

## Corporate Bond Portfolio Team



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# Robust Corporate Bond Multi-factor strategy in a Market Crash

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We have incorporated a multi-factor risk premium strategy as a part of our global corporate bond process since May 2012<sup>1</sup>. This note aims to give a brief overview on the performance of the multi-factor strategy during the first part of the COVID-19 crisis as well as previous crisis. Moreover, we also discuss implementation issues.

The aim of our corporate bond multi-factor strategy is to utilize and benefit from structural and behavioral anomalies in credit markets. It is, however, not for predicting the timing and length of a market crash - and it, by no means, aims to predict the timing and length of a pandemic - such as the COVID-19 pandemic. It is not at top-down timing strategy. Instead, it is a bottom-up strategy where the aim is to generate robust excess performance through the cycle. The multi-factor strategy is a combination of Value, Momentum and Quality factor strategies. Each single factor outperforms the market in the long run, but they play very different roles throughout the business cycle.

The role of Value is to find bonds that are mispriced compared to the fundamental credit quality of a company. High-ranking value bonds usually do well in a positive economic cycle, but returns are typically negative in the beginning of a crisis. The Momentum factor role is to find positive trending companies or exclude negative trending companies. Momentum works as an early warning factor. The role of

quality is to provide robustness in negative markets. High-ranking quality bonds are usually not interesting in positive markets, but mitigate drawdowns in distressed markets. Investing in the factors individually requires a view on state of the economic cycle. Put differently, the correlation between the individual factors is low. By combining the factors, we get a model that is more robust through the changing economic cycles due to the low correlation between the factors.

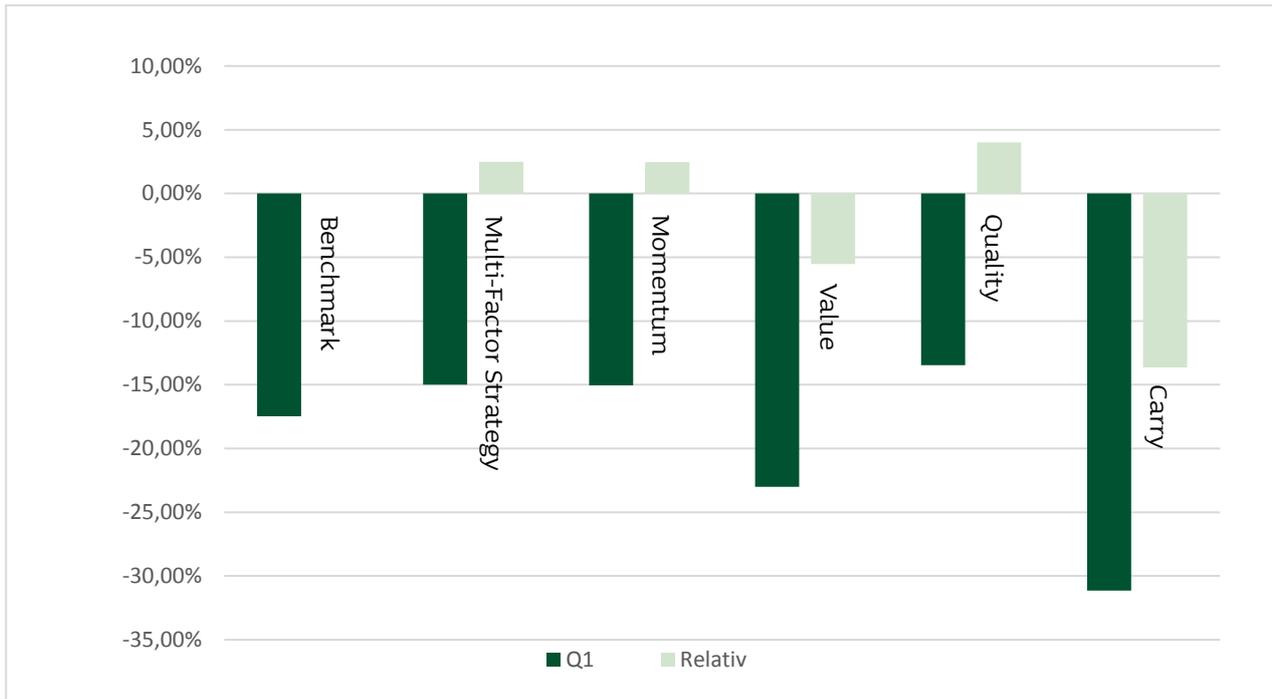
During the 1<sup>st</sup> quarter of 2020, the multi-factor model strategy has outperformed the high yield benchmark by almost 250bp<sup>2</sup>. It is, however, more interesting that the single factors have played their expected role during the market crash (figure 1) Quality is greatly outperforming with approx. 400bp. The “flight to quality” effect of the Quality factor seems to work. At the other end, Value is underperforming the benchmark with 550bp. We have also added results from a simple Carry strategy<sup>3</sup>. It is showing an extreme underperformance of more than 1350bp. These results are coherent with the results during former crisis. In what might just be the first leg of the COVID19 crisis, combining Value, Momentum and Quality have proven to be robust and managed to produce better returns than the global high yield benchmark. Similar to the financial crisis of 2008, the PIIGS crisis of 2011 and the shale oil crisis of 2015, the multi-factor strategy has delivered robust returns and smaller drawdowns than the market (figure 2).

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<sup>1</sup> Please see [Robust Investing in Corporate Bonds with Factor Investment Styles](#) for a discussion of the factor model

<sup>2</sup> Not subject to any diversification constraints or trading costs. See ‘Implementation’ section below for details on actual portfolio performance.

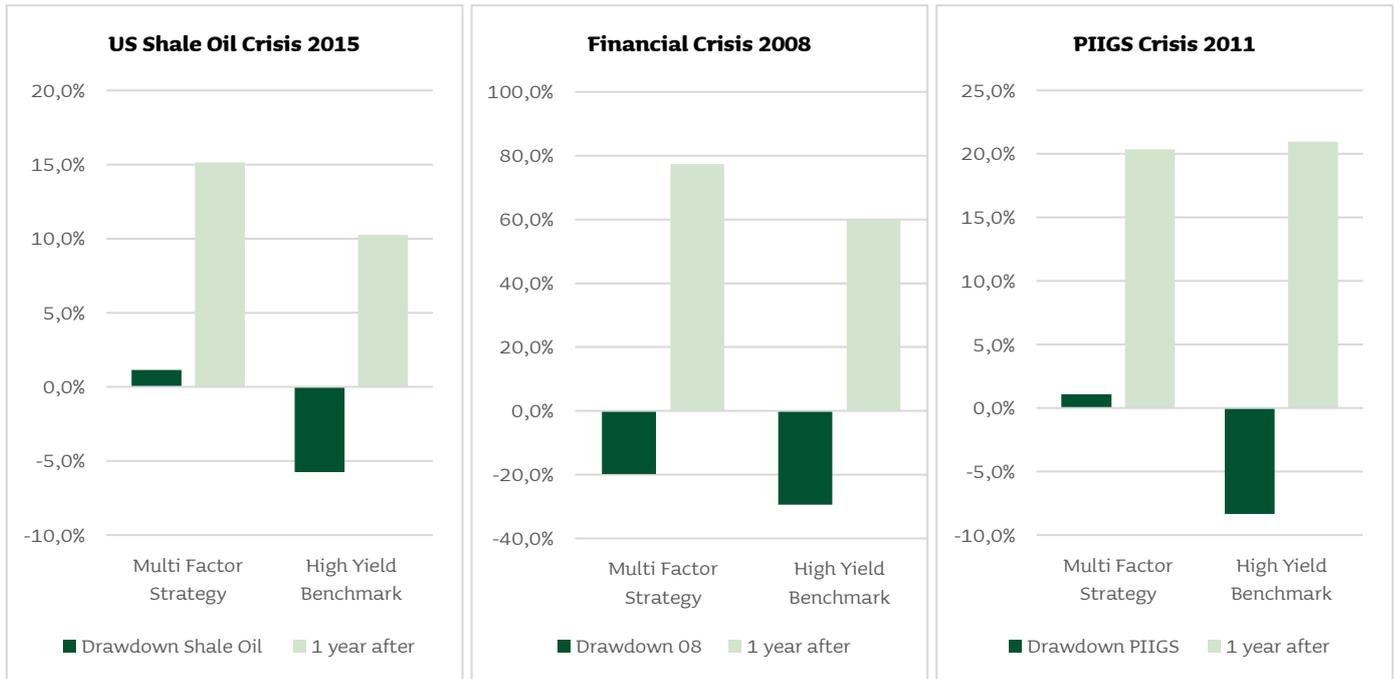
<sup>3</sup> The Carry strategy is simply buying bonds with top quintile spreads. The Carry factor is not included in the multi-factor strategy. It has massive drawdowns and underperforms in the long run.



**Figure 1:** Q1 top quintile returns from the different factor strategies and the high yield benchmark during the COVID19 crisis. Returns are ex. cost. Source: Jyske Capital and ICE

The multi-factor strategy performs quite well during the Great Financial Crisis of 2008, the European Sovereign debt crisis of 2011, and the US shale oil crisis of 2015. During all three crisis, the drawdown return is superior for the multi-factor strategy compared to the global high yield benchmark. Furthermore, the multi-factor strategy outperforms the benchmark the first

year after benchmark bottoms out in 2008 and 2015. It is only slightly lagging the benchmark in 2011. During the previous market crashes, the multi-factor strategy managed to reduce the drawdown without removing the upside when the market turned around. It will be interesting to see if this is also the case for the COVID19 crisis.



**Figure 2:** The graphs compares the max drawdown returns for the multifactor strategy(top quintile) and for the high yield benchmark during past crises. The 1 year after returns are calculated as total return 1 year after bottom benchmark value. Returns are ex. cost. Source: Jyske Capital and ICE

### Implementation

Today, there are numerous factor equity strategies in which are automatically implemented through ETFs. That is not the case for corporate bonds. Even in a normal business environment, it is more complex to maneuver around the high yield market compared to the stock market, and the complexity is significantly magnified during a market crash. The constrained liquidity of high yield corporate bonds makes it very difficult to implement any portfolio strategy automatically. During a market crash, liquidity typically evaporates and making automated implementation even more difficult and potentially very dangerous. Automated implementation could lead to very high trading costs or a tilted portfolio due to the

lack of liquidity. To overcome the liquidity issues, trading cost issue and potential model risk issues, we overlay the factor model with a qualitative process incorporating a rigorous risk management and portfolio construction process.

The results displayed below show the actual results of the global high yield portfolio since inception.

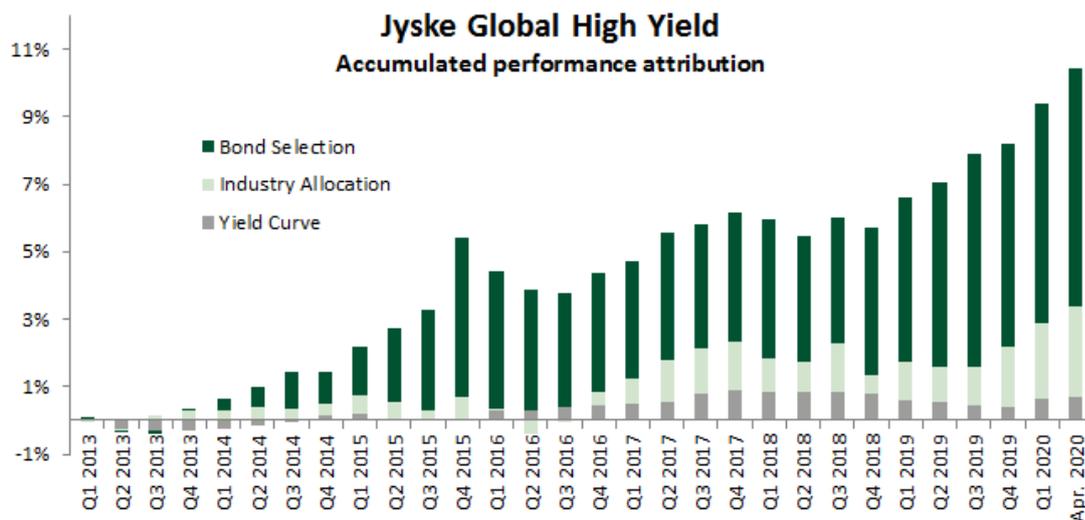
The stability and consistency of the multi-factor model is clearly mirrored in the actual portfolio performance showing that combining a multi-factor strategy with a more traditional fundamental qualitative process can deliver very robust excess returns through the cycle.

## Performance

	<b>Total Return</b>	<b>Excess Return</b>	<b>Tracking Error</b>	<b>Information Ratio</b>
2013	7.98%	0.09%	0.76%	0.12
2014	6.11%	1.46%	0.60%	2.42
2015	2.93%	3.92%	1.43%	2.74
2016	10.29%	-0.89%	1.31%	-0.68
2017	7.56%	1.86%	0.84%	2.21
2018	-4.39%	-0.46%	0.79%	-0.58
2019	13.93%	2.60%	0.78%	3.36
2020	-7.09%	1.88%		
Since Jan. 2013	4.86%	1.40%	1.09%	1.28

Source: Jyske Capital and ICE BofA index. Performance. Returns gross of management fee. 2020 until end of April.

## Attribution



**APPENDIX**

	<b>Drawdown 08</b>	<b>1 year after 08</b>	<b>Drawdown PIIGS</b>	<b>1 year after PIIGS</b>	<b>Drawdown Shale Oil</b>	<b>1 year after Shale</b>	<b>Drawdown COVID19</b>
Multi Factor Strategy	-19,8%	77%	1,1%	20,4%	1,1%	15,1%	-15,0%
High Yield Benchmark	-29,4%	60%	-8,3%	21,0%	-5,8%	10,3%	-17,5%
Value	-28,3%	92%	1,8%	21,0%	-6,0%	15,6%	-23,0%
Momentum	-14,8%	61%	0,5%	14,0%	4,8%	14,5%	-15,0%
Quality	-13,9%	44%	0,7%	16,2%	3,2%	9,1%	-13,5%
Carry Strategy	-40,7%	121%	-3,6%	21,5%	-18,4%	25,5%	-31,1%

The table compares the max drawdown returns for the multifactor strategy and for the high yield benchmark during the financial crisis 2008, the PIIGS crisis 2011, the Shale Oil crisis 2015 and the COVID19 crisis(top quintile). The 1 year after returns are calculated as the total return 1 year after bottom benchmark value. Returns are ex. cost. Source: Jyske Capital and ICE

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