

# Staying vigilant in Buy and Maintain credit portfolios

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## Key points

- Buy and Maintain strategies can offer investors many of the same benefits of more traditional active funds, while avoiding the pitfalls of passive investing
- They have a lower turnover and a longer-term investment timeframe, aiming to hold bonds that can perform throughout a market cycle
- These strategies can give investors the tools to potentially help them balance multiple objectives, from ESG goals to achieving resilient long-term returns

Buy and Maintain credit portfolios are often - and wrongly - thought of as being sleepy, 'set-and-forget' investment vehicles. But this is not the case; they are very much actively managed strategies with a long-term focus.

Their low-to-moderate turnover can still potentially yield many of the same benefits of more mainstream active funds and can simultaneously help investors avoid the pitfalls of traditional passive credit management.

Below we look at the benefits of active management, explain the key differences between Buy and Maintain and more traditional active strategies and look at how investors can 'get active' in Buy and Maintain.

## The benefits of actively managing portfolios

Our [recent paper](#) outlined the primary benefits of Buy and Maintain investing in credit, which include:

- The potential to help overcome the pitfalls of traditional passive credit investing by avoiding the inherent inefficiencies from the fixed index constituents (being forced sellers of downgraded bonds) and index construction - overexposure to bonds and sectors with the most debt outstanding)
- Actively monitoring and, critically, amending risk exposures over time in anticipation of long-term trends, or in response to short-term movements. In traditional passive strategies, the only quality control is delegated to third-party credit rating agencies
- The ability to integrate responsible investment considerations to achieve investors' financial and non-financial goals, such as net zero, biodiversity or social factors

Active management, either through a Buy and Maintain or a 'full active' strategy, allows investors to design their portfolios in a bid to avoid bonds which could be downgraded; manage the exposures of any downgraded bonds; and to continuously amend these exposures over time.

Additionally, active credit management also enables investors to balance multiple objectives and achieve a blend of the above benefits rather than focusing on just one; furthermore, none of these benefits are offered by traditional passive investing.

We believe each of these aspects should lead to actively managed credit strategies either outperforming passive credit strategies or performing in line with a lower amount of risk.

### How does Buy and Maintain differ from 'full' active credit management?

Buy and Maintain strategies are actively monitored and managed, which is important in terms of delivering both investors' financial and ESG considerations. However, Buy and Maintain strategies should still be distinguished from 'full' active strategies, although we recognise the lines are often blurred. We outline key differentiators below:

**Turnover levels:** The most obvious first differentiator is the average annual turnover rate – measured by the sales and purchases of bonds within a portfolio. In our experience, Buy and Maintain strategies typically have less than 25% turnover per annum whereas for active strategies it is often 50% per year or even more. Lower turnover can be associated with lower transition costs, helping to avoid the drag on total returns.

Of course, turnover is vital in any actively managed portfolio, to refresh investment ideas and adapt to changing market conditions. The question for investors here between Buy and Maintain and more traditional strategies comes down to the turnover's magnitude and whether it is to rebalance for future longer-term themes, or short-term opportunities.

**Investment timeframe:** But the difference goes deeper than a turnover number, which is often simply the output of the investment philosophy and process of each strategy. Buy and Maintain vehicles typically have a longer-term investment timeframe; they aim to hold bonds that can perform throughout a market cycle, rather than taking shorter-term tactical plays.

Throughout the investment process there is a heavier focus on credit fundamentals when selecting bonds rather than near-term relative value plays or technical drivers. Due to this long-term focus Buy and Maintain is typically more benchmark agnostic, has less of a focus on month-by-month performance and instead looks to outperform over the longer term. The low turnover is therefore a result of the investment timeframe, rather than a determinant of it.

**Client outcomes:** The outcomes investors seek also differ between Buy and Maintain and other active strategies – Buy and Maintain tends to, although not always, focus on downside risk mitigation while the latter often have a specific outperformance target to hit.

Many investors use Buy and Maintain as the stable, core holding within their fixed income portfolios given the potentially more predictable nature of the returns. Simultaneously they can use more traditional active strategies as the satellite 'alpha generators', effectively splitting credit volatility – i.e., beta - and alpha, noting however that many full active strategies can play a core part in investors' portfolio.

This stable nature is also the reason many cashflow-focused investors select the Buy and Maintain style. Additionally, many investors believe the long investment timeframe of Buy and Maintain can deliver more meaningful responsible investment outcomes. A lasting and ongoing partnership with underlying issuers can help deliver positive engagement outcomes, such as setting and executing a credible decarbonisation objective over several years.

### Being active in a low turnover Buy and Maintain credit strategy

There is a clear and very meaningful difference between Buy and Maintain and passive credit fund management, and this can be split between the active investment process, re-shaping portfolios and proactive communication with clients.

One of the most important aspects of active management is the security selection and portfolio construction undertaken in the investment process. This process is similar across full active and Buy and Maintain portfolios, with the difference in timeframe and fundamental focus already described above.

Taking well-measured and targeted risk exposures helps to achieve the Buy and Maintain strategy's targeted financial objectives such as improving risk-adjusted returns or yield and spread enhancement. Getting the portfolio ramped up and optimised for potential future scenarios is one of the most critical aspects of being active.

Included within this active investment process is also the ongoing monitoring of risks and opportunities – taking into consideration the credit analyst, macroeconomic and investment analytics teams' views of issuer-level, central bank, and portfolio-specific risks.

The active monitoring of risks and opportunities is what ultimately provides a portfolio management team with information to reshape the portfolios as they see fit and distinguishes this active approach from traditional passive management.

## Using natural cashflows and active turnover

While the investment process provides the information required to take active positions, natural cashflows and active turnover are the real tools portfolio managers can use to re-align client portfolios – here's how:

**Bond maturities:** Credit portfolios benefit from the natural cash injections they receive from the proceeds of bond coupons and maturities. For a typical global credit portfolio this amount could be 5% to 10% per year, more than enough to take advantage of the new issuance market premiums and to direct into attractive sectors, currencies, or issuers in a cost-effective manner. Actively laddering the differing maturities of the bonds invested in helps to provide a regular natural income stream and avoid any gap risk in those cashflows and is a critical component for efficient and active bond portfolio management.

**Client flows:** Client flows into or out of portfolios can also be used to re-align the risk exposures, provide some yield enhancement, and help to achieve any responsible investment objectives. Many clients choose to top up their Buy and Maintain portfolios when market yields or spreads are wide relative to historical levels or when dispersion appears across markets.

The magnitude of these flows can be material (more than 25% of current portfolio size) when investors are altering their strategic allocation or looking to deploy excess collateral and therefore can have a meaningful impact in capturing new opportunities. Recent examples include the COVID-19 crisis (when US dollar-denominated bonds were cheaper than their peers) or the UK crisis around liability-driven investment when sterling bonds were cheaper.<sup>1</sup>

**Active turnover:** Active strategies are continuously looking for new opportunities across markets. A moderate amount of carefully considered turnover could be due to concerns about the fundamental viability of an issuer, for responsible investment concerns, or simply to improve the yield/spread and therefore potential future returns of the portfolio.

Having said this, we do not trade simply to squeeze out marginal returns/spread at the expense of achieving consistent and sustainable returns for our clients. We understand the larger picture of where Buy and Maintain portfolios fit within clients' total portfolios. For all the bonds we buy, we would be comfortable holding them to maturity and this is indeed the intention at purchase. However, as described, there are numerous reasons why this is not always the case.

## The upshot

The active monitoring and management of Buy and Maintain credit portfolios can potentially yield many benefits to investors, including managing portfolios to anticipate long-term trends and adapt to the ever-changing market conditions. Investor outcomes vary between Buy and Maintain and full active strategies, with Buy and Maintain focusing more on the predictability of returns and credit fundamentals.

While Buy and Maintain strategies typically have a lower turnover because of this long-term focus, alongside natural cash and client flows, this more moderate turnover provides an opportunity to realign risk exposures and achieve ESG objectives.

Proactive communication can also play a role in delivering better client outcomes through highlighting attractive market opportunities.

Overall, Buy and Maintain strategies provide investors with the necessary tools to potentially help them balance multiple objectives, avoid traditional passive pitfalls, and aim to achieve resilient long-term returns.

<sup>1</sup> [Gilt trip: Lessons for institutional credit investors from a UK liquidity crisis](#), AXA IM, October 2022

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