



# The Changing Landscape for Fixed Income Investors and the Rise of Structured Credit

April 2022

---



Insights and trends from over 100 leading institutional investors on fixed income asset allocation, the growth of structured credit, and the future of the fixed income market




# Introduction

---

The fixed income market has come under pressure over the past two years due to **rising inflationary pressures and interest rates** in the wake of the emergency stimulus packages unleashed to tackle the economic impact of the COVID-19 pandemic.

A clear sign of the pressure on the fixed income market was the number of bonds trading with negative yields – at one point at the end of 2020, **bonds worth over \$18 trillion** were trading with negative yields – and while yields are improving the search for alternatives to the fixed income market is continuing.

Many pension funds and other institutional investors have been **cutting back on their allocation to traditional fixed-income assets** such as corporate and government bonds, because of the poor returns. The investments have to go somewhere else, however.



A major beneficiary of the search for alternatives has been the structured credit market with growing interest in investment vehicles focusing on transportation, infrastructure, real estate, and private debt that can deliver robust income streams whilst having a **strong focus on capital preservation and lower correlation to risk assets**. The sector has also benefited from greater innovation, an improving regulatory environment and increased transparency.

We conducted independent global research with institutional investors across the US, UK, Switzerland, Sweden, Norway, The Netherlands, Germany, Finland, and Denmark, who collectively have around **\$440 billion in assets under management**, to find out their views and how they are investing.

The findings make for fascinating reading and provide an insight into **how pension funds and other institutional investors have changed allocations** and what they plan for the future.

# How fixed income allocations are changing

Over the past 18 months, many pension funds and other institutional investors have **reduced their exposure to traditional fixed income assets** such as corporate and government bonds because they have delivered poor returns.

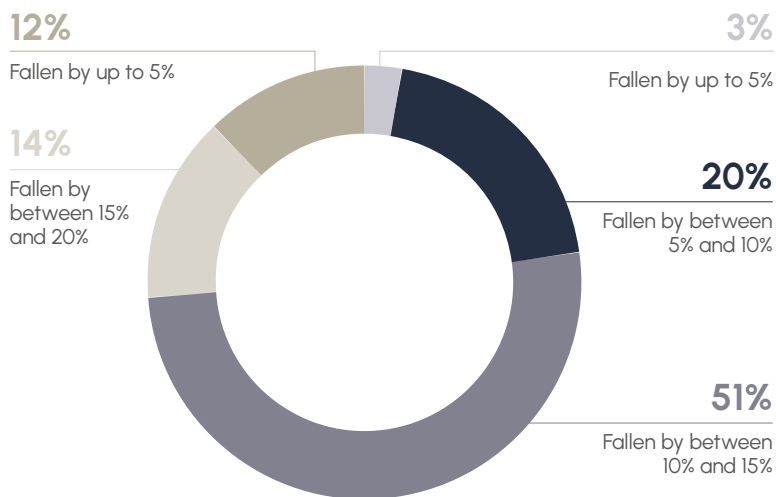


The research found nearly **one in four (23%)** had reduced their allocation to traditional fixed income assets over the past 18 months by **up to 10%**, and **51%** said they have cut by between **10% and 15%**. A **further 14%** have reduced their exposure by more, and **just 12%** say they have increased it.



## How have allocations to fixed income assets changed over the past 18 months?

### Number of pension funds and institutional investors



# Why have investors cut allocations?

Around **61% have cut** because of the **strong performance of equities** which meant they increased their allocation to this asset class. However, **53% said it was because of rising inflation** and the **threat of this continuing**, and **46% said it was due to falling valuations in fixed income assets**. Some **42% blamed poor yields** on many traditional fixed income assets.

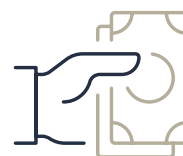


**25%**

of funds taken out of fixed income had been invested in structured credit-focused investments

Nearly **half (49%) of professional investors** interviewed said that at least **25% of funds taken out of fixed income** had been invested in structured credit-focused investments that offer attractive yields whilst preserving capital.

Some **57% said they had allocated this amount into private equity**, while 49% shifted money to commodities, 40% to real estate and 35% to equities.



**57%**

have allocated this amount into private equity

# The future for fixed income

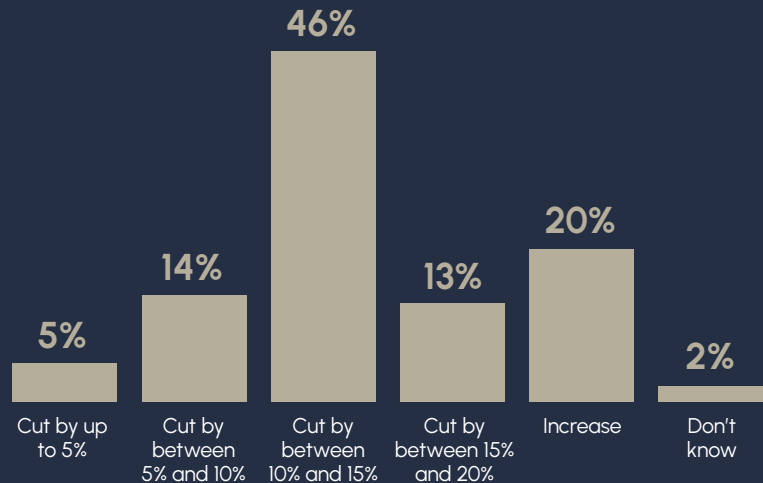
With inflation rising and interest rates increasing, the outlook for some traditional fixed income markets remains poor.

Over the next 18 months **78% of pension funds** and other institutional investors interviewed plan to reduce their exposure. **Around a fifth (19%)** said they expect to reduce their exposure to traditional fixed income assets by up to 10% while **nearly half (46%)** said they would cut it by between 10% and 15%, and 13% said they would reduce it by more. Only **one in five professional investors** interviewed (20%) said they expect to increase their exposure.



## How will allocations to fixed income assets changed over the next 18 months?

Number of pension funds and institutional investors



Nearly **73% of respondents** say that at **least 25% would go into equities**. Some **55% said they would allocate this amount to private equity**, and the same said this for real estate. Just over half said that **at least 25% of the funds** they plan to take out of traditional fixed income assets would be allocated to structured credit-focused investments.

# The rise of structured credit

Structured credit, when underwritten and managed appropriately, can provide an **attractive alternative to traditional fixed-income investments**, and that message is getting through to pension funds and other institutional investors.

Over the past 18 months **91% say they have increased their allocation to structured credit investments** across different asset classes and are likely to continue to do so in the next 18 months particularly in commercial real estate where **between 85% and 90% have done so**.



The corresponding figures for structured credit investment vehicles concerning residential real estate, specialist areas of corporate finance – **such as commercial aviation and shipping - and consumer credit** - student loans and auto credit/ leases for example - are **65%, 75% and 73% respectively**.

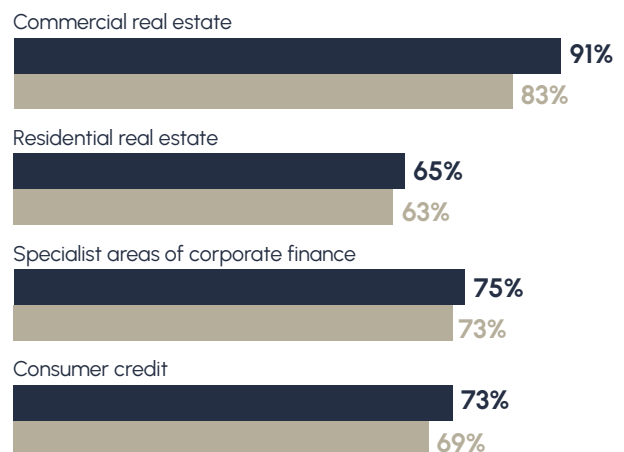


**83%**

of products focusing on commercial real estate

The majority intend to **increase their allocation** to structured credit investment vehicles focusing on these areas over the next 18 months. Some **83% of professional investors** interviewed said this about products focusing on commercial real estate.

## Structured credit investment vehicles that focus on these asset classes



Percentage of pension funds and other institutional investors who say they increased their allocation to these investment vehicles over the past 18 months

Percentage of pension funds and other institutional investors who say they plan to increase their allocation to these investment vehicles over the next 18 months

The **three main reasons** for growing interest in structured credit investment vehicles the research found were **greater innovation in the sector, an improving regulatory environment and greater transparency**.

# What structured credit issuers need to do

Around **86% of pension funds** and institutional investors questioned believe there will be more new structured credit issued in 2022 than there was in 2021.

However, those issuing the structured credit need to ensure they have a strong focus on ESG, as **80% of pension funds and other institutional investors** expect to place a greater focus on this over the next 12 months when selecting investment opportunities in the sector.

This explains why **36% of those interviewed** anticipate a dramatic increase in ESG factors accounting for rating actions concerning structured credit over the next 12 months, and a further **49% expect a slight increase**.

When asked to pick the most important features when considering whether to subscribe to a new debt issuance from an organisation, **53% selected energy efficiency** in their top three, and this was followed by **46% who cited energy consumption** and **44% who chose levels of recycling**.

How many investors believe it is the most important



**53%**

Energy efficiency



**46%**

Energy consumption



**44%**

Levels of recycling



**43%**

Staff turnover



**38%**

Emissions



**36%**

Workforce diversity



**29%**

Excluding non-ESG sectors



**11%**

ESG policies

When it comes to investing in structured credit, **34% of professional investors** said it is very important that the financial institution offering these co-invest in their investment vehicles with the same underlying risk and fee structure, and a further **63% said this is quite important**.

# Conclusion

---

The traditional fixed income market has endured a difficult period and **many investors clearly feel this is set to continue with rising inflation** and interest rates set to increase.

The outlook for fixed income remains mixed with continued inflationary concerns and tightening monetary conditions following a sustained period of emergency stimulus introduced during the pandemic. However, with alternative credit offering increasingly attractive risk-adjusted returns, we expect to see **further reallocation into this space from traditional fixed-income investments over the course of the year.**

One investment area that has benefited from this is structured credit focusing on assets such as transportation, infrastructure, real estate, and private debt. Investment vehicles in the sector **can deliver attractive returns on a risk-adjusted basis with lower levels of correlation to risk assets** when compared to many traditional fixed income assets.

The structured credit market has been enjoying strong growth relative to traditional fixed income assets as central banks begin to tighten monetary policy. The resulting **outperformance, improving regulatory environment, and increased transparency** means structured credit will likely continue to attract asset allocations.

We remain bullish over the medium term and expect structured credit to continue to outperform, particularly in commercial real estate and corporate credit. **Structured credit investment vehicles focusing on transportation, infrastructure, real estate, and private debt** that can deliver robust income streams whilst having a strong focus on capital preservation and lower correlation to risk assets.

Even through the worst of the Covid crisis, the **structured credit market grew**, and our research shows that **investors expect the number of issuances to increase further** this year. However, investors are becoming more demanding in terms of what they expect before they invest, particularly with regard to ESG factors.





# About the research

---

Aeon Investments commissioned the market research company PureProfile to interview **100 institutional investors** across the **US, UK, Switzerland, Sweden, Norway, The Netherlands, Germany, Finland** and **Denmark** who collectively have around **\$440 billion in assets under management**. The survey was conducted online in October 2021.



# About Aeon Investments

---

Aeon Investments is a **London based credit-focused investment company**. It originates, structures, and invests in **long-term, income-focused investments** on behalf of its stakeholders, families, foundations, institutions, and sovereigns.

Aeon employs a **relative value fixed-income strategy** and specialises in **structured credit in segments** that offer competitive returns on a risk-adjusted basis with lower levels of correlation to risk assets, specifically in the **real estate, infrastructure, transportation, and private debt sectors**.