



NEWTON

Investment
Management

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FIXED-INCOME SOLUTIONS FOR A CHALLENGING INVESTMENT BACKDROP

For professional investors only.
This document is for Australian wholesale clients and New Zealand wholesale clients only.
Please read the important disclosures at the end of this document.

Why we believe superannuation funds should consider the **Newton Global Dynamic Bond** and **Global Dynamic Bond Income** strategies as **effective 'one-stop' solutions** to navigate the evolving macro backdrop.

Introduction

The current macro backdrop continues to create tough conditions for investors who rely on fixed income for both income and returns.

Years of financial repression from governments and central banks, rising national debt levels, and the threat of increasing default rates have all led to increasingly paltry returns on so-called 'safe-haven' government bonds, while the potential return of inflation means investors in bond strategies unable to adapt to the changing backdrop may run the risk of seeing returns eroded over time.

At the same time, there is a growing demand for environmental, social and governance (ESG) considerations to play an increasingly important role within the investment process for bond managers.

This article will seek to show how **Newton's Global Dynamic Bond** and **Global Dynamic Bond Income strategies** have a number of attributes that could prove useful in terms of mitigating the concerns raised above, and explain why they are worth consideration by superannuation funds that need solutions for a range of challenges posed by the current backdrop.

FIXED-INCOME SOLUTIONS FOR A CHALLENGING INVESTMENT BACKDROP

An effective 'cash-plus' strategy

Superannuation funds may sometimes hold cash positions for longer than they intend.

With yields on short-dated cash instruments barely above zero, being able to invest in a strategy targeting an absolute return of cash +2% per annum, becomes an attractive alternative for cash holdings relative to other cash-based strategies.

In our view, our **Global Dynamic Bond strategy** could be an effective short-to-medium term option for those looking to make their cash work harder.

A steady income return over time

Many funds may desire a steady and consistent income from their lower-risk fixed-income investments, to help manage payment schedules and investment volatility.

Our **Global Dynamic Bond strategy** offers investors the prospect of a steady and consistent income stream, complemented by capital gains on the assets it holds.

For those investors with a higher risk tolerance, who are seeking an enhanced return outcome, the income version of the strategy – **Global Dynamic Bond Income** – offers all the attributes of the core strategy but with a slightly more aggressive asset allocation; it can take punchier positions in the different sectors of the bond asset class.

Liquidity

The **Global Dynamic Bond strategy** can be used as a useful asset-allocation tool to counterbalance investments in more illiquid fixed-income assets.

Both **Global Dynamic Bond** and **Global Dynamic Bond Income** are liquid strategies, which means that investors are able to get rapid access to their investments should proceeds be required at short notice.

A number of credit strategies in the sector are unable to match the transparency and liquidity of these strategies.

Limiting volatility

For investors requiring a return with relatively low volatility, our core **Global Dynamic Bond strategy** seeks to limit drawdown at times of market stress and dislocation.

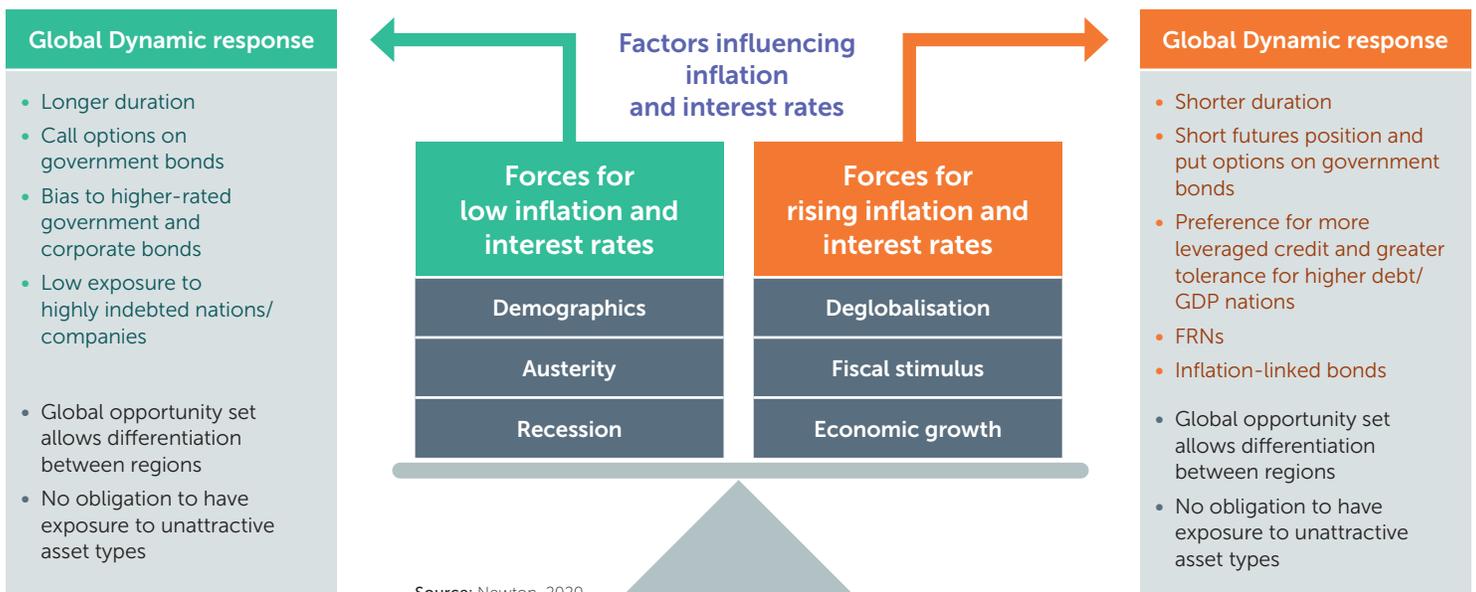
PROTECTION FROM INFLATION

With the general consensus that the global economy is slowly moving from a deflationary to an inflationary environment over the mid to longer term, both the **Global Dynamic Bond** and **Global Dynamic Bond Income** strategies have flexible mandates that allow them to offer a level of protection for their longer-dated bond positions from any return to an inflationary environment over the next two to five years.

The experienced team can use floating-rate notes (FRNs) and invest in other inflation-linked assets such as US Treasury Inflation-Protected Securities (TIPS). They also have the ability to flexibly reduce duration, which can help offer an effective counter to a return to an inflationary environment over the mid to longer term.

Exhibit 1 shows how the **Global Dynamic Bond strategy** has the ability to alter its approach to deal with low and deflationary environments (on the left-hand side) and for a return to a more inflationary environment (on the right-hand side).

Exhibit 1: Newton Global Dynamic Bond strategy in different market regimes



WHY AN ACTIVE, FLEXIBLE APPROACH BEATS A PASSIVE ONE

Bond indices are constructed by market capitalisation; the greater the volume of a country's issuance, the heavier its index weighting. As governments issue more debt, they become larger constituents of the index.

An index-based approach entails holding more of the debt of such issuers, regardless of the soundness of underlying fundamentals.

Unconstrained by an index – flexible by nature

The **Newton Global Dynamic Bond strategy** can invest up to 50% in any one of the four mainstream global asset classes:

- Government bonds
- Emerging-market sovereign bonds
- Investment-grade corporate bonds
- High-yield corporate bonds

It also has the flexibility to make opportunistic use of:

- Cash
- Derivatives
- Currencies
(minimum 50% in base currency)

WHY A GLOBAL APPROACH WORKS

After years of coordinated monetary and fiscal policies, individual countries are adopting different approaches to tackling the aftermath of the global financial crisis. As a result, considerable divergence in relation to monetary and fiscal policy, inflation and credit conditions between economies seems likely to lie ahead.

We believe investing in a range of bond and currency markets around the world should allow investors to benefit from the divergence we anticipate in interest rates, currencies and bond markets in general.

This approach takes into consideration where we are in the credit cycle and adjusts to the changing liquidity environment.

We believe it is possible to actively manage a mix of global bond markets to generate a positive return through the cycle. Creating a positive return from bond markets relies on adjusting exposure to a mixture of interest-rate and credit risk.

For a fixed-income absolute return strategy, we believe it is important to avoid losing money when interest rates are rising and when issuers are vulnerable to rating downgrades and defaults. Committing more capital to bond markets when the outlook has improved can be more beneficial. This straightforward approach is possible because we have an experienced team, with a tested process that is not constrained by committees and bureaucracy.

We also believe there are advantages in not being tied to an index, but using global market opportunities and risks to create a high-conviction portfolio of securities, backed up by themes and attractive fundamentals. We believe that the freedom to move dynamically between different regions and asset classes should help investors to weather bouts of market turbulence while remaining true to their long-term objectives.

Below, we set out our view on the challenging current environment facing bond investors, which we believe makes employing a flexible, unconstrained and dynamic approach to fixed-income investing more important than ever.



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Current environment

- Extremely low yields 
- Significant economic and political risks 
- Policy uncertainty – from quantitative to fiscal easing? 

Potentially dangerous strategies in current environment

- Index-tracking 
- Benchmark-orientated 
- Over reliance on narrow or less liquid segment of market 

Source: Newton, 2020.

FIXED-INCOME INVESTING THROUGH AN ESG LENS

Environmental, social and governance (ESG) factors have become increasingly important to investors who require more than simply a return on their fixed-income investments. Newton was an early adopter of sustainable fixed-income investing, having integrated ESG considerations into its bond investment process since 2010.

The core Global Dynamic Bond strategy has always scored favourably for its ESG credentials but the more recently launched sustainable version of the strategy scores very highly against its peers in the MSCI Fund Universe for its ESG metrics.

Exhibit 2 shows some of the different ways in which our ESG investment lens helps us to focus on making investments which we believe can contribute toward more positive environmental, social and governance outcomes over the longer term.

Exhibit 2: An example of what investors are looking for beyond just a return: Newton Sustainable Global Dynamic Bond strategy

ESG SCORE PEER PERCENTILE¹



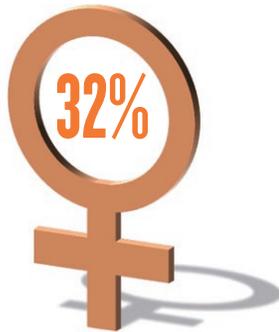
0: Worst percentile ← → 100: Best percentile

ESG SCORE THEME SCORE²



BOARD COMPOSITION

Average of **32% female directors** in holdings in the Newton representative portfolio.
Average **board independence** of holdings in the Newton representative portfolio is **76%**



TACKLING CARBON EMISSIONS⁴

The carbon intensity of the Newton representative portfolio is **84% less than the MSCI ACWI³**.
The reduction in carbon emissions on absolute terms is equivalent to:⁵



ENCOURAGING ENVIRONMENTAL IMPROVEMENTS

Average water reduction target set by each of the Newton representative portfolio holdings is **24%**



TARGETING EMISSIONS

Average emissions reduction target set by each of the Newton representative portfolio holdings is **53%**



Notes: 1 The overall strategy ESG quality score measures the ability of underlying holdings to manage key medium to long-term risks and opportunities arising from environmental, social, and governance factors; 2 Theme score of key issues considered by MSCI ESG Manager; 3 iShares MSCI ACWI ETF. Comparisons are made to demonstrate correlation only and are for illustrative purposes only; 4 This is estimated using ISS DataDesk based on £1 million AuM as at December 2019; 5 This is calculated using ISS data and the United States Environmental Protection Agency (EPA) Greenhouse Gas Equivalencies Calculator.

The representative portfolio adheres to the same strategy as the Newton Sustainable Global Dynamic Bond (GBP) Strategy. Each client portfolio is individually managed. Actual holdings will vary for each client and there is no guarantee that a particular portfolio will have some or all of the characteristics described in the representative portfolio shown.

Source: Newton, MSCI ESG Manager, April 2020. ©2020 MSCI ESG Research LLC. Reproduced by permission. Data covers corporate bonds only. MSCI Fund Universe peer group: Bond Global GBP.

CONCLUSION

We believe that **Newton's Global Dynamic Bond strategy** offers a liquid, low-volatility fixed-income option that has the flexibility to adapt to a more inflationary outlook while offering the prospect of a more lucrative alternative to cash for those asset owners looking to invest over the short to mid-term.

Its sister strategy, **Global Dynamic Bond Income**, offers a slightly higher-octane version of the core strategy for those who have a higher risk budget and want a higher pick-up above cash and prevailing low-bond yields. It also provides an option for those who require a low-volatility source of steady income.

For investors looking for more than simply a return on their investments, **ESG considerations** are integrated into the investment process of all our fixed-income strategies.



NEWTON GLOBAL DYNAMIC BOND STRATEGY

Key investment risks

Your capital may be at risk. The value of investments and the income from them can fall as well as rise and investors may not get back the original amount invested.

- **Objective/performance Risk:** The performance aim is not a guarantee, may not be achieved and a capital loss may occur. Strategies which have a higher performance aim generally take more risk to achieve this and so have a greater potential for returns to vary significantly.
- **Currency Risk:** This strategy invests in international markets which means it is exposed to changes in currency rates which could affect the value of the strategy.
- **Derivatives Risk:** Derivatives are highly sensitive to changes in the value of the asset from which their value is derived. A small movement in the value of the underlying asset can cause a large movement in the value of the derivative. This can increase the sizes of losses and gains, causing the value of your investment to fluctuate. When using derivatives, the strategy can lose significantly more than the amount it has invested in derivatives.
- **Changes in Interest Rates & Inflation Risk:** Investments in bonds/money market securities are affected by interest rates and inflation trends which may negatively affect the value of the strategy.
- **Credit Ratings and Unrated Securities Risk:** Bonds with a low credit rating or unrated bonds have a greater risk of default. These investments may negatively affect the value of the strategy.
- **Credit Risk:** The issuer of a security held by the strategy may not pay income or repay capital to the strategy when due.
- **Emerging Markets Risk:** Emerging Markets have additional risks due to less-developed market practices.
- **CoCos Risk:** Contingent Convertible Securities (CoCos) convert from debt to equity when the issuer's capital drops below a pre-defined level. This may result in the security converting into equities at a discounted share price, the value of the security being written down, temporarily or permanently, and/or coupon payments ceasing or being deferred.
- **Counterparty Risk:** The insolvency of any institutions providing services such as custody of assets or acting as a counterparty to derivatives or other contractual arrangements, may expose the strategy to financial loss.

NEWTON GLOBAL DYNAMIC BOND INCOME STRATEGY

Key investment risks

Your capital may be at risk. The value of investments and the income from them can fall as well as rise and investors may not get back the original amount invested.

- **Objective/performance Risk:** There is no guarantee that the strategy will achieve its objectives.
- **Currency Risk:** This strategy invests in international markets which means it is exposed to changes in currency rates which could affect the value of the strategy.
- **Derivatives Risk:** Derivatives are highly sensitive to changes in the value of the asset from which their value is derived. A small movement in the value of the underlying asset can cause a large movement in the value of the derivative. This can increase the sizes of losses and gains, causing the value of your investment to fluctuate. When using derivatives, the strategy can lose significantly more than the amount it has invested in derivatives.
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WANT TO FIND OUT MORE?

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