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Pilar Gomez-Bravo
director of fixed income - Europe
MFS Investment Management

Credit comes full circle

The MFS Global Credit Fixed Income strategy is a disciplined, fundamental-driven portfolio with multiple alpha sources.

Globally there's a view the current credit cycle is nearing its end – but it should not spell doom and gloom for credit managers, MFS Investment Management (MFS) says.

If you are a true believer of the lower for longer yield environment, and couple this with low global economic growth and low inflation, then credit as an asset class remains attractive.

MFS director of fixed income for Europe, Pilar Gomez-Bravo [01], says economic growth outside of the US and Europe and the maturation of several credit markets is opening the door for new investment opportunities.

More specifically, the MFS Global Credit Fixed Income strategy continues to find opportunities at the issuer level in developed countries. Gomez-Bravo says MFS has the capability to conduct extensive analysis of corporate bond issuers and their capital structures.

"With the increased levels of company mergers and acquisitions it allows us to capitalise on and leverage opportunities where we can see strong cashflow generation," she explains.

With more than 20 years' experience the portfolio manager says she has seen continued development and innovation in some of the complex structures which allow well-resourced investors to potentially add more value to their clients.

"MFS is in an enviable position for continuing to invest in the fixed income platform in terms of talent and technology," Gomez-Bravo says.

Investment philosophy

The global credit fixed income strategy is co-managed by Robert Persons (CFA) and Gomez Bravo (CFA). The investment team is strongly aligned to the belief that global credit markets can deliver alpha from multiple sources, enhance returns and diversify risk.

"As fundamental-oriented investors we can capitalise on the persistent structural inefficiencies (ratings, liquidity and investment horizon) and the mispricing of risk that allows security selection to deliver consistent alpha over time," Gomez-Bravo says.

"However security selection alone is not enough. We do maintain and express views across regions, sectors and the quality spectrum that allows us to dynamically allocate portfolio risk to those parts of the world that we see offering greater risk adjusted opportunities."

She adds MFS' fixed income success is derived from the strength of its global research platform and the investment manager's "highly collaborative culture." Everybody from portfolio managers to credit analysts to traders can provide unique insights into client portfolios, she says.

It also provides a better understanding of the investment manager's active approach to credit. Gomez-Bravo goes on to explain there is daily interaction among equity and fixed income research analysts, traders and portfolio managers. The teams review and discuss new and secondary bond issues, market conditions, market flows and any other factors relevant to the credit markets. She says the fixed income analysts cover all sectors including sovereigns, investment-grade and high-yield corporates, emerging markets, securitised and local agencies.

"We also have an experienced team and rigorous hiring process that ensures that the collaboration and culture is maintained," Gomez-Bravo says.

MFS acknowledges its role in the development of credit-oriented active bond management dating back to the 1970s. And its strong collaborative culture provides a solid foundation on which to grow the fixed income franchise, it says.

Risk management

The collaborative culture is mirrored when it comes to integrating risk management into each step of the MFS investment process. It allows the group to size exposures appropriately and in accordance with its fundamental views.

The starting point, as Gomez Bravo explains, is establishing a risk budget. The manager seeks top-down macroeconomic views and bottom-up perspectives before targeting a level of risk relative to the strategy's benchmark – the Bloomberg Barclay's Global Aggregate Credit Index (Unhedged).

Economists, credit analysts, quantitative analysts, traders and strategy groups within the fund manager will generate their views before it is reconciled to set the risk budget, typically ranging between 50 and 300 basis points of tracking error relative to the benchmark. Monthly risk allocation forums are then held to discuss sector values, views on US rates and the US yield curve, and global currencies and rates in general.

MFS adds it will look to "derive outperformance through top-down risk analysis reflected in market allocation, sector selection and duration management versus the benchmark, as well as allocation to non-benchmark securities."

The global credit fixed income strategy generally focuses its investments on lower-tier investment-grade bonds (BBB) and higher-tier below investment-grade bonds (BB) where its credit research suggests there's significant opportunity to add value.

MFS says a bond's valuation is largely determined relative to its view of a credit's fundamental credit quality rather than to the agency-assigned ratings.

"We believe that public equity markets are generally more liquid than public corporate bond markets, and that changes in equity prices tend to lead to changes in corporate bond prices," it says.

"Rising equity prices and low equity volatility suggest improving credit fundamentals and are often precursors to upgrades and tighter credit spreads. Conversely, high and increasing volatility and an underperforming stock price are often precursors to wider credit spreads.

"We are seeking to identify companies in which the equity market is trading the name differently from the bond market."

Gomez-Bravo adds a focus on managing downside risk is also critical in generating attractive long-term risk-adjusted performance.

"We're fortunate to work with a wide breadth of retail and institutional clients globally. The types of objectives and the ability to assume risk can differ significantly across different clients, although at this moment in time a common theme is the maximisation of yield per unit of risk," she says.

Through a separate account structure MFS can customise institutional mandates tailored for specific portfolios and client objectives.

The current climate

Gomez-Bravo and her team see the unwinding of central bank policy as one of the most crucial elements to being an active credit manager.

"The global economic cycle could be at an inflection point, and whilst the credit fundamentals of the companies we invest in remain solid, we do worry that global central bank policy – after being so influential in markets over the past 10 years – is starting to diverge, which could lead to unforeseen circumstances," she says.

"On top of that, we feel valuations across a variety of parts of the credit market are stretched. So what we have been doing is reducing the aggregate level of risk in our portfolios."

She adds while the strategy has been focusing more on reducing credit risk, it is also asking whether there is any specific issuer risk where the manager can yield a unique advantage. FS

The quote

MFS is in an enviable position for continuing to invest in the fixed income platform in terms of talent and technology.

Watch the video on www.fsitv.com