The Case for Investing in Durable Income

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Key Takeaways

- Traditional fixed income returns are very low and outperforming efficient markets is difficult. It is increasingly hard to ignore emerging fixed income investing risks from unexpected inflation, interest rate and credit spread widening.
- Investing passively in traditional fixed income exposes investors to low expected returns, has little scope for capital appreciation, comes with significant interest rate risk, forsakes opportunities in unlocking an illiquidity premium, as well as excludes niches in credit investing.
- With increased risk aversion, reduced risk appetite is expressed through a preference for holding shorter duration assets, pursuit of interest rate neutral strategies and an expectation of a higher illiquidity premium.
- Durable Income is a complement to traditional fixed income investing in an inevitable (albeit difficult to time) rising rate environment.
- Durable Income, unlike fixed income, has its foundation in multiple resilient drivers of return; interest rates, credit spreads, illiquidity and alternative risk premiums amongst others. The more the sources/drivers of return, the lesser the dependence on a particular market factor, and the more resilient the investing thesis.
- Durable Income, unlike fixed income is more resilient to economic downturns, to changes in credit and market risk and to macroeconomic conditions.
- Durable Income preserves the attractive features of the fixed income asset class - stable, consistent, predictable returns - but potentially mitigates its risks as well as provides opportunities for capital gains.
- Durable Income characteristics including steady current income, low volatility, and low correlation to other investments provides portfolio diversification benefits.
- Durable Income investing, when implemented on behalf of investors and their Financial Advisors, through sponsor managers practicing active management, is a source of both market based (beta) and skills based returns (alpha).

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Introduction

Opinions differ as to what constitutes Durable Income. For example, is investing in traditional fixed income such as in government treasury or in corporate bonds the same thing as investing in Durable Income?

The answer is a resolute no.

Durable Income investing is very different from fixed income investing for it has different asset characteristics as well as sources of risk and return drivers. Such differences can be a source of both resilient long term income and skills based excess returns, as well as a valuable investment diversification tool. Intuitively, Durable Income cash flow streams are relatively stable and predictable - say for example in the case of a long term infrastructure investing concession, often resulting from either a captive customer base, or from long-term contracts, or regulated pricing schedules, and limited competition or licensing. Stable, income producing, occupied, core real estate is yet another example. In these two instances the stable cash flows generated by mature infrastructure assets, such as electricity transmission cables, roads, and oil pipelines are analogous to the rental income streams in core real estate. These stable cash flows provide resilient long term income – in other words Durable Income.

- Durable Income has stable resilient cash flows derived from multiple return drivers – not just interest rate bets

Durable Income, unlike fixed income is more resilient to economic downturns, to changes in credit and market risk, as well as to evolving macro-economic conditions. Also, Durable Income returns are derived through multiple return drivers, and not just from interest rate bets alone.

Durable Income's long term predictability is critical to investors seeking to match long term yielding assets against long term liabilities (e.g., pension plan and insurance company liabilities or individual retirement needs). In some cases their long term inflation linked cash flow characteristics are attractive duration hedges for long term liabilities.

Durable Income is expected to support relatively higher dividend yields, typically mid to high single digit per annum, in conjunction with moderate capital appreciation. It is expected to exhibit a low correlation with the overall market, thereby offering considerable portfolio diversification benefits too.

This unique combination of attributes as an investment class makes it particularly attractive for a wide range of investors, but especially for those seeking to add long dated, stable income-generating investments to their portfolio.

This paper discusses Durable Income from an alternative investments perspective. To draw the distinction from fixed income, it dissects the empirical properties of one of the most diversified investment grade traditional fixed income indices – the Barclays Capital U.S. Aggregate Bond Index, outlines the investing case and explores its potential role in investment portfolios.

The Challenge of Fixed Income

Fixed income bonds remain the cornerstone of investor portfolios. Traditionally investment grade bonds, with their predictable income streams coupled with low volatility in returns have found favor with long term buy and hold investors.

However, the fixed income environment is quite challenging. Both short and long term yields remain low — In the U.S, 10-year treasury yields at 2.84% are currently 71 basis points below their 10 year historical average of 3.55% (August 20th, 2013). Furthermore, while expected returns have declined, concomitant risks have not. Indeed, risks may in fact have risen, with rising real interest rates and unexpected inflation looming in the horizon. With low rates, unabated levels of capital seeking a 'safer parking lot' finding its way into traditional fixed income sectors, these markets have also become much more efficient. Investors, finding it harder and harder to identify attractive fixed income sub-types, or managers who can consistently outperform their benchmarks (i.e., generate alpha), gravitate to marquee names who have been having a field day garnering assets and charging fees.

- Traditional fixed income investors may no longer be getting compensated for taking on risks from widening spreads, rising interest rates, as well as exposure to unexpected inflation

Traditional fixed income investors may no longer be getting compensated for taking the risks that they do – risks from widening spreads, rising real interest rates, as well as exposure to unexpected inflation. Passive exposure to traditional sources of fixed income may no longer necessarily be an optimal investing strategy. Such an approach may not necessarily create long term returns and protect capital in the future.

Investors planning for retirement, predominantly invested in traditional fixed income, may find their future income return streams deteriorate. Increasing retirement contributions, depending on how much is contributed, may be only a temporary solution. Also, there are real constraints on individual income in ability to increase savings. Tactical hedging moves that would preserve the current asset allocation and could remove future risks, while keeping upside performance, are often impractical and may come at costs that outweigh benefits. Asset reallocation is an option, but individuals would have to consider both transition costs and assess departures from current allocation when they already reside on the efficient frontier.

- Preserve the attractive features of the fixed income asset class, but potentially mitigate its risks

While there are many options available to mitigate retirement income risks, it is only when choices are analyzed both quantitative and qualitatively, should informed retirement investing decisions be made.

In a low returns environment with very real embedded risks, an alternative to investing in traditional fixed income securities exists.

And that alternative is investing in Durable Income.

Yet, fixed income's draw of steady current income, low volatility, and low correlation to other investments remains stronger than ever before. Ideally, investors need a way to preserve the attractive features of the fixed income asset class, but potentially mitigate its risks as well as increase returns over the long term. While the current environment is challenging, investors may still be able to design their portfolios to preserve the attractive features of fixed income, but improve the risk return tradeoff, by pursuing Durable Income investing strategies.

The more the drivers of return the lesser the exposure to single sources of risk. And that is the foundation of creating resilient Durable Income.

From an alternative investments perspective, Durable Income can be a source of both skills based return (alpha) as well as a valuable diversification tool in portfolio construction. It provides exposure through both illiquid long-term private investment vehicles as well as in more liquid trading formats. This versatility makes it extremely attractive for different investor segments.

Fixed Income vs. Durable Income – Difference?

We demonstrate later in this paper that Durable Income mitigates the shortcomings of traditional fixed income investing. In other words it provides for what fixed income does not provide (i) higher absolute returns; (ii) both capital appreciation and income return; (iii) potential for higher risk adjusted return; (iv) unlocks an illiquidity premium when warranted; (iv) has long term resilience; (v) and includes niche opportunities in credit investing.

Durable Income, unlike many fixed income investing sources, accessed on behalf of investors and their Financial Advisors, through skilled sponsor managers allows investors to tap multiple return sources beyond just interest rates:

- Returns from interest earned on money lent.
- Returns from taking on credit risk.
- Returns from locking in money for long periods by way of an illiquidity premium.
- Returns that skilled managers generate from active decisions; from market timing by increasing or decreasing exposures, through sector over/under weight, through security selection as well as employing other ways to outperform the market.

> The more the drivers of return the lesser the exposure to single sources of risk. And more resilient and durable the income

Properly designed, Durable Income strategies offer ways to invest with lower volatility, create lower correlation to traditional fixed income sources, and generate a more predictable income stream. These have particular value in a low returns regime, where unexpected interest rate and inflation shocks risk reduce the value of traditional fixed income portfolios. Also there are periods of time when certain sectors of the fixed income/ credit/ real assets market offer better relative valuations providing opportunities for outsized return; actively managed Durable Income strategies, as alluded to earlier , unlike passive fixed income investing, have the potential to create skills based returns.

Durable Income is a wide category but with shared features:

- Expected Returns: High single digits.
- Source of Returns: Periodic stable cash flows.
- Effect of Asset Value Growth: Modestly positive.
- Opportunity for Active Management: High.
- Investing horizon: Mid to long term.
- Liquidity: Varies.
- Effect of Inflation: Sometimes hedged with inflation linked cash flows.
- Effect of Interest Rate Increases: Modestly negative/ neutral; inflation correlation partially hedges nominal interest rates.

From Fixed Income to Durable Income

- Barclays Capital U.S. Aggregate Bond Index is a good proxy for fixed income. Examining index composition, credit quality and returns reveals fixed income characteristics

To illustrate how investors can move from traditional fixed income to Durable Income we

(i) Review the composition and characteristics of the traditional fixed income asset class (which we proxy for using the Barclays Capital Aggregate Bond Index). We then point out the pros and cons of passively investing in traditional fixed income.

(ii) Discuss how investors can conceptually 'repackage' common return sources, in a way that may better meet their objectives.

(iii) Finally, we show how investors can participate in obtaining Durable Income exposure.

Composition and Return Characteristics of Diversified Fixed Income

U.S. Fixed Income consists of many underlying sectors: treasuries, investment grade corporate bonds, high yield securities, mortgages, municipals, and asset backed securities, among others. The Barclays Capital U.S. Aggregate Bond Index - Index Ticker: Bloomberg LBUSTRUU is a popular proxy for fixed income; it is a broad-based benchmark that measures the investment grade, fixed-rate taxable bond market, including treasuries, government-related and corporate securities, MBS (agency fixed-rate and hybrid ARM pass through), ABS, and CMBS. Exhibits 1, 2 and 3 provide key details about the index.

Exhibit 1 | Barclays Capital U.S. Aggregate Bond Index: Composition

	Number Issues	Amount Outstanding (MM)	Market Value (MM)	% of Index
U.S. Treasury	234	5744602	5882147	36.12
Government-Related	1543	1605463	1686757	10.36
Corporate	4682	3335624	3546718	21.78
Securitized	1973	5012182	5167234	31.73

Exhibit 1 suggests that the index is balanced and well diversified across treasuries, government related, corporate debt and securitized instruments. Additionally, within each of these broad sectors the index is fairly well exposed to subsectors; viz:

- Interest rate risk is systematic risk and cannot be diversified away

- U.S. Treasury: Intermediate, Long and Treasury 20+ Year
- Government-Related: Intermediate, Long, Agencies, Local Authorities, Sovereign, Supranational
- Corporate: Intermediate, Long, Industrial Utilities and Financial Institutions
- Securitized: CMBS, ABS, MBS, Covered Bonds, Mortgage, Public Sector, Hybrid

In other words an investment into the index provides for excellent diversified exposure, avoids concentration risk but exposes an investor to that singular common risk factor prevalent in all of the above instruments - Interest Rate Risk. Interest rate risk is systematic risk and cannot be diversified away in the above composition of asset subtypes.

- Actively managing credit risks unlocks term premium in credit spreads

Exhibit 2 | Barclays Capital U.S. Aggregate Bond Index: Credit Quality

	Number Issues	Amount Outstanding (MM)	Market Value (MM)	% of Index
U.S. Aggregate	8432	15697870	16282856	100
Quality				
Aaa	2474	11533418	11848065	72.76
Aa	1070	784191	815800	5.01
A	2189	1703127	1824954	11.21
Baa	2699	1677134	1794038	11.02
Maturity				
1-3 Yr	2355	3922397	4054486	24.9
3-5 Yr	1860	3075752	3230478	19.84
5-7 Yr	989	2485142	2631860	16.16
7-10 Yr	1430	3302654	3371049	20.7
10+ Yr	1798	2911926	2994983	18.39

Exhibit 2 suggests that the widely diversified index composition, with around 73% credits rated Aaa, is predominantly investment grade. In other words, is composed of 'safer' credits. While perceived safety is a seemingly desirable property, this provides significantly less exposure to another important driver of returns – investors forsake potential returns that come from carefully taking on and actively managing Credit Risk, manifested in term premium in credit spreads.

Exhibit 3 | Barclays Capital U.S. Aggregate Bond Index: 10 Year Returns

	Since Inception Return on	Since Inception Return on	Return for Period	Annualized Return
	8/20/2003	8/20/2013		
Total Return	1,024.57	1,684.24	58.66%	4.72%
Price Return	13.49	17.55	3.58%	0.35%
Coupon Return (with reinvestment)	1,014.19	1,672.69	58.06%	4.68%
Other Return (e.g. Currency, Paydown)	-3.11	-5.99	-2.97%	-0.30%
Coupon Return (without reinvestment)	230.15	282.4	46.03%	4.60%
Excess Return	n/a	n/a	5.88%	0.40%
Duration-Neutral Treasury	227.08	399.7	52.78%	4.33%

Exhibit 3 suggests that the index possesses the return characteristics that investors have historically associated with traditional fixed income.

- First, over the last 10 years (Aug'03- Aug'13) it has had an annualized return of 4.72%. Of this the coupon income (with reinvestment) is 4.68%.
- Second, it provides fairly steady returns. For this period we separately calculated the index volatility to be 3.93% on an annualized basis.
- Third, from a portfolio construction standpoint, we separately derived and infer the index to have low correlation to major asset classes.

- Traditional fixed Income investing has provided low returns with low volatility, no illiquidity or credit risk premium and almost no capital gain

Perils of Traditional Fixed Income Investing

A closer examination of the Barclays Capital U.S. Aggregate Bond Index characteristics, captured earlier, reveals many weaknesses.

- **Low absolute returns:** It offers investors very little excess return; a paltry 40 basis point premium relative to cash.
- **No capital appreciation:** In other words nearly all the return has come from only interest income (i.e. driven by interest rates) and almost none from capital appreciation (i.e. not from good buy and sell market timing and security selection decisions).
- **Low risk adjusted returns:** It has a Sharpe ratio of just 0.1. This is very low in both absolute terms and when compared to most investing strategies. Investors are decidedly not getting compensated for the risks that they take.
- **No illiquidity premium:** Since the underlying securities are all very liquid, such a strategy offers zero opportunity for investors to appropriate valuable illiquidity premiums.
- **Significant interest rate risk:** For every 1% increase in short term interest rates, the index declines by almost 4.48%; the sensitivity to interest rates measured by the duration of the index. Any short-term increase in interest rates could therefore significantly impair returns.

- **Excludes niche opportunities in credit investing:** Finally, while the index accurately captures performance of the overall U.S. fixed income market, it ignores some of the more attractive niche areas. For example, it excludes the potential to derive returns from bonds with equity-type features (e.g., warrants, convertibles, contingent capital securities), tax-exempt municipal securities, private placements, floating-rate issues, strips, inflation-linked bonds, structured notes, loan participation notes, pass-through certificates as well as illiquid securities with no available internal or third-party price source.

Options for Traditional Fixed Income Investors

In terms of assessing the future it might be helpful to essentially focus on three questions:

- Can one explain the sources of returns, skill/market?
- Types of market environments to which certain fixed income investments are suited?
- How much of the return is due to passive market factor exposure such as interest rate, value, momentum, passive exposure, slope of the yield curve, correlations, market volatility and will this impact returns in the future?

- Durable Income has different risk, return and asset characteristics which complements fixed income

Investors looking to passively access fixed income may choose to track the index using exchange traded notes, OTC derivative products, index linked insurance products, mutual funds and exchange traded funds. They may even try and outperform the index by identifying skilled fixed income managers. In the former case there is no escaping the drawbacks of the overall asset class, namely low returns, low risk adjusted returns and significant interest rate risk amongst others. In the latter case, as fixed income markets have become more competitive, finding managers who can consistently outperform the index has become challenging.

Durable Income offers a way out. Investors and their Financial Advisors can structure a customized fixed income portfolio that matches the favorable characteristics of fixed income without explicitly tracking the asset class. In other words, structure a portfolio that will have benefits of broad based fixed income exposure but with greater resilience over longer periods of time while materially reducing systematic fixed income risks.

While the Durable Income option is ambitious, we believe it can be accomplished through a two-step process.

- Step one involves finding a combination of underlying fixed income subtypes, which provide a more attractive risk reward trade-off. In other words, construct a more efficient and resilient way to access fixed income characteristics than fixed income.
- Step two involves developing tactical exposures within fixed income sub-sectors that can generate both durable income and relatively sustainable alpha over the long term.

We describe each step in more detail below.

More Efficient Way for Fixed Income Exposure

Constructing a more efficient benchmark begins by understanding sources of returns and risks, and then combining them in a way that provides the best risk adjusted return at a portfolio level.

Market risk specifically addresses asset price risk. The market prices of many fixed income instruments can be highly volatile. For instance, price movements of derivative fixed income contracts are influenced by, among other things, interest rates, market volatility, and the price of the underlying asset or, changes in liquidity conditions. Changes in the financial market environment are often the fundamental cause for price moves, including changing supply and demand relationships, fiscal, monetary and exchange rate policy, or other national and international political and economic events. All these factors are ultimately uncertain and news about them can influence prices giving rise to market price risk.

Certain fixed income sectors have prepayment and extension risks embedded in them. For example Mortgage Backed Securities (MBS) are created from mortgages which are pooled together, packaged, and sold through the issuance of pass-through certificates. The underlying mortgages are highly sensitive to interest rates because they may be prepaid earlier or later than expected by the borrower, depending on levels of interest rates. The repayment activity of the underlying mortgages, in turn, affects the repayment timing and duration of the MBS and therefore its market value.

- Credit, market, liquidity and concentration risks interact in unexpected ways in fixed income investing

Another source of risk is that from concentration. For example, concentrations in securities of a specific industry may expose an investor to undiluted industry risks that could lead performance to deviate significantly from general market trends. In similar manner, significant concentrations in specific security types may expose an investor to greater market price risk because of interest rate movements or other market conditions.

It is important to keep in mind that credit risks and market risks, though often considered separately, are in fact intimately related. This is best seen when considering debt securities such as corporate bonds. For a hold-to-maturity investor, the only risk that really matters is credit risk, i.e. whether or not the issuer defaults at some point in time prior to maturity. However, for any shorter term-oriented investor, or more generally anyone who may sell the corporate bond before maturity, credit risk translates into market risk. Indeed, if after the bond purchase the issuer's credit quality deteriorates, this will be reflected in a decline in the bond's price and an increase in its credit spread. Therefore, a default needn't actually occur. To have a price effect – and therefore market risk – it is enough for the likelihood of a default to change over time.

Durable Income investing isolates sources of return into several broad categories, including for example:

- **Interest rates –** Investors earn a risk free interest rate for lending their money over a short period of time, plus a term premium for lending their money over longer periods of time. Interest rates are the principal determinant of fixed income securities prices. As interest rates rise fixed income securities lose value and vice versa.
- **Credit spreads –** Credit risk is risk due to uncertainty about a counterparty's ability or willingness to meet its debt obligations. On top of returns from interest rates, investors earn an additional spread for lending money to compensate for taking on credit risk. This excess return compensates investors for the risk of default.
- **Liquidity –** Certain securities are relatively illiquid. These securities therefore offer investors a return premium relative to their more liquid counterparts. Different investors have different needs for liquidity and may vary considerably as to the time horizon of their investments. Investors who have uncertain needs for cash generally have higher liquidity needs. Typically individuals, especially those nearing retirement or those who may have large expenditures in the near term usually have the highest need for liquidity and income. Some individuals do not have immediate liquidity needs, but anticipate future major expenditures (purchasing a house, paying for children's education, retirement, etc.) On the other hand, large endowments or life insurance companies typically have well-defined expenditures over long-time horizons and thus have much lower liquidity demands. Endowments may never need to dip into the principal of their investment accounts. Investors with longer time horizons and lower needs for immediate liquidity will usually allocate more to Durable Income alternative assets.
- **Alternative risk premiums –** A number of fixed income instruments expose investors to risks unrelated to interest rates or the business cycle. For example, a municipal arbitrage strategy exploits the spread between taxable and non-taxable debt and is most adversely affected by changes in tax policy, something that is (directly) exogenous to interest rate and the equity markets. A second example, certain MBS securities, expose investors to a complex cash flow profile, as the coupon is linked to both fixed interest rate and floating interest rate indices. These instruments provide additional return in exchange for complexity risk.

Durable Income drivers include interest rate, credit spread, Illiquidity and alternative risk premiums

Exhibit 4 | Sources of Return by Asset Subtypes

Less Durable → More Durable (top to bottom); Few Return Factors → More Return Factors (left to right)

	Interest Rates	Credit Spreads	Liquidity	Alternative Risk Premium
Treasury Bonds	✓			
Credit Default Swaps		✓		
Inv. Grade Corporate Bonds	✓	✓		
Municipal Bonds	✓			✓
High Yield Corporate Bonds	✓	✓	✓	
Private Oil & Gas	✓	✓	✓	✓
Private Infrastructure	✓	✓	✓	✓
Real Estate	✓	✓	✓	✓

As Exhibit 4 indicates, some asset subtypes, such as treasury bonds and credit default swaps, provide access to just one source of return- interest rates and credit spreads respectively. By contrast, other sectors generate return from multiple sources. For example, investing in private oil & gas partnerships, or in private infrastructure, or in private real estate provides multiple sources of return: interest rates, credit spreads, liquidity and alternative risk premium.

The more the sources/drivers of return, the lesser the dependence on a particular market factor, and the more resilient the investing thesis. And this sets the basis for Durable Income and differentiates it from traditional fixed income investing.

Durable Income is About Active Investing

- Active management drives Durable Income

Passive allocation to traditional fixed income may make sense for investors and their Financial Advisors who have a strong view that interest rates are unlikely to rise, and are comfortable excluding exposure to other sources of potential return. However, passive investments may not be optimal for investors and their Financial Advisors who seek to unlock multiple sources of return and build Durable Income portfolios. In fact, investors and their Financial Advisors are better served and may potentially outperform the index by re-allocating across the various return sources.

Investors may, with guidance from their Financial Advisors, also use derivative securities, such as futures or swaps, to more precisely tailor fixed income exposure. As an example, consider someone looking for regular income, but wants to avoid swings in portfolio value due to interest rate movements. This may be accomplished by investing in long-term municipal bonds, which on a post tax basis have historically provided higher yields than treasuries, and hedging the interest rate risk using treasury futures. This while theoretically possible is rather impractical for most retail investors.

Investors long familiar with exposure to passive risk factors, rightfully, increasingly see passive investing as largely undifferentiated and commoditized; for example, investors can gain passive exposure to traditional fixed income at very low cost. Smarter investors and their advisors focus on taking on and managing active risk as a means to improve investment returns. It is for this reason Durable Income investors and their Financial Advisors seek out skilled active sponsor managers to implement trading and investing views.

Exhibit 5 | Durable Income Resilience

	Traditional Fixed Income	Durable Income
Driver of Return	Unique macroeconomic factor – interest rate	Multiple factors- interest rates, credit spreads, illiquidity premiums, alternative risk premiums etc.
Number of Sources	Relatively few	Virtually unlimited
Correlations	Higher, as return is predominantly market beta	Lower, as return comes from multiple beta sources and unique manager decisions
Dispersion in Performance	Relatively consistent performance as markets are efficient	Large dispersion as driven by skill
Forecast Risk	Higher	Lower, as actively managed to changes in market conditions
Fees	Can be accessed for low fees	Can only be accessed for higher fees

Durable Income portfolios may be classified as 'alternative' to traditional strategies within the major fixed-income asset classes. In general these components can be described as market-valued investment strategies that extract value from a spread (or risk premia) from a corresponding class of market instruments. These strategies have their own idiosyncratic risk profiles which are also characterized by having lower correlation to main market benchmarks.

Durable Income is very different from traditional fixed income

Active risk refers to the risk and return generated by the unique decisions of an investment manager or a program sponsor, such as that derived from (active) security selection and market timing decisions. Typically, active trading strategies attempt to add value in one of two ways:

1. Market Timing – Tactically changing exposures to different sectors (either through rebalancing or leverage) in order to capitalize on short-term trends.

2. Security Selection – Identifying undervalued (overvalued) securities, and purchasing (selling) these in the expectation that prices will return to fair value.

For example consider real estate cycles, which follow broader patterns. During periods of economic growth real estate demand increases and supply follows to fulfill the demand. As the economy slows, demand decreases, vacancies increase and real estate values fall. Finally, after a period of economic recovery, the cycle repeats itself. Durable Income has its basis in knowing the correct market entry and exit points.

Consider another example. During some periods credit spreads spike substantially, and then slowly return to fair value. Historically, returns from investing in corporate bonds after these spikes tend to be fairly high. Investors may be able to outperform the broad corporate credit market by increasing their exposure after a spike in credit spreads, and reducing it over time as spreads trend downwards – an example of unlocking credit spreads as a driver of return.

The best Durable Income sponsor managers, and there are few and far between, are successful in tactical investing for they have a strong knowledge of their respective sectors. In addition to identifying historical patterns, these managers understand why market dislocations and patterns are likely to persist. For example, in the case of corporate credit, infrequent credit events create a large supply of lower rated bonds in a short period of time. Sudden supply shocks tend to increase credit spreads, which subsequently decline as the market absorbs the new supply. Astute sponsors recognize that many patterns can occur just by chance, and avoid developing trading strategies based on patterns they cannot explain. Beyond historical analysis, they understand how an investing thesis evolves over time in response to new market conditions.

In other words they are skilled in identifying entry and exit points, choosing appropriate instruments to access exposure, ensuring appropriate diversification, defining appropriate leverage amounts and hedging strategies, understanding financing and transactions costs and above all in executing and monitoring performance.

Conclusion

- Durable Income augments and diversifies away from traditional fixed income investing

Many investors are drawn to fixed income because it provides steady income, and has the ability to diversify portfolio risk. Fixed income investors contend with the challenges of very low expected returns, a paucity of skilled managers who have the potential to outperform the benchmark in what is a fairly efficient asset market as well as take on interest rate, credit spread and unexpected inflation risk.

Complementing traditional fixed income investing with Durable Income investing may be a better way forward for investors and their Financial Advisors. By creatively using expressions to access real assets, too often overlooked liquid fixed income asset subtypes and investing with active managers focused on pursuing absolute returns (with aligned incentives), portfolios can be structured that maintain the attractive features of traditional fixed income while mitigating attendant risks. Financial innovation and new products provides flexibility to repackage various fixed income return sources in a way that better meets long term income goals.

Believing that one has a definitive read on markets is perilous. Often, one lacks market conviction when no clear trends emerge. In such times it serves well to take a defensive stance. Assets with shorter duration, safer and backed with real assets, an optimal holding period, moving defensibly, being alert to changing credit standards can be a good way to participate in markets. And that is what creates Durable Income and capital preservation.

Durable Income helps in augmenting and diversifying away from traditional fixed income investing and serves as a valuable portfolio component.

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