

Pro Spotlight: Accounting for Clients Unique Needs

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As senior investment strategist and head of Pension Strategy for Allspring's Global Client Strategy team, **Andy Hunt** is focused on developing tailored fixed income solutions. His experience in actuarial science gives him an edge in accounting for the unique needs of each client.

Q: HOW DID YOU SHIFT FROM ACTUARIAL WORK TO BUILDING FIXED INCOME SOLUTIONS FOR INSTITUTIONAL INVESTORS?

A: That's really been the focus of my whole career. I started on the consultant side, doing asset-liability modeling and client-specific asset allocation. It quickly became apparent to me that the fixed income allocation needs to be much more client specific. Its composition can and should be much more based on client-specific liabilities and outcome goals. That's not the case for the composition of the equity piece, which can be similar for most investors.

It's a natural area for a recovering actuary or mathematician to end up, working on that dimension of risk management and appropriate fixed income exposure. I think that experience provides great discipline in understanding the fixed income market from the client's point of view, whether that's a property casualty insurer, a life insurer,

a pension plan sponsor, or an individual desiring retirement income. The different liability streams call for different approaches to investing fixed income capital.

Q: WHAT IS IT ABOUT FIXED INCOME IN PARTICULAR THAT CREATES SUCH NEED FOR TAILORED SOLUTIONS?

A: Fixed income has two basic dimensions, both of which can be scaled—anywhere from zero to a large amount. First is Treasury exposure and duration because, as the risk-free rate, it has beneficial characteristics that tend to be unique and different from return-seeking assets. Then you've got the credit dimension, which is everything that sits on top of the risk-free rate. They both have significant range, and they both matter a lot in creating an appropriate fixed income portfolio for each client.

The fixed income world is also a lot more nuanced and fragmented than the equity world, but bond math applies to all of it. I think the discipline of a client solutions approach is to apply that bond math to reflect the client's idiosyncrasies and create a model that can be readily understood and efficiently applied. So while there's a lot of market complexity, the solution doesn't have to be complex.



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And then there's the benchmark landscape, which is very different from that of equities. Issuers dictate what's in the market; the bond indexes just sweep it all up and investors buy it. We help clients by starting with their needs, so they buy what they want and what suits their needs rather than what the market wants to sell. That general discipline applies to both the portfolio design element and the actual implementation. Portfolio design is all about the benchmark—it's the top-down point of view that focuses on risk and opportunity capture—whereas implementation is how you buy bonds to add value versus the benchmark. I firmly believe there's a lot of scope for added alpha in fixed income because of the perpetual market inefficiencies. It's worth the effort because of the potential to both lower risk and add return. The best portfolios are much better than the average ones.

Q: WHY DO YOU THINK IT'S IMPORTANT TO TAILOR THAT FIXED INCOME EXPOSURE?

A: So, there are layers and nuances beneath those big concepts of duration and credit. For example, on the duration side, we work with some corporate pension plans that want to hedge their assets to their liabilities. That's a big part of risk management. But how much do you hedge? Should it be 50%, 75%, or 100%—or even more? There's also the shape of the yield curve. Is it flattening or steepening? That's become an interesting conversation recently because the yield curve had been incredibly flat and has now reverted to a more normal steepness. That also changes the dynamic for liability-driven investing. Is this the time to lock down on that steeper profile? We can help corporate pension plan sponsors think about how and when to approach it.

Credit, on the other hand, has become very expensive, and spreads are historically thin. Should you diversify your portfolio? Can you broaden your credit exposure or broaden the opportunity set to allow your managers to create value for you? In a world of tight credit spreads, alpha opportunity capture has become more important to more of our clients. And there are different ways to find alpha. So, you might seek alpha from a complementary process that's diversifying to your existing managers. How you create that complementarity is important, especially if you have multiple managers. That's why we look to deliver investment processes that are deliberately different by design in how they create value. There are lots of layers to both duration and credit that call for a tailored solution.

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Q: HOW DOES THE ROLE OF FIXED INCOME DIFFER BETWEEN PUBLIC AND PRIVATE PENSION PLANS?

A: Public and private pension plans have very different needs, largely due to their liability valuation and accounting treatments, and the role of fixed income in their portfolios reflects this. Corporate plans have mark-to-market liabilities, which means the liabilities exhibit duration risk. The assets they hold should also reflect this mark-to-market risk by matching the asset and liability durations.

Public pension plans don't mark-to-market their liabilities. Their liabilities are still long-dated, but duration risk is not so apparent and, hence, portfolio needs differ. Because these plans tend to invest heavily in illiquid assets, like real estate and other private market assets, their fixed income portfolios should be oriented to provide a strong liquidity source and a countercyclical strength when volatility rises, thus enabling and supporting their long-term exposures.

Q: HOW DO YOU SEE FIXED INCOME SOLUTIONS CONTINUING TO EVOLVE?

A: The industry has made a lot of progress around customizing fixed income to meet investor needs. We see a stronger architecture of innovative approaches, improved indexes, and better products. But, the attention of many investors is on other matters, and they gravitate to simple, mainstream fixed income benchmarks, even though a tailored solution could better suit their needs. I believe there is a lot of scope for mass tailoring. This does not have to be complex or costly. Technology can make solutions more accessible to more investors. Yes, there is an ongoing need to build knowledge and understanding of fixed income markets in general as they can seem complex, but that is the task we are taking on, and I believe we are slowly winning the game.

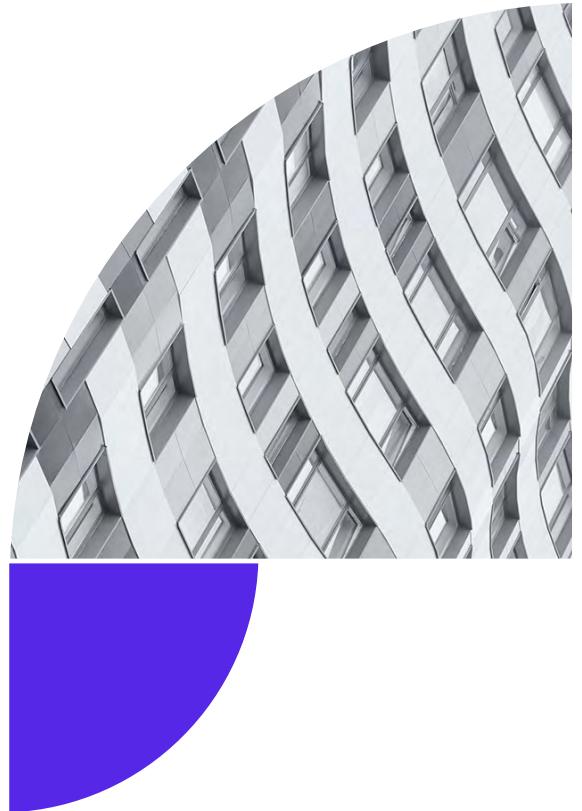
The greatest unmet need for tailored fixed income solutions may be among 401(k) plans, to meet the demands of young participants all the way through to those in retirement. I feel they're still served generically overall, as though they have the same investment needs and challenges at all ages. But, by virtue of their life stage, accumulated assets, composition of investments, and risk tolerance, they really encapsulate the notion of a changing investment need—and one in which a tailored fixed income portfolio can add value over time. I think technology will play a part in advancing new plan solutions as well as education, but the potential upside for millions of participants—and ultimately retirees—is undeniable.



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