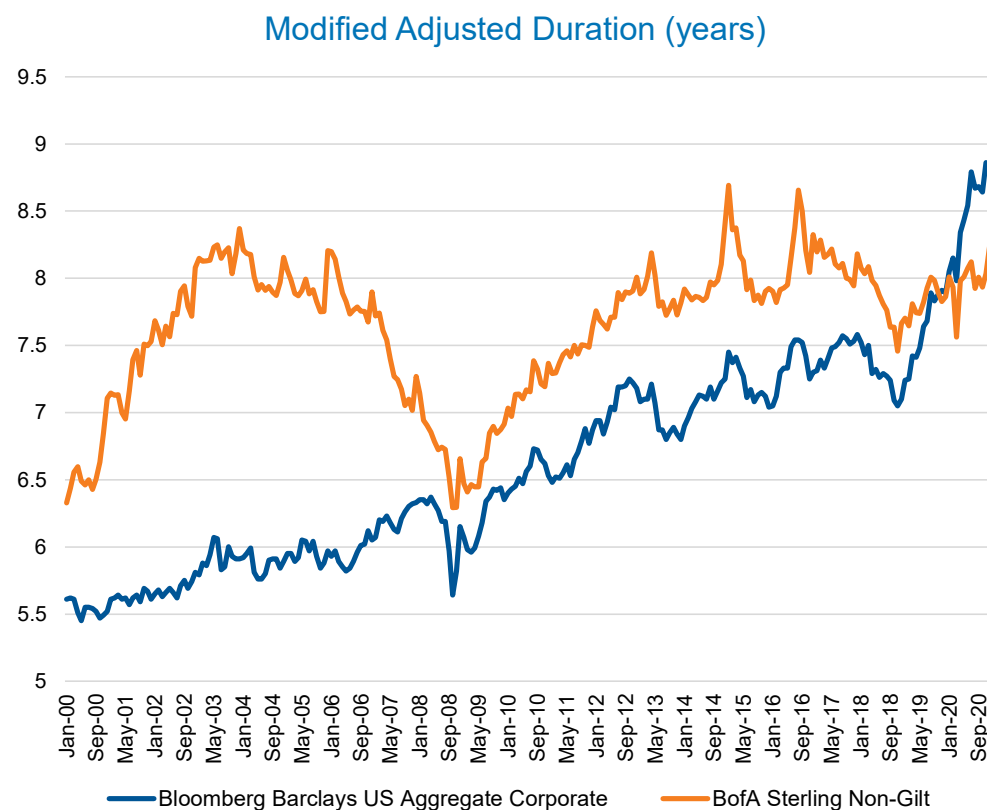
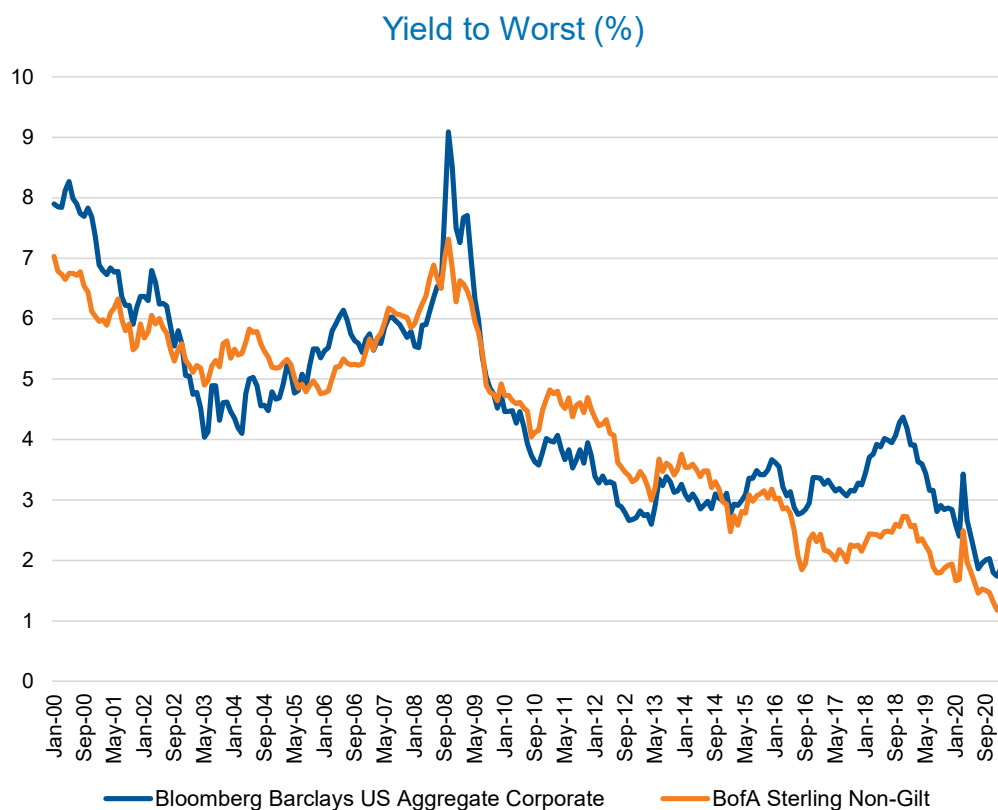
Revenge spending and structural change

In Focus – March 2021

Data as of March 2021

Securitized Credit Overview

Reaching extremes - getting paid less for more risk



Source: Bloomberg, as of 03/31/2021.

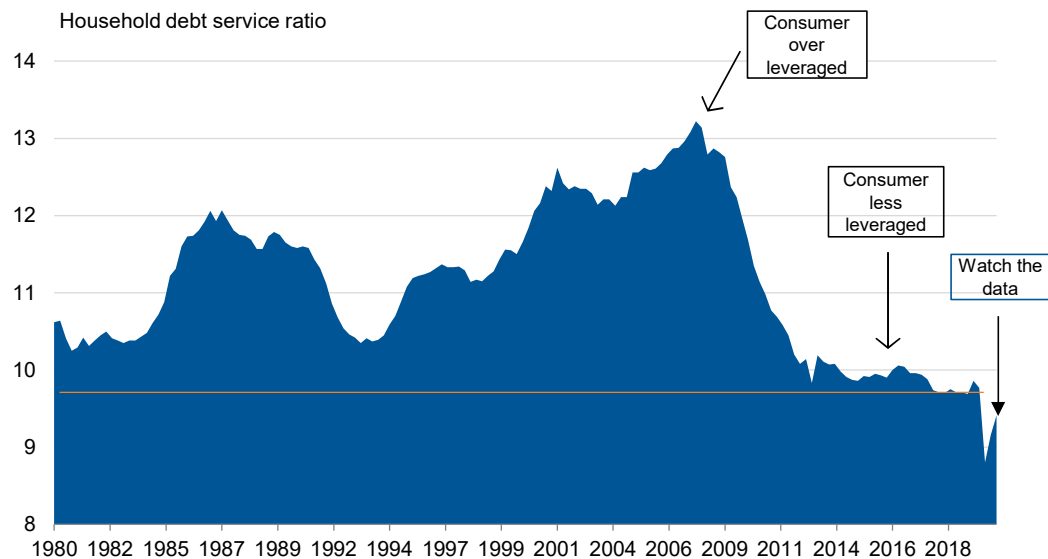
Investing across the credit universe, returns are low, low, low

	Securitized Credit							US Fixed Income				"Plus Sectors"			Equity
Sector	Schroder Securitized Credit	US Agency MBS	US CMBS	US ABS	US CLO	BBB US CMBS	US BBB CLO	US Fixed Income	US Treasuries	US 1 - 5 yr. Corp. Bond	US IG Credit	US High Yield	US Leverage Loans	EM Debt	US Equity
Index	GBF (USD)	US MBS Index	US CMBS Index	US Asset Backed Securities Index	CLO Index	BBB US CMBS Index	CLO BBB Index	US Aggregate Index	US Treasury Index	1 - 5 yr. Corporate Index	US Corporate Index	US Corporate High Yield Index	Leveraged Loan Index	EM USD Aggregate Index	S&P 500
Duration (yrs)	4.22	4.09	4.69	1.78	0.25	4.66	0.25	6.40	6.79	2.82	8.48	3.87	0.25	6.68	
Credit quality	A	AAA	AAA	AA+	AA	BBB	BBB	AA	AAA	BBB+	A-	B+	B	BBB-	
YTM (%)	2.83	1.82	1.93	1.07	3.70	4.75	4.82	1.61	1.00	0.97	2.28	4.23	3.74	4.01	1.49
1Y volatility	3.95%	1.16%	3.13%	1.73%	4.07%	9.01%	11.28%	3.61%	3.13%	4.90%	7.79%	6.88%	4.97%	7.22%	17.33%
3Y volatility	7.21%	2.08%	4.45%	2.72%	6.04%	12.57%	15.13%	3.56%	4.52%	4.88%	7.12%	9.46%	9.16%	8.45%	18.40%

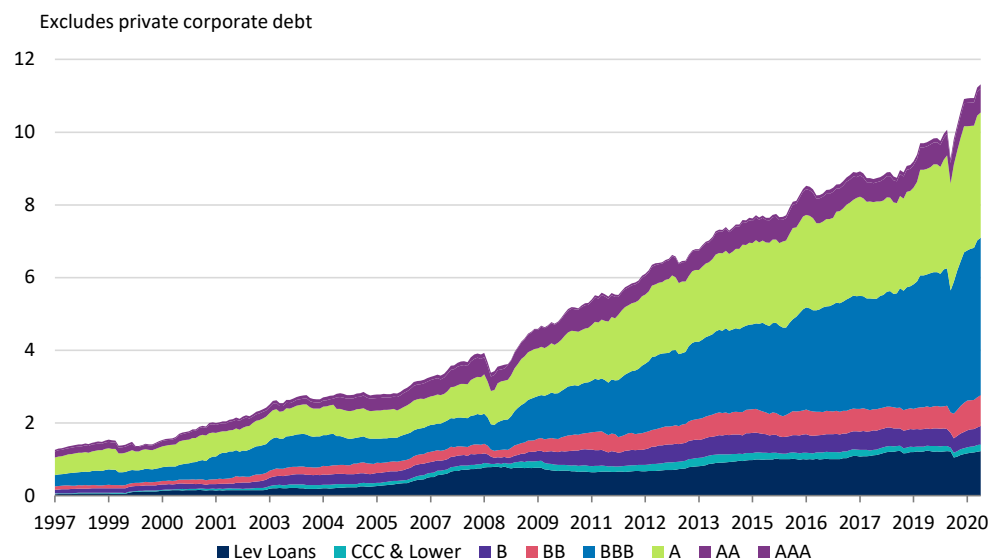
Source: Schroders and Bloomberg as of March 31, 2021. For illustration only. Duration, credit quality and performance may differ across representative accounts within any composite. Yields are subject to fluctuate over time. Past performance is no guarantee of future results.

Structural change in leverage

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

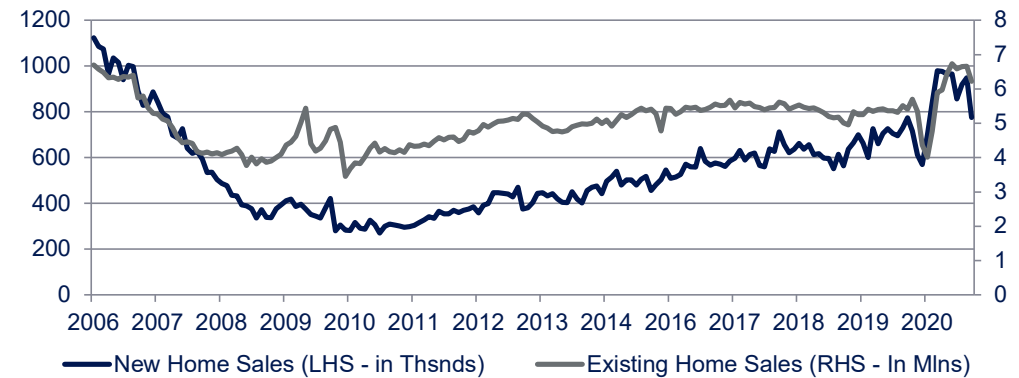
Source: Federal Reserve Board as of December 31, 2020, left side graph. Source: Bloomberg, through December 2020, right side graph. There is no guarantee current market conditions will continue or produce favorable results.

Focus on housing: supply & demand, politics & inequality

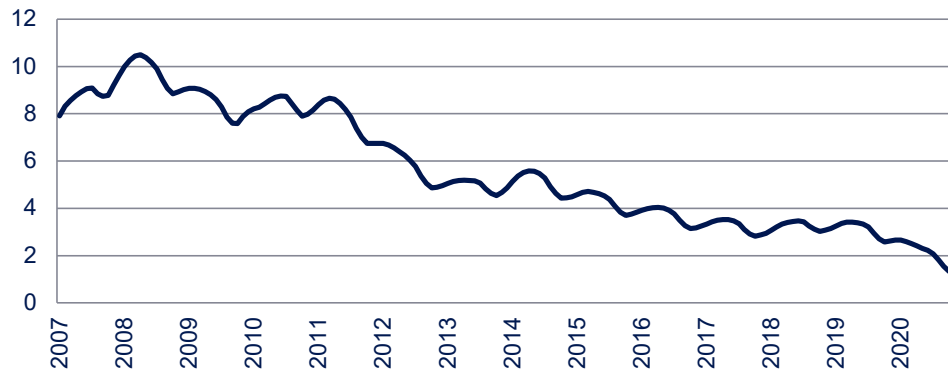
Mortgage purchase applications and Avg. 30-year mortgage



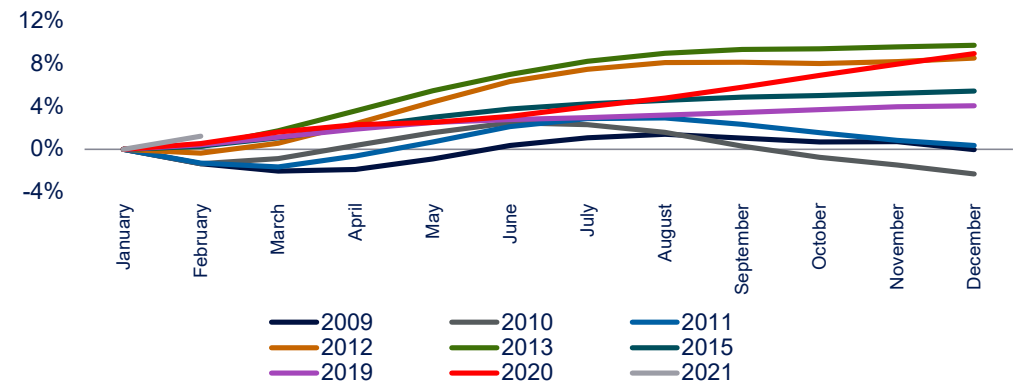
¹New and existing home sales



Months supply of active listings



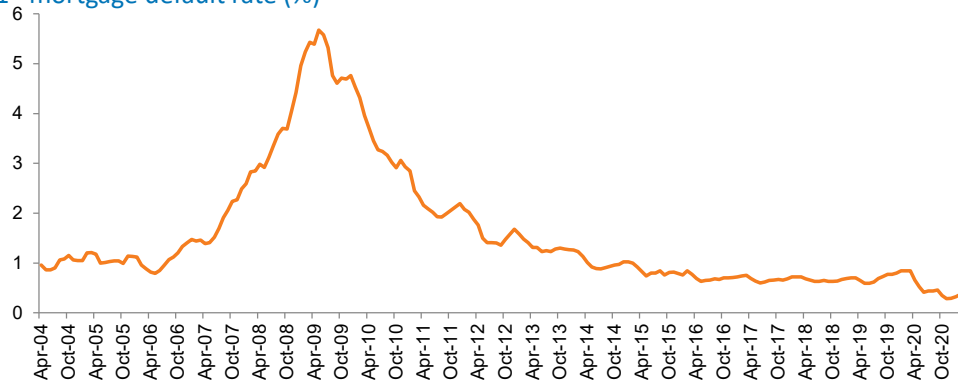
Cumulative home price appreciation change



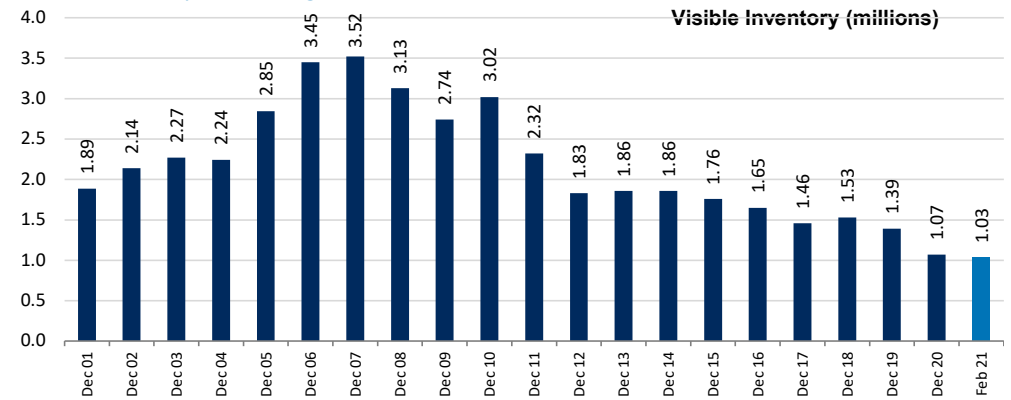
Source: Bloomberg as of 3/26/2021, CoreLogic as of 02/28/2021. ¹Home sales as of 02/28/2021.

Focus on housing: #TheZero distressed supply / strong demand

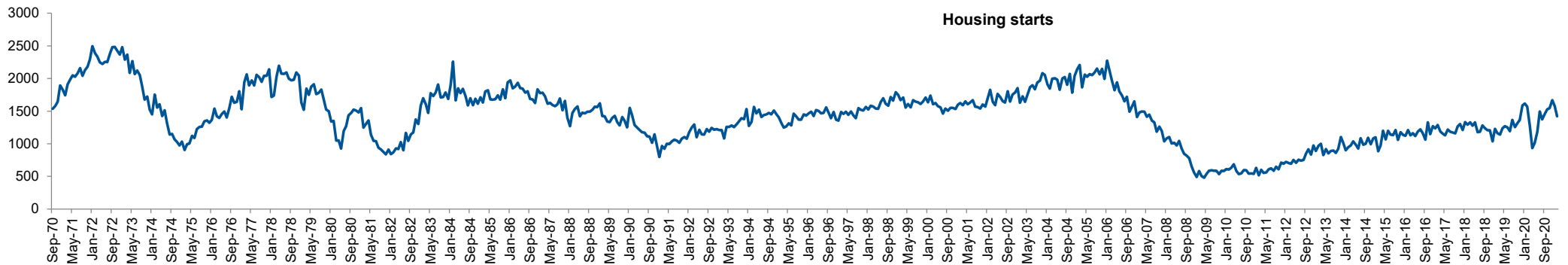
1st mortgage default rate (%)



Visible inventory of existing homes for sale hit new low



Demand should high be due to shelter-in-place



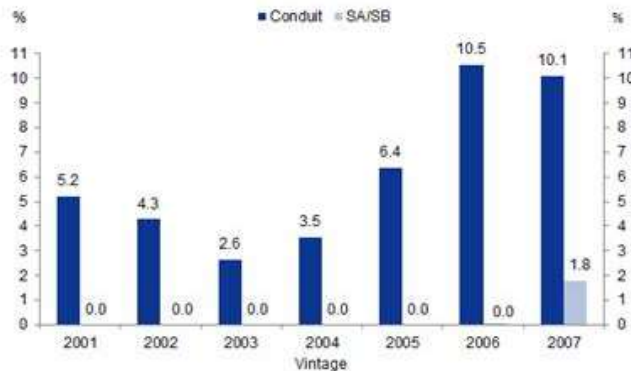
Source: Bloomberg as of 02/28/2021. Data reported on a lag.

Single asset- single borrower (SASB) & why you want it

30+ day delinquency rate by CMBS sector, 2012-2021 vintage transactions



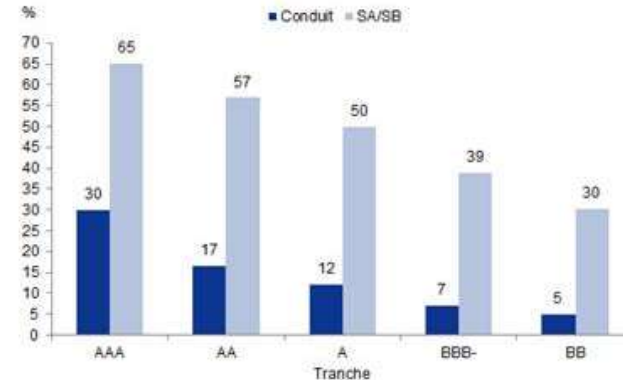
Cumulative loss rate by vintage, conduit vs. SA/SB CMBS 1.0 transactions



30+ day delinquency rate by sector and property type, 2012-2021 vintage CMBS transactions




Average credit enhancement level by rating, SA/SB vs. conduit CMBS



Source: Intex, Trepp, Goldman Sachs.

- ☐ Your FOCUS determines your reality
- ☐ CMBS SASB outcomes are better than conduit
 - ☐ Better asset quality
 - ☐ Lower leverage
 - ☐ Stronger sponsors
- ☐ Delinquency is lower & losses are lower
- ☐ Credit support is higher



Thank you.
Any questions?



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