DISCUSSION ON

LESSONS LEARNED FROM MARKET IMPACT OF THE PANDEMIC

BMCG September 2020

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New Normal ?

Thoughts from a LDI investor perspective

Lessons learned ..(any ?)

- Similar patterns and sequence. If markets stop central banks come in
- Fundamentals matter less, Risk taking is awarded
- Dislocations can persist for long
- New quality of liquidity crunch in rates cash and derivatives markets advocates full focus on functioning repo markets to limit liquidation pressure, spillovers

Market environment - what is new ? what is normal ?

- Lower rates for longer. Anchored in front & flatten the curve
- Monetary policy, policy and regulatory support for real economy and for markets
- Higher uncertainty at global scale

Investment Perspective - What does that mean ?

- Higher uncertainty, lower attractiveness of volatile and risky assets
- Rates lower for longer in highly convex LDI context supports duration extension
- Compressed Spreads in business context increase yield and income challenge
- Portfolio rotation for regulated investors means acting rationally in context of capital framework and fundamentals
- Focus on strategy review : Real estate (office, hotels), Equity (tech), Corporate Credit (exposed sectors)
- LDI investors have whort term advantage (less prone to cyclical) long term challenge (business model)

Debt Markets – Implications and Trends

Fixed Income Market Segments

Sovereigns and Swaps

- March standstill in most liquid market of the world. Little price discovery. liquidity premium in markets are too low
- New EU debt will become a benchmark for safe duration exposure in portfolios
- Derivatives : challenge is margin calls not tradable volume. Repo market is critical.

Corporate Credit

- IG Benchmark universe solid, companies well funded partially thanks to politics and monetary policy support
- In the long run economy decline may lead to larger increase of defaults (notably HY sector), but refinancing shocks likely limited compared to previous cycles, depend on central bank tolerance
- TLTRO: low incentive for banks to issue debt leads to scarcity (covered bonds, senior)

Alternative Debt

- Real Estate : big focus on office (configuration / valuations), Hotels, Airports
- Infrastructure performing well, opportunities in PPP and distressed
- Due diligences delayed (some) and re-designed. First virtual due diligences. Benefit for larger Asset Managers ?

ESG

- Megatrend. Real world development political/ regulatory reaction
- Portfolio alignment with ESG despite crises. Carbon neutrality a main focus (Net Zero Asset Owner Alliance)
- Sector impact: avoid stranded assets / capture new opportunities

Operations

- Physical presence in the offices still <50%. Qualitative assessment on shift to virtual is positive
- No operations related issues with performance so far

Points for Discussion

New Normal after Covid-19 – lessons learnt and impact on financial markets (structure, trends)

- What is the learning by markets from the crisis that helps to prevent a next one, similar in nature ?
- Has the market accepted that these extraordinary measures are temporary ?
- What severance of potential refinancing shocks are central banks willing to tolerate ?
- Will issuance and Client Demand Turn More Green?
- Crowding out ? What if foreign investors leave the Eurozone and Europeans move to US, EM,.. ?
- Has leverage sustainability increased structurally given lower rates, liquidity support, moratoria, insolvency delays ?
- In US defaults double from Europe. What role does support for corporates vs individuals play ?
- Evaluate political implications on CDS