

Barings: Global Innovators in High Yield



With one of the largest high yield teams in the industry, Barings turns to the global Open Trading all-to-all marketplace to gain an edge in what can be an inefficient market.

SEPTEMBER 2019

Over the past year, the high yield markets have experienced their share of ups and downs. This volatility, demonstrated in the graph below, was most pronounced late last year, when credit spreads widened on a long list of familiar concerns—uncertainty over trade wars, Brexit and the pace of interest rate hikes by the Federal Reserve, as well as slowing economic growth and weakness in global energy markets.

“Through November and December, which were arguably the most volatile few months over the past three years, we not only had to trade our high yield portfolios, but handle subscriptions and redemptions from clients as well,” says David Mihalick, Head of U.S. Public Fixed Income at global asset manager Barings, headquartered in Charlotte.

Barings, a subsidiary of insurer MassMutual, managed \$325 billion of client assets as of June 30, of which \$243 billion was fixed income, including \$51 billion in U.S. and European high yield bonds and loans. The fixed income team, including a high yield group of over 70 investment professionals and thought to be among the largest in the industry, includes six traders – four at Barings’ Charlotte headquarters and two in London.



“Through November and December, which were arguably the most volatile few months over the past three years, we not only had to trade our high yield portfolios, but handle subscriptions and redemptions from clients as well.”

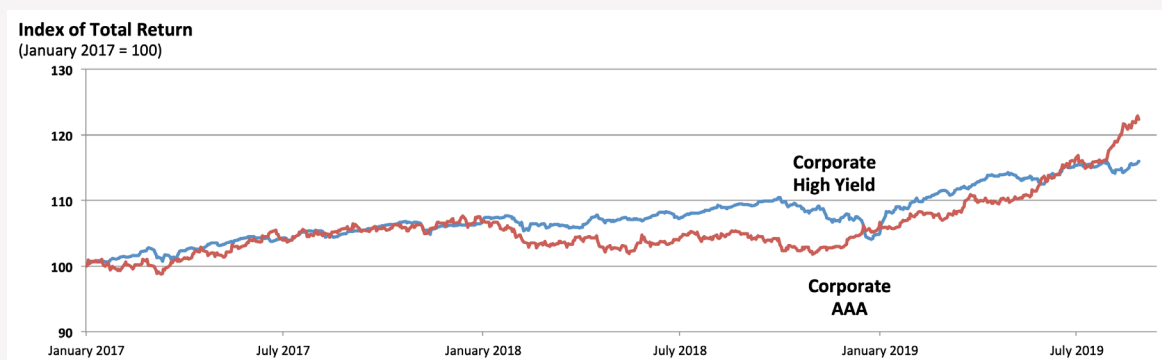
DAVID MIHALICK

Barings' Head of U.S. Public Fixed Income

"In 2018 our volumes were up 6% on secondary bonds," Mihalick says, "and keeping up with that volume required thousands of transactions. MarketAxess has developed into one of our top counterparties in high yield, and we were able to find liquidity in places that we had not before, through the all-to-all reach of Open Trading."

High yield prices weakened early in October 2018 and recovered in early 2019, but not before seeing lots of volatility.

TOTAL RETURN OF BANK OF AMERICA MERRILL LYNCH US CORPORATE AAA AND US HIGH YIELD B INDEXES, JANUARY 2017 TO AUGUST 2019



Source: Federal Reserve Bank of St. Louis, as of September 4, 2019

TECHNOLOGY BRINGS EFFICIENCY AND AGILITY

Barings started trading high yield bonds through MarketAxess in 2013. "Originally we were submitting RFQs like everyone else," says Steve DiVittorio, Barings' Head of Public Fixed Income Trading. "But we were intrigued with the features of Open Trading, and the profile of participants trading through it."

"We wound up putting every bond holding that we had into the system, getting alerts every time something would trade, and we became more active with Open Trading. We also put MarketAxess on the desks of some of the portfolio managers

– so that they could have a window into real-time market dynamics. Ultimately, we found that through MarketAxess, we were finding quality trades, and our volumes on the platform increased." MarketAxess also provided Barings with a direct link to trading by ETF managers, a growing force in the high yield market (See "ETFs in the Ecosystem of High Yield" on page 6).

"The technology of the MarketAxess platform has become an incredibly valuable tool for our daily trading," he explains: "We have client portfolios of all sizes, and any time there's a list of smaller trades, where we're soliciting bids on 10 or 15 names, we'll put them on. That would take us an hour or two to execute on the phone, but only 10 minutes on MarketAxess. We can then devote



“Ultimately, we found that through MarketAxess, we were finding quality trades, and our volumes on the platform increased.”

STEVE DIVITTORIO

Barings' Head of Public Fixed Income Trading

that time to getting better looks on more difficult, credit-focused trades where we can do larger blocks. That additional time for research helps us execute the ideas behind our strategies, which is central to serving our clients.”

“Odd lot trades can be extremely important to us, and to be able to execute at as close to the bid side as possible when buying odd lots is crucial,” DiVittorio says. “We utilize MarketAxess to handle client flows and ramp our accounts, enabling us to be consistent with pro rata portfolio allocations and provide good executions as well. Those details are critical in delivering our strategies across the board with clients, and meeting our fiduciary obligations in the process.”

But over time, Barings has turned to MarketAxess for increasingly larger volumes: “Today it’s not uncommon for us to trade round lots of \$1 million or \$2 million, and we’ve responded to RFQs for as much as \$10 million via Open Trading.”

“MarketAxess also introduced us to straight-through processing technology, which is even more powerful,” says DiVittorio. “We don’t have to enter our trades or book them several times – we just execute them on the system and STP carries them all the way through. We’re saving a bunch of time every day – about a third of our bond business is going through that way.”

LOANS: A SECOND HIGH YIELD MARKET

The high yield trading desk at Barings covers the full spectrum of below investment grade instruments, and seamlessly moves between bonds and loans in the U.S. and Europe. As of June 30, 2019, the firm managed \$37.6 billion in bank loans, across the U.S. and Europe. “Knowing how well MarketAxess worked for us in the high yield bond space, we thought it would be great if we could trade loans through the same platform,” notes DiVittorio: “I went to MarketAxess and asked how we might make that happen, and they said ‘Coincidentally, loans are our next asset class to target.’ We started working together on a structure, and in late 2016, Barings made the first electronic loan trade on the MarketAxess platform, on the first day it was available.”

“In late 2016, Barings made the first electronic loan trade on the MarketAxess platform, on the first day it was available.”

STEVE DIVITTORIO

Barings' Head of Public Fixed Income Trading

"The loan market is much smaller than the high yield bond market, when it comes to the number of investors and dealers," he adds: "Last year we traded with about 50 dealers in bonds, but only about 20 in loans." The market is growing rapidly, however: The Loan Syndications and Trading Association reports outstanding loans of \$1.1 trillion at year end 2018, 20% higher than a year earlier. Trading volume reached \$720 billion for the year, up 13%.

"Both are part of the overall high yield universe," DiVittorio explains, "but the technicals and the dynamics of how they trade are very different." Loans are typically not securities, and often settle on paper documents, following a far slower schedule.

Loan trading is a throwback as well, as dealers typically submit lists of desired trades to their clients through a manual system of spreadsheets, DiVittorio notes. "If I'm doing 10 loan trades, it can take 10 to 15 minutes each to find out who has the best offer, to engage, and talk about where they offer it – equating to an hour or two at least. With MarketAxess I can have them done in 10 minutes."

In addition to a simpler process, loan market participants enjoy a boost in liquidity through MarketAxess. Sixteen leading dealers trade through the platform, which came into its own in the fourth quarter of 2018, when MarketAxess handled \$1.4 billion in secondary market trading volume; round lots accounted for about three quarters of trades. Loan trading on the platform for the full year reached 4,200 transactions and \$3.3 billion.

In addition to a simpler process, loan market participants enjoy a boost in liquidity through MarketAxess.

TARGETED RESEARCH AND HIGH-CONVICTION PORTFOLIOS

"One important aspect of our style is that we're always looking to make good relative value trades in the portfolios," DiVittorio says: "We have a cross-Atlantic presence, and the teams in Charlotte and London are constantly talking to each other about finding relative value across geographies, as well as across the sub-asset classes of bonds and loans. Having a tool like MarketAxess gives us a better view into all the markets."

Overall, Mihalick and DiVittorio believe MarketAxess is crucial for Barings to deliver its value proposition to clients. "One aspect of that is ensuring that our portfolio managers have timely market color when they are making decisions," says DiVittorio: "Both from a market information perspective and from an execution perspective, our portfolio managers have been pleased with what MarketAxess has been able to provide."

"Both from a market information perspective and from an execution perspective, our portfolio managers have been pleased with what MarketAxess has been able to provide."

STEVE DIVITTORIO

Barings' Head of Public Fixed Income Trading

Barings is known for their rigorous fundamental analysis and bottom-up credit research, which result in high-conviction portfolios. "We pride ourselves on the depth of our research. We are true credit pickers and that's where we believe we add the most value for our clients, as opposed to sticking close to indexes," says DiVittorio.

"We're active across the entire high yield universe – from the largest credits to smaller names, and as a part of that, we have the ability and expertise to invest in smaller deals – \$250 million to \$350 million. Because we know the credits, and have spent the time underwriting them, we're also comfortable taking meaningful stakes in select deals," he explains. "Investors that are more index-oriented might not look at deals of that size, and let them go."

This more discriminating style means that Barings' portfolios may include credits that are lesser-known and less liquid. "It's impossible to talk to every dealer about every name that we like, but through MarketAxess opportunities come up on the system that trade less often, and we otherwise wouldn't know about."

"We think active management creates value in both loans and high yield bonds, and our top priority over the long term is getting the credit calls right – owning the right companies, and aggressively managing credit risk and portfolio exposures through economic cycles," says David Mihalick. "With the gains in trading efficiency we get from MarketAxess, we've got more time to devote to credit research and strategic portfolio positioning."

"We think active management creates value in both loans and high yield bonds, and our top priority over the long term is getting the credit calls right – owning the right companies, and aggressively managing credit risk and portfolio exposures through economic cycles."

DAVID MIHALICK

Barings' Head of U.S. Public Fixed Income

ETFs IN THE ECOSYSTEM OF HIGH YIELD

ETFs dedicated to high yield made up a market of about \$30 billion to \$35 billion at year end 2018, amounting to about 2.7% of the overall \$1.3 trillion U.S. high yield bond market, all according to research by MarketAxess. ETFs' share of trading, however, is far higher, at least as a proportion of overall high yield risk: The five largest high yield ETFs see average daily trading volume in their shares of about \$2 billion, versus a \$10 billion average volume for the broad high yield market. However, the actual trading of cash bonds by ETF managers, for the processes of creation and redemption of ETF shares, is far smaller – averaging perhaps \$200 million to \$250 million a day.

Still, in an asset class that can at times be inefficient such as high yield, knowing what ETF market makers are trading is a must. "Trading by high yield ETFs is a very important indicator of what's happening in high yield pricing every day, and ETF market makers trade through MarketAxess almost exclusively," says Steve DiVittorio: "I wouldn't say they have taken over high yield, but they certainly are the marginal buyers and sellers in the market." Initially ETF market makers only sent RFQs to the system as liquidity takers, but realizing they can trade inside the bid-offer spread, have more often been responding to RFQs, expanding their role to act more like dealers.

"We think fundamentals still drive the high yield market in the long term, but for daily trading, seeing those ETF flows in real time is very important," David Mihalick says: "To be able to capture how many offers or bids are wanted in MarketAxess, and see what their lists look like and in what size, are very helpful in letting us know what's happening in the market in the short run."

MarketAxess.com | ©2019 MarketAxess Holdings Inc. (the "Company"). MarketAxess, the MarketAxess logo, Open Trading, Trax, and "Now you're in the market" are trademarks of the Company. MarketAxess Corporation is a member of FINRA and SIPC. MarketAxess Europe Limited and MarketAxess Capital Limited are authorised and regulated by the UK Financial Conduct Authority. MarketAxess Singapore Pte. Limited is recognised by the Monetary Authority of Singapore. This information is not intended to represent an offer or solicitation of any financial instrument. Proprietary and confidential information of the Company—all forms of copying prohibited.