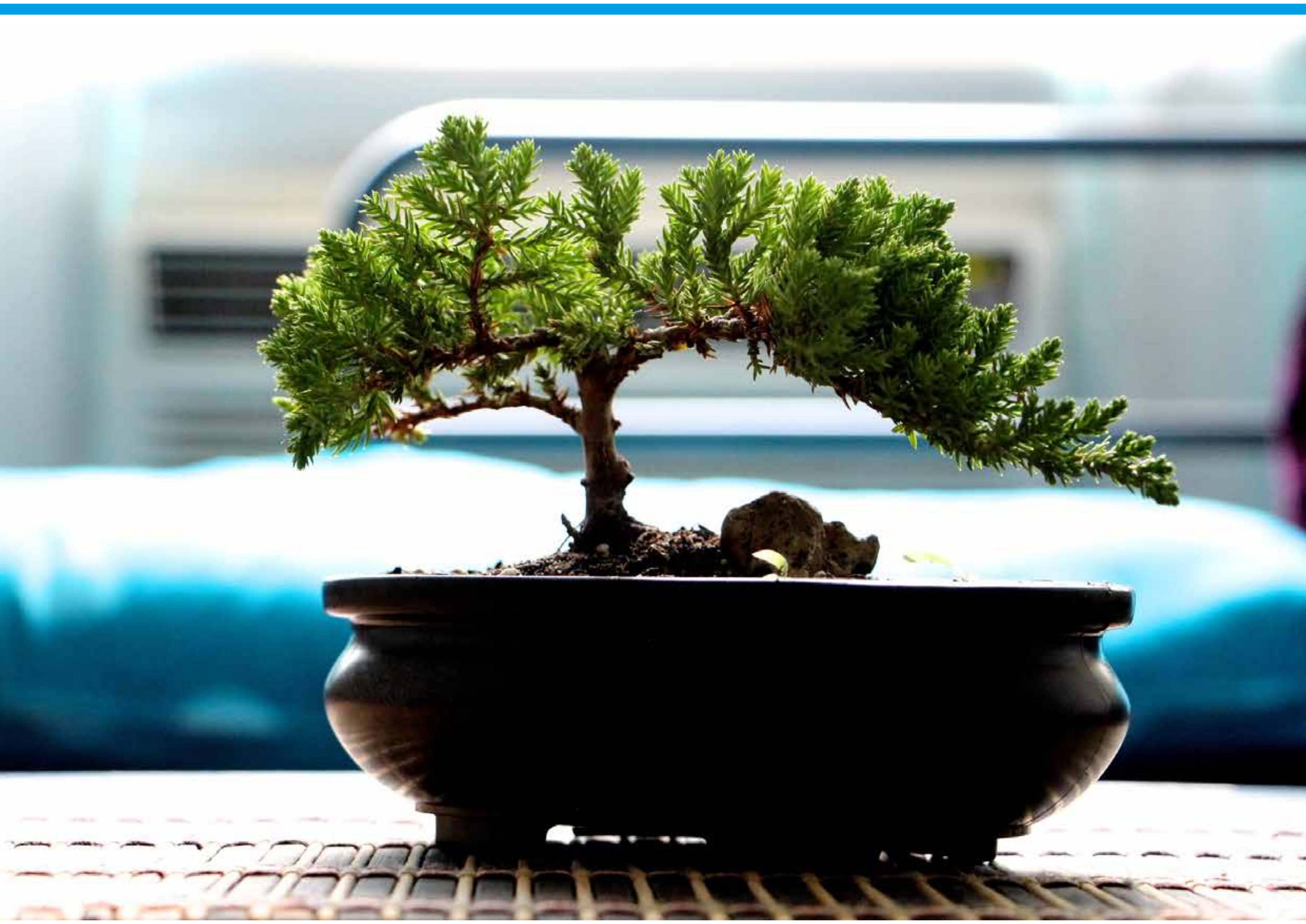
For Investment Professionals

Global fixed income

Buy and Maintain Credit

Generating cashflow, preserving capital and harnessing long-term credit risk premium



INVESTMENT MANAGEMENT

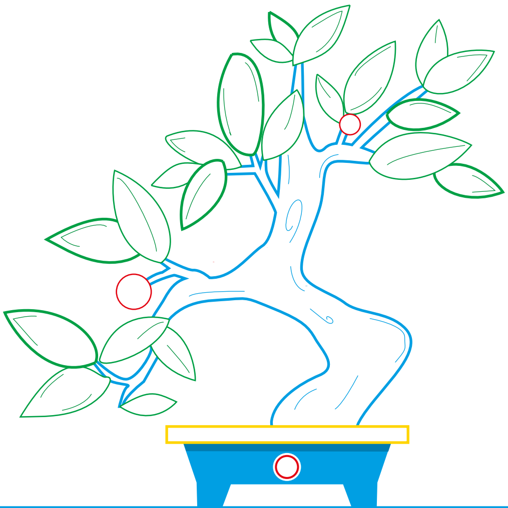
What is buy and maintain credit?

Buy and maintain credit investing is focused on efficiently capturing the credit risk premium available in fixed income markets whilst preserving portfolio value over time.

This type of investing differs from many other actively managed portfolios as it does not seek to deliver performance relative to a market value weighted benchmark. Bonds are specifically selected with the expectation that they will be held to maturity. They therefore need solid fundamentals. In a similar vein, turnover is low, with trades not influenced by systematic factors such as downgrades or index rebalancing.

Trading tends to focus on selling bonds at risk of considerable downside and buying those with improving fundamentals. Preserving the future value of the portfolio remains the key objective throughout.

The table below compares key characteristics of a buy and maintain strategy with passive and typical fully active investment approaches.



Key characteristics

Strategy	Passive	Fully active	Buy and maintain
Return target	Index return	Index return + performance target	Return based on initial yield or spread
Investment time horizon	Driven by index rebalancing requirements	Rolling 3-year periods	To maturity / 5 years+
Risk profile	Risk reduced relative to benchmark	Risk limits relative to benchmark	Risk viewed on an absolute basis
Stock selection process	Systematic / rules based	Manager discretion Strategic and tactical positioning	Manager discretion Strategic positioning
Turnover	Driven by index rebalancing requirements	Medium to high, typically 100%+	Low
Duration	Index duration	Manager discretion Strategic and tactical positioning	Tailored to client needs
Costs	Low	Standard active fees	Typically between passive and active

How can pension schemes use buy and maintain?

1) Generate cashflows

Buy and maintain credit places emphasis on bonds with a higher certainty of cashflows that can be used to help match a pension scheme's liability profile. Buy and maintain credit can act as the foundation to a cashflow matching strategy.

2) Diversification

Buy and maintain credit strategies are typically benchmark agnostic, this enables freedom to ensure allocations are truly diversified by sector, issuer and region.

3) Efficiently allocating to corporate bonds

Being free of traditional index rules means that these strategies do not need to change allocations based on movements of corporate bond benchmarks. This can reduce transaction costs and avert the need to sell bonds that are unlikely to default.

Our approach to buy and maintain

When we manage buy and maintain credit portfolios, we focus on three main areas:

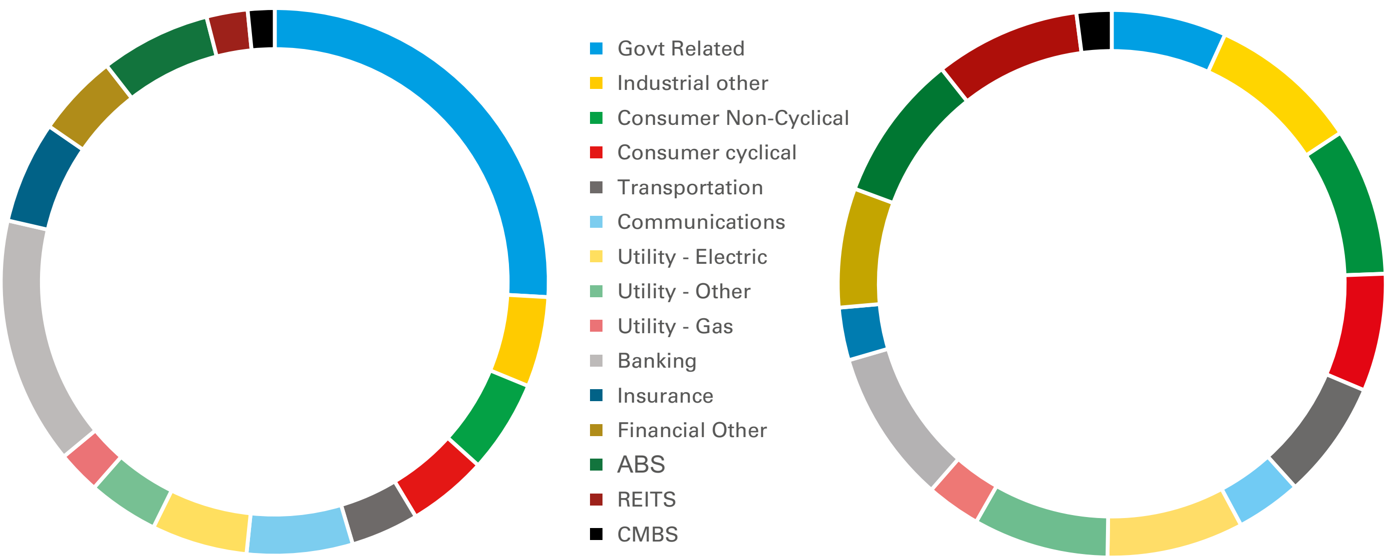
Global diversification – A global approach enables us to build in more diversification, focus on preferred issuers and take advantage of relative value across regions. This is important because in a sterling-only issuer universe issuer and sector concentration is higher than it would be under a global approach.

Low turnover – Our strategy will only sell and replace a bond if our long-term view of the bond deteriorates significantly. Our focus is making sure that any trading in the portfolio is considered extremely carefully to avoid unnecessary costs.

Value preservation – Protecting the capital within the strategy is the number one priority. Within the credit market is it possible to take a lot more risk for only a little more expected gain. For this strategy, we understand that the cashflows being generated by the bonds are being used to pay your pensioner payments.

Typical market-value weighted index sector allocation

Typical buy and maintain sector allocation



Source: Markit, iBoxx Non-Gilt Index, Barclays and LGIM internal data, as at 31 December 2017

Portfolio construction

Our buy and maintain investment process has two distinct parts – the buy process which determines initial portfolio construction and the maintain process which covers portfolio monitoring, decisions about when to sell securities and when to hold them, plus how to replace the value of bonds that have been sold.

Buy – In line with your scheme's cashflow needs, we prefer to invest in strong cashflow-generating companies within fixed-asset heavy, high barrier-to-entry industries.

The process uses LGIM's top-down macro thematic views and bottom-up issuer-selection. Fundamental credit research is a key aspect of our approach; to help preserve your scheme's long-term capital we place emphasis on credit quality over technical market conditions.

We specifically select bonds with the expectation that they will be held to maturity and therefore they need to have solid fundamentals as well as reflect our longer-term investment themes.

Maintain – Although it is our intention to hold bonds to maturity, we will replace a bond if we become concerned about severe downside risk in a specific security, sector or region. The key decision here is when to sell and when to hold. When replacing a bond, we focus on preserving the overall value of the portfolio whilst monitoring the risk levels.

Buy process

Construct portfolio to reflect long-term thematic views of the LGIM investment process.

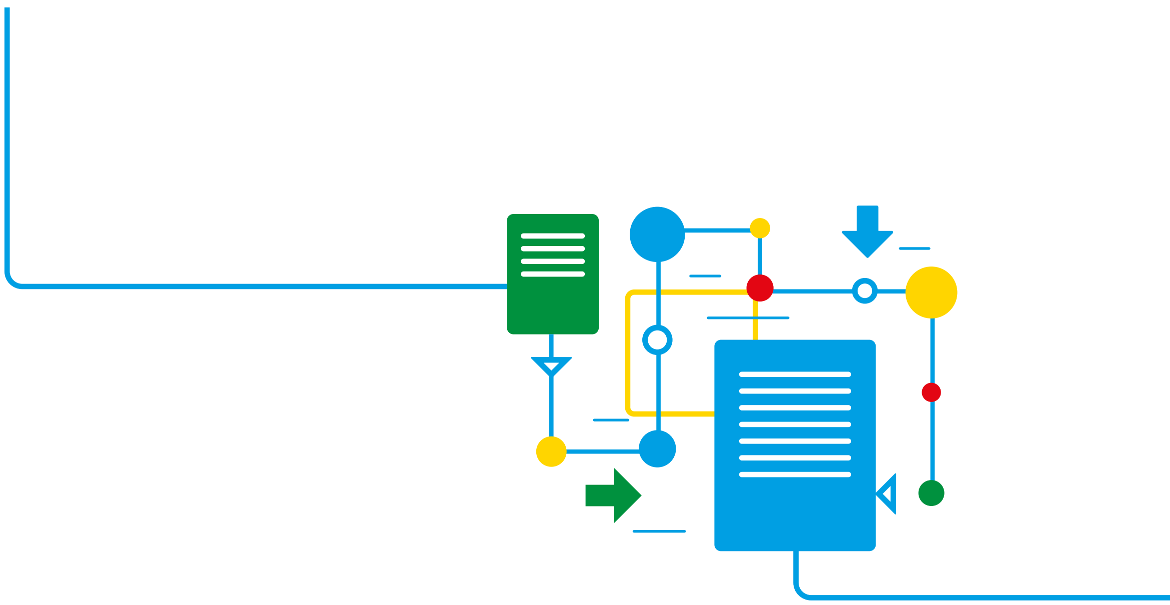
Reflect best bottom-up ideas.

Filter out issuers of concern.

Maintain process

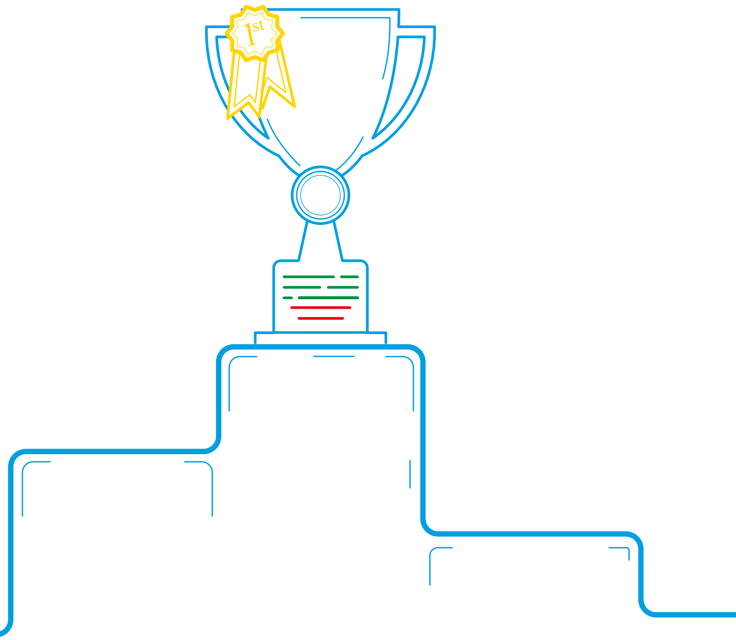
Trade to preserve value based on changes in fundamental views.

Avoid defaults.



Awards

We were thrilled to see our work recognised by peers and clients, winning several awards.



PROFESSIONAL PENSIONS
UK PENSIONS AWARDS 2017
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PROFESSIONAL PENSIONS
UK PENSIONS AWARDS 2017
WINNER
Fiduciary Manager of the Year

PROFESSIONAL PENSIONS
UK PENSIONS AWARDS 2016
WINNER
Investment Manager of the Year

PROFESSIONAL PENSIONS
UK PENSIONS AWARDS 2016
WINNER
Risk Reduction Provider of the Year

PROFESSIONAL PENSIONS
UK PENSIONS AWARDS 2016
WINNER
LDI Manager of the Year

Scale, experience and track record

We have significant experience managing buy and maintain credit for both pension clients and our insurance company parent Legal & General, for which we manage a £51bn portfolio providing the cashflows to pay annuity policies.

The strategy draws upon our broad, experienced team of fund managers and credit analysts based in London and Chicago, with a strong track record of avoiding defaults and downgrades across various market cycles.

Legal & General INVESTMENT MANAGEMENT

£51bn
Annuity AUM

£21bn
Buy and Maintain AUM

£149bn
Global fixed income AUM

Long-term track record of value preservation

By number of issues		USD (since 2007)	EUR (since 2008)	UK (since 2006)
Downgrades to high yield	LGIM	5	23	14
	Benchmark	201	343	261
Defaults	LGIM	1	0	1
	Benchmark	5	9	6

HAVE WE AVOIDED DOWNGRADES AND DEFAULTS?
Our global Buy and Maintain Pooled Fund has incurred two issuer downgrades to sub-investment grade since incepton. In comparison the iBoxx GBP non gilt index has experienced 17 over the same period*

*at 31 December 2017

CONTACT US

For further information, please contact Christy Morrison, Head of Global Fixed Income Distribution

020 3124 3195 **christy.morrison@lgim.com** **lgim.com**

Important Notice

The value of an investment and any income taken from it is not guaranteed and can go down as well as up, you may not get back the amount you originally invested.

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