

Sustainable Multifactor Bond Investing - CFA Society VBA Netherlands

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Credit is the final frontier of factor investing

	Value	Quality	Momentum	Mean reversion	How to get exposure
EQUITY	<ul style="list-style-type: none"> ▪ Liquid Instruments (stocks, futures, forwards) ▪ Low Transaction Costs ▪ Electronic Trading ▪ Good Data Availability (decades of public history) ▪ Plentiful Academic Research ▪ Simple Single Instruments 				Factor Mutual Funds Factor ETFs CTAs Hedge Funds
COMMODITIES / FX					
RATES					
CREDIT	Illiquid, hard to short, many bonds per issuer and under-researched by academia				Fidelity Bottom Up Systematic Credit Strategies

Source: Fidelity International, 2021.

The solutions to factor-based credit investing

Issues with factor investing in credit



Hard to Short



Less liquid and more costly to trade



Lack of data



Complex instruments and structures



Under-researched

Multifactor Credit Approach

Cannot do long short in credit. Has to be a long only solution.



Electronic trading is becoming more common. Transaction cost consideration is vital.



Rely on fixed income expertise and intelligent mappings/techniques



Focus on the issuer level to start with and worry about the bond selection separately

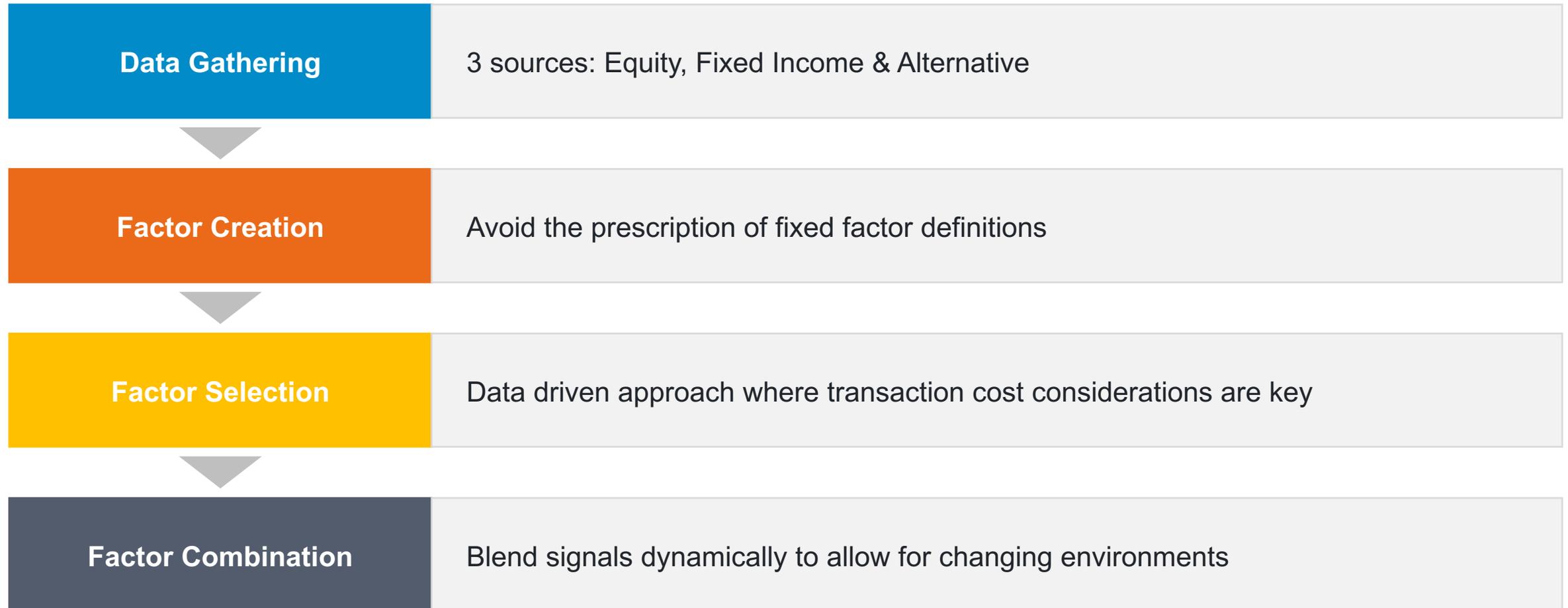


Distinguish between issuer and bond-level selection



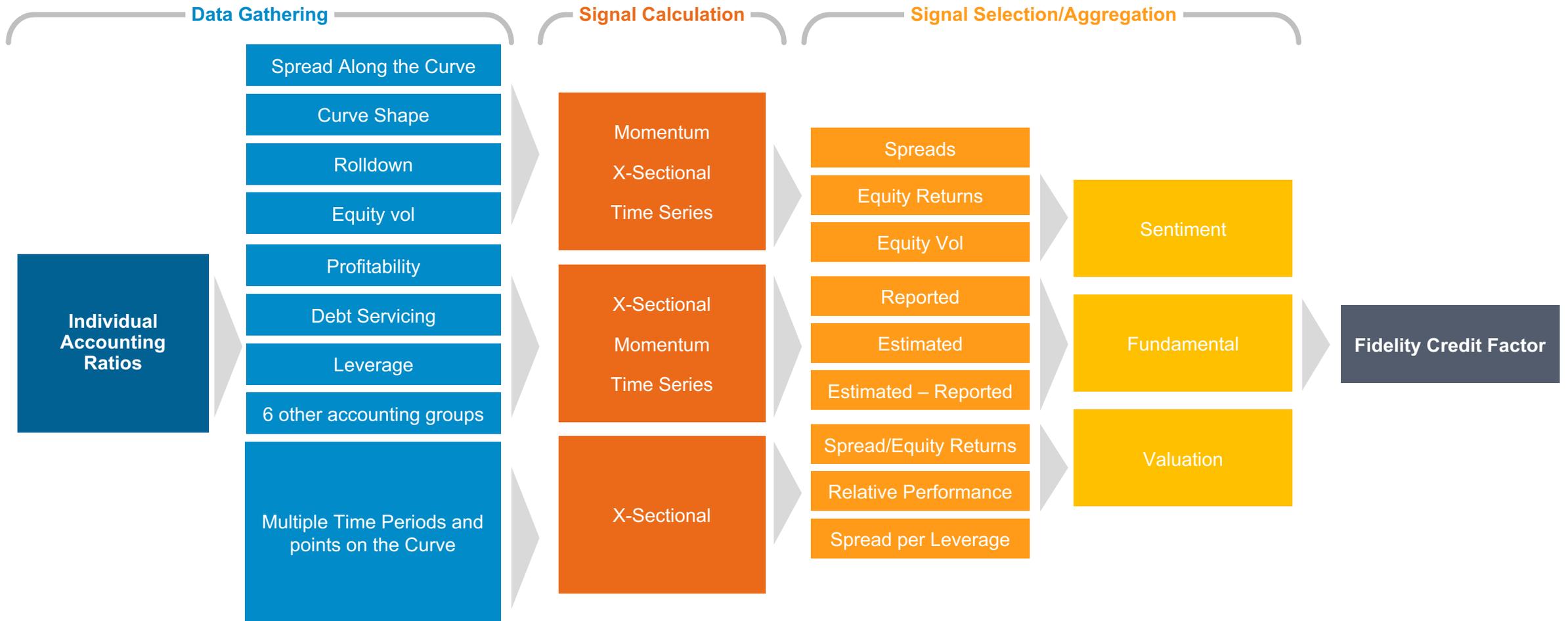
Source: Fidelity International, 2021.

Key elements of the factor construction process



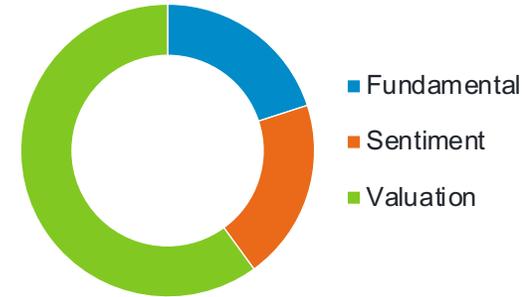
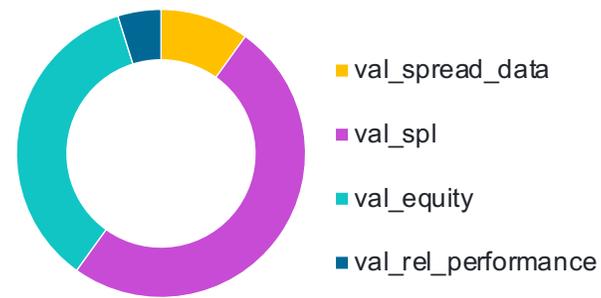
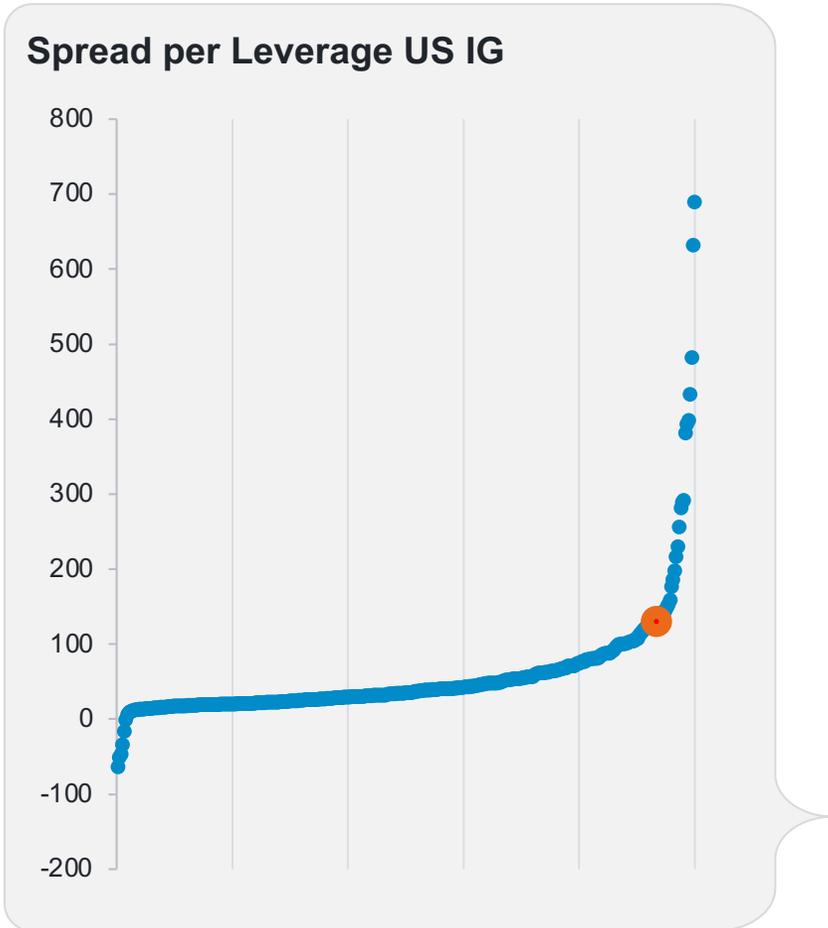
Source: Fidelity International, 2021.

Fidelity's Credit Factor construction in detail



Source: Fidelity International, March 2021.

Issuer factor creation example – Amgen Inc.

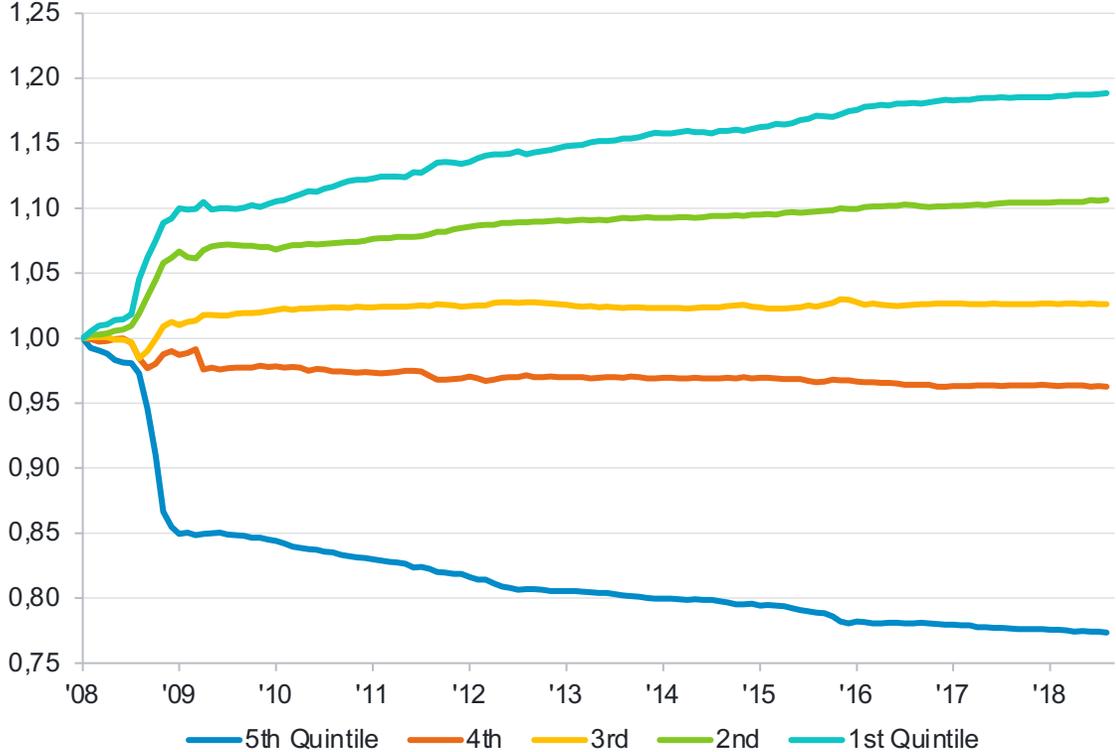


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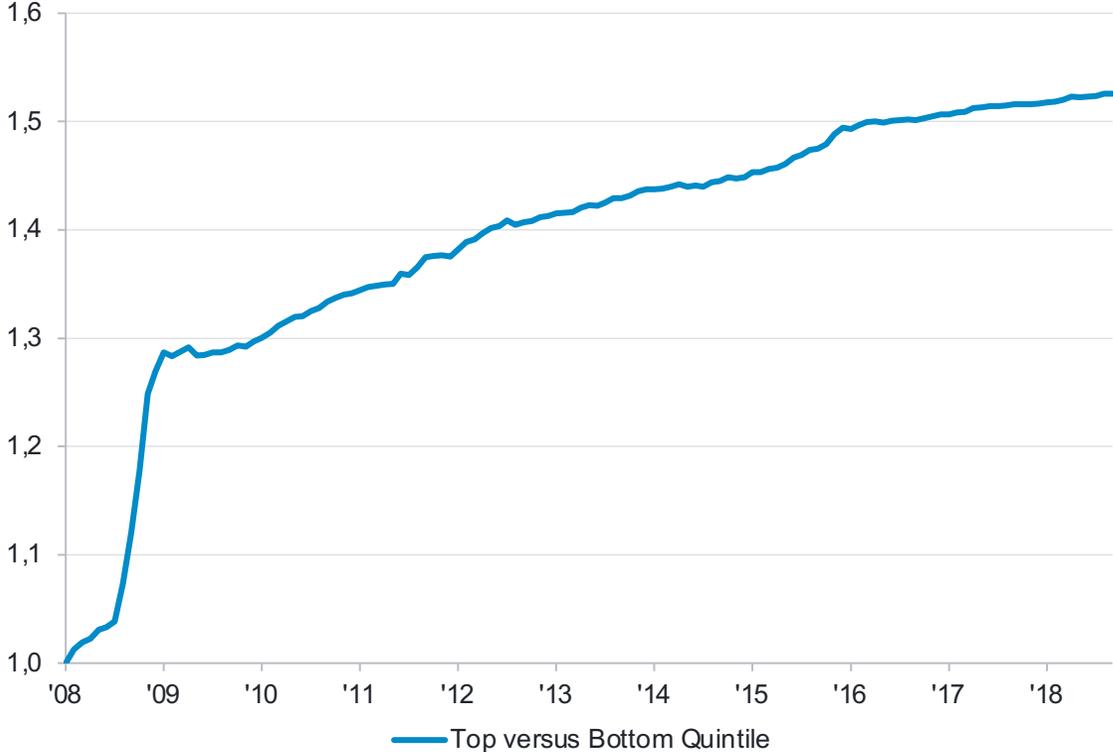
Source: Fidelity International, March 2021.

A multifactor credit approach to identify issuers

Quintile Performance of Overall Credit Factor



Top versus Bottom Quintile

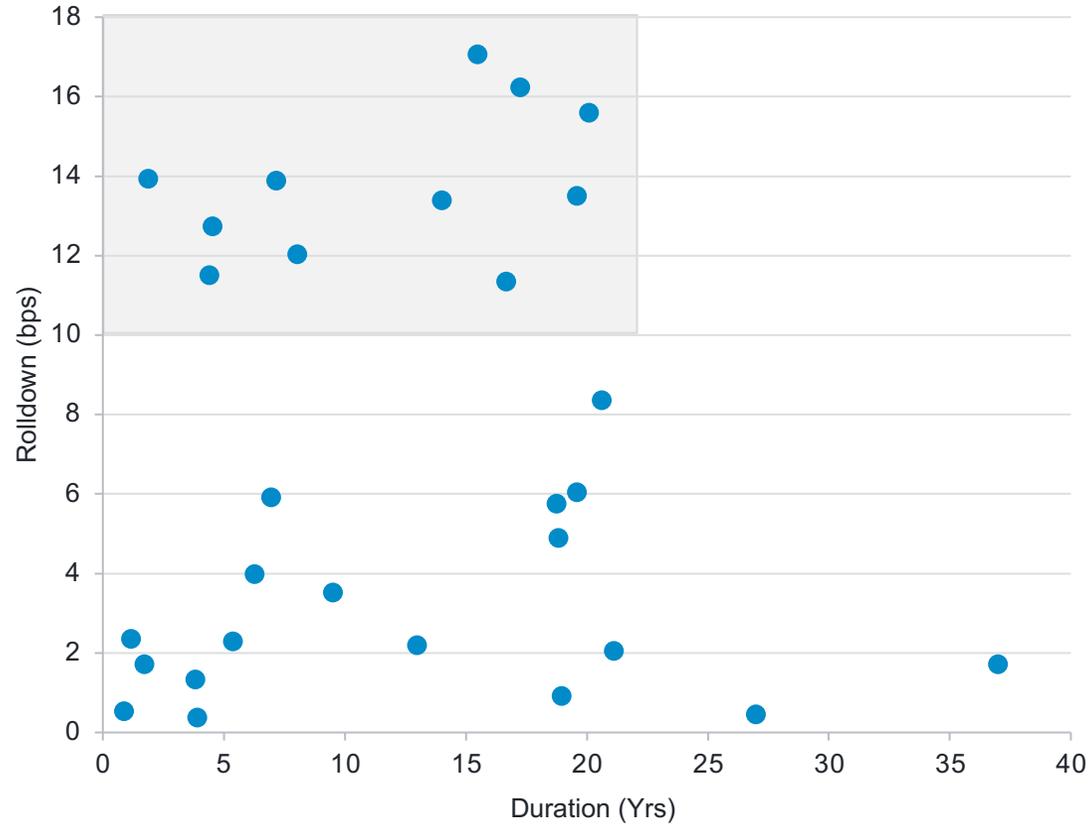


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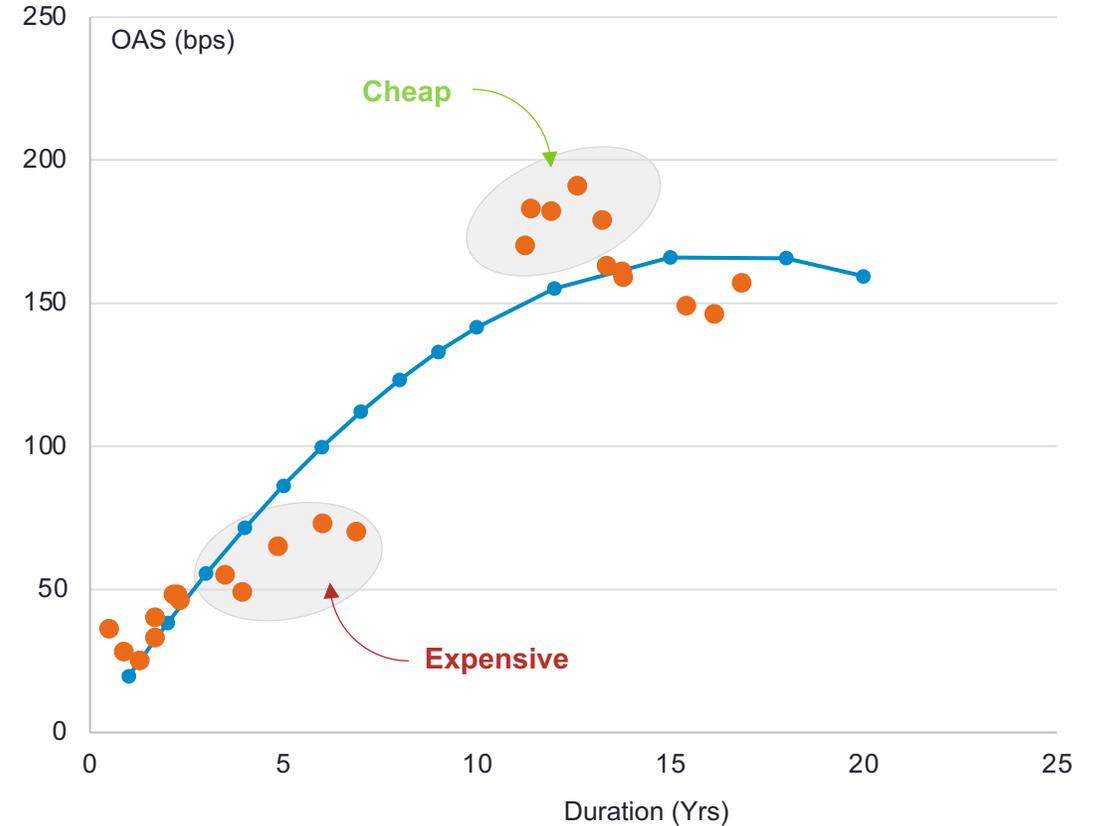
Source: Fidelity International, January 2021. Data from January 08 to September 18. Splitting the USD IG universe by quintile (on a issuer level) shows that the performance of the top quintile is far superior to the bottom quintile.

Bond selection example – Amgen Inc.

Bond Roll Down vs duration



Bond Residual



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Source: Fidelity International, March 2021.

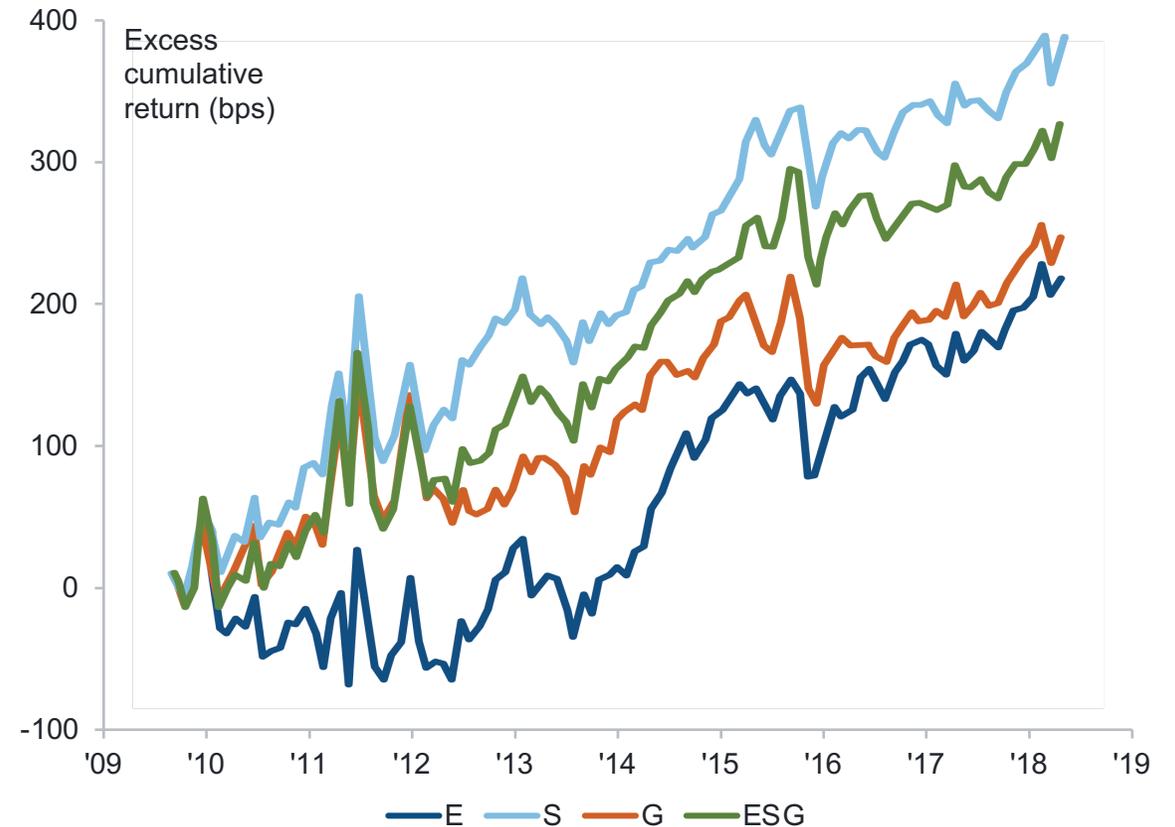
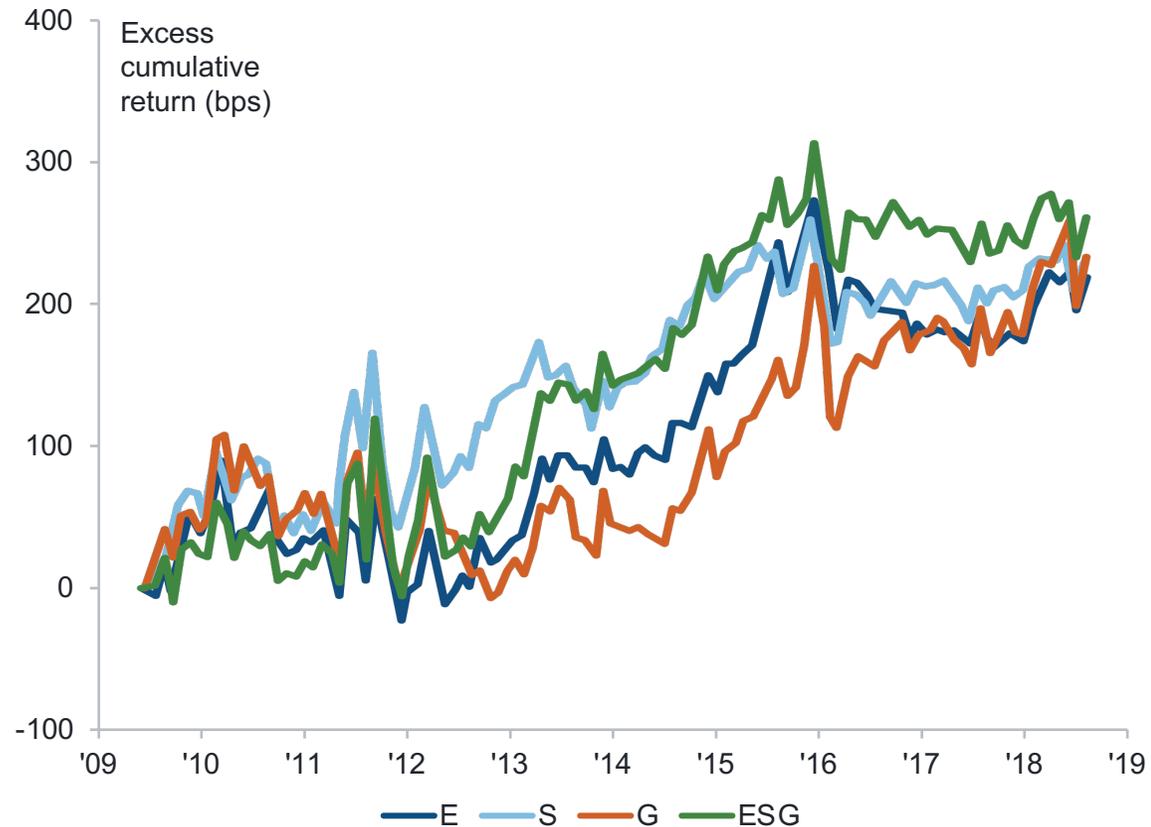
Portfolio construction: Maximise exposure to factors



Source: Fidelity International, March 2021.

ESG Factors Can Drive Portfolio Alpha

Environmental and Social ranks have been good signals of future bankruptcy risk



This example uses assumed figures and is for illustrative purposes only. Past performance is not a reliable indicator of future results. Returns may increase or decrease as a result of currency fluctuations.

Source: Fidelity International, Sustainalytics, "The impact of ESG investing in corporate bonds" published July 2018. Full paper available under <https://www.fidelityinstitutional.com/en/the-impact-of-esg-investing-on-corporate-bonds-cf89bb/>

Incorporating Fidelity Sustainable Family criteria

Fund Sustainability Aims



ESG Rating

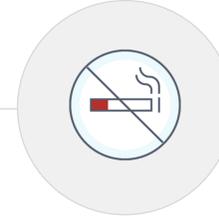
- Min 70% of portfolio rated BBB min by MSCI and exclusion of CCC
- Tilt towards better ESG ratings
- Screens based on Fidelity ESG internal rating



Carbon footprint

- Lower carbon emissions than benchmark

Firm Wide & Sustainable Family Exclusions



Business activity

- Exclusion of:
- Cluster munitions and landmines (firm wide)
 - Weapons
 - Tobacco
 - Thermal Coal



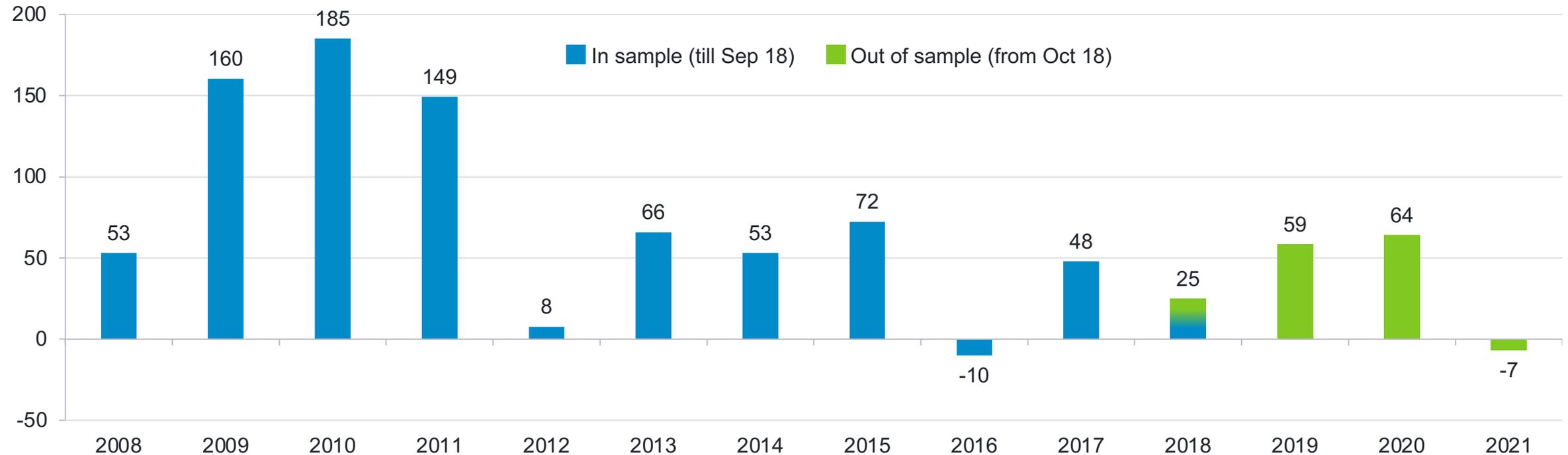
Global norms

- Exclusion of UN Global Compact violators

Source: Fidelity International, March 2021. Violators of UNGC determined using third-party data in conjunction with Fidelity Analysts. Fidelity sustainable ratings scale (A-E) and fundamental ratings scales (Strong Buy – Strong Sell). A minimum 70% of the fund's net assets will be invested in securities that maintain sustainable characteristics. This typically consists of companies with MSCI ESG ratings of AAA-BBB, or if unrated by MSCI, rated A-C by Fidelity for sustainability. MSCI rates issuers on a AAA-CCC scale according to their exposure to industry specific ESG key issues and their ability to manage those issues relative to peers.

Steady returns, even through tough markets

Simulated gross alpha Global Corporate Bond - in basis points, after transaction costs



Simulated past performance is not a reliable indicator of future results. The value of investments and the income from them can go down as well as up and investors may not get back the amount invested. Returns may increase or decrease as a result of currency fluctuations.

The effect of transaction costs is included. The effect of fees is not included.

Source: Fidelity International, March 2021. Performance in USD, monthly data 31 December 2007 – 31 January 2021. Simulation was based on proposed strategy. The data is purely representative and holdings in the fund may vary. Benchmark: Bloomberg Barclays Global Aggregate Corporate Bond Index.

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