Robeco High Yield Bonds

Changing the role of the multi-factor model in Robeco High Yield Bonds

- All holdings in Robeco High Yield Bonds will be fundamentally covered
- It will no longer apply the multi-factor model as an independent sleeve
- The fund will continue to rely on input from quantitative tools, for support

Robeco High Yield Bonds fund will no longer use the multi-factor quant model to manage part of its portfolio, and it will become a purely fundamentally driven strategy. The portfolio management team will continue to use inputs from the multi-factor model to generate trade ideas and spot potential losers. For clients wanting a fully fledged multi-factor quant solution for high yield, Robeco continues to offer these solutions.

Moving the strategy towards one which is purely fundamentally driven

Robeco High Yield Bonds fund will no longer use the multi-factor model to manage part of its portfolio. The team will continue to use inputs from the model to generate trade ideas and to spot potential losers.

The main reason for discontinuing the use of the multi-factor model as independent component of the fund, is that the universe to which we apply the model has become too small to ensure optimal results. Many issuers from the universe of the quant model have over time been transferred to our fundamental analyst team, which means that these issuers are now fundamentally covered.

The overall size of the fund has grown to the extent that we are increasing our number of holdings, which we prefer to do through holdings in fundamentally covered issuers. We have a high degree of confidence in the alpha-generating ability of the multi-factor approach, confirmed by the fact that it added an annual 0.2% to the fund's relative performance over its live period. As with any quant approach, though, the model requires sufficient breadth to continue to generate attractive alpha. We are reaching the

Article
For professional investors
June 2020

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point where this condition is no longer met and we therefore will discontinue use of the model in managing a portion of the Robeco High Yield Bonds fund.

Main takeaways

- The Robeco High Yield Bonds fund will no longer apply the multi-factor model as an independent sleeve to manage its small and mid-cap exposure
- The fund will be a purely fundamentally managed global high yield fund, supported by quantitative tools
- The multi-factor model will continue to generate trade ideas and serve as an early warning indicator for spotting potential losers
- Clients continue to have the option of Robeco's standalone multi-factor high yield products. The Robeco Global Multi-Factor High Yield fund and client mandates have been running since July 2018, managed by Patrick Houweling and Mark Whirdy.

Why are we phasing out the multi-factor sleeve within the fund?

We implemented a multi-factor sleeve within the Robeco High Yield Bonds fund in 2005, with the aim of using this to efficiently cover small caps in the investment universe. The fund size was much smaller at the time and we were able to build the multi-factor sleeve with listed small caps that were not covered by our fundamental analysts. The multi-factor sleeve was a highly diversified portfolio of around 150 issuers and about EUR 750 million in assets. To begin with, it represented roughly one third of the fund assets.

Over the years, the fund assets continued to grow on the back of a successful track record, and the strong investment philosophy and research-driven process. In order to keep up with the growth in assets under management, we had to either expand the number of individual positions or the average size of the positions within the multi-factor sleeve. Both options proved to be difficult. Firstly, increasing the average position size was something we were not comfortable doing, as it would reduce our ability to sell out of the position once the factor exposure deteriorated.

Secondly, buying more issuers was difficult because the universe to which we applied the multi-factor model had shrunk over the years. This was as more and more issuers were transferred to our growing team of fundamental analysts. As a result, the weight of the multi-factor sleeve came down over the years.

With the growth in AuM, we also had to expand the number of issuers that are fundamentally covered by our analysts. Not every issuer or issue is scalable with the rise in AuM, though, as market liquidity and amount outstanding can be constraints.

The issuers that were added to our fundamental coverage list were the ones that screened positively in the first filter. An undesirable consequence for our multi-factor sleeve was that the issuers that screened negatively from a fundamental perspective, ended up in the universe for the multi-factor model. In short, the universe turned into a list of issuers that mostly screened negative.

While we believe that a multi-factor approach works in high yield, it should be applied to a universe which is as broad and unconstrained as possible. A multi-factor strategy needs breadth in order to deliver the best possible results. Robeco offers our clients such a strategy: Robeco QI Global Multi-Factor High Yield, managed by Patrick Houweling and Mark Whirdy. The fund applies a similar multi-factor approach as that used in our fund. The universe is global high yield excluding financials, with nearly 3,000 bonds to choose from. The strategy has gained much attention and inflows from sophisticated investors since it became available to external clients in 2018.

Sander Bus, lead portfolio manager of the Robeco High Yield Bonds fund says: "The multi-factor approach has worked for our fund for many years. It has helped us to use our analyst capacity in the best and most effective way."

Commenting on the decision to separate the fundamental and multi-factor approaches in high yield, Sander says: "I believe that offering a pure fundamentally managed and a standalone multi-factor high yield fund is in the best interest of our clients".

Q&A

Does Robeco still believe in the multi-factor strategy?
Yes, we strongly believe in the multi-factor strategy. The approach works within credit markets, with strong evidence from the academic literature[1] and in practice. We see tremendous inflows into our multi-factor strategies and believe this is a growth area for many years to come.

Why did we not chose to implement a quant sleeve on the entire high yield universe?
The Robeco High Yield Bonds fund in essence is a fundamentally run global high yield fund. Our highest conviction positions are in issuers/issues which are

[1] See Houweling and Van Zundert, "Factor Investing in the Corporate Bond Market", Financial Analysts Journal 2017.

fundamentally covered. This is what we have been doing since 1998 and is embedded in our investment DNA.

Did the multi-factor sleeve perform?

The multi-factor sleeve added value over the period since we started tracking the performance, in 2009. The standalone annualized outperformance has been 0.98%, with a tracking error of 1.68%. The weight of the multi-factor sleeve averaged around 20% since 2009, implying an annualized outperformance contribution of nearly 20 bps for the fund.

Will the multi-factor model still play a role in the investment process of this fund?

Yes it will. We continue to apply the ranking provided by the model to identify interesting investment opportunities. We can apply it to new deals and to the secondary markets. In addition, bottom-ranked bonds can be identified and discussed amongst the PMs and analysts.

Will the fund become tilted to large caps?

No, the fund will not become tilted to large caps. We will ensure that we have ample fundamental coverage in the entire universe in order to capture the small-cap premium.

Do you see this as a major change in the investment process?

No, we do not consider this to be a major change in our investment process. Firstly, the importance of the multi-factor model within this strategy has reduced over the years. In addition, we have maintained a strong performance track record and invest fundamentally in issuers where we have the highest conviction. This has been supported by the steady growth over the years in the number of our credit analysts. The bottom line is that focusing on fundamentally covered high yield issuers makes the investment process even clearer and more structured.

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