MSCI

FROM YEARS TO MONTHS: ACCELERATED DEVELOPMENT OF SYSTEMATIC CREDIT

Leveraging existing equity and fixed income tools to more swiftly address client demand for systematic strategies

HEDGEWEEK

- More than two-fifths of hedge fund managers deploy systematic fixed income trading, or are considering it
- New technology and investment opportunities are driving the shift
- Challenges like sufficient internal expertise seen as surmountable

Systematic fixed income strategies are playing an increasingly prominent role in the industry, as new technology and investment approaches unlock more opportunities in credit.

New Hedgeweek survey data has revealed that more than a fifth (21%) of hedge fund managers already deploy systematic fixed income strategies, and the same proportion are exploring them (see Fig. 1). Eighteen percent of managers are considering implementing systematic fixed income strategies, but have not yet committed to do so, while an additional 3% have firm plans to do so.

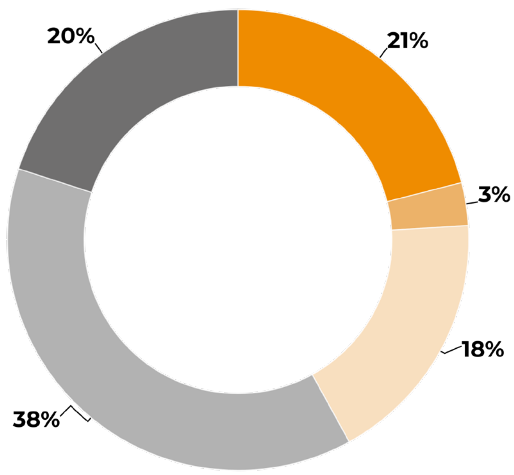
That signals a higher level of active industry deployment and future intent than widely assumed within the industry, according to Michael Hayes, who leads MSCI's research on fixed income, derivatives and model validation.

"There is a big opportunity building in systematic credit and hedge funds are now at the forefront of this trend," he says. "We've seen a lot of a lot of systematic equity groups expanding into credit, in response to demand from investors."

The objective of outperforming bond markets with superior risk-adjusted returns was seen as the biggest driver by Hedgeweek's manager audience, picked by 36% (see Figure 2). This was followed by "new alpha sources" (31%) and "meeting client demand" (26%).

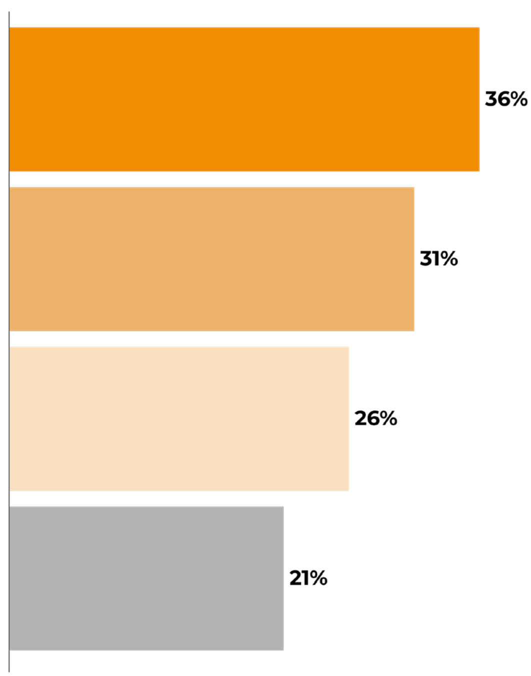
"Systematic strategies are appealing to institutional asset owners because they are in some ways more transparent than a discretionary strategy," says Hayes. "You can describe the system that underlies the strategy and back-test it. It is also more customisable, which feeds into another key industry trend. There is also less key person risk."

Figure 1 Have you (or are you considering) launching new systematic fixed income strategies?



Analyst note: "No – not relevant (e.g. we are a service provider)" answers were removed from the calculation.

Figure 2 What would be the main reason to launch systematic fixed income strategies?



Analyst note: Multi-selections permitted.

Sources: *Hedge Fund Manager Survey Q4 2024*

On the supply side, the credit markets are becoming significantly more liquid with more electronic trading and the rise of ETFs. That means the barriers to entry are much lower, he adds. "Phone traders used to execute everything. Nowadays it's mainly, in some cases entirely, electronic. You can get into the space more easily without hiring an army of traders or a new set of quants."

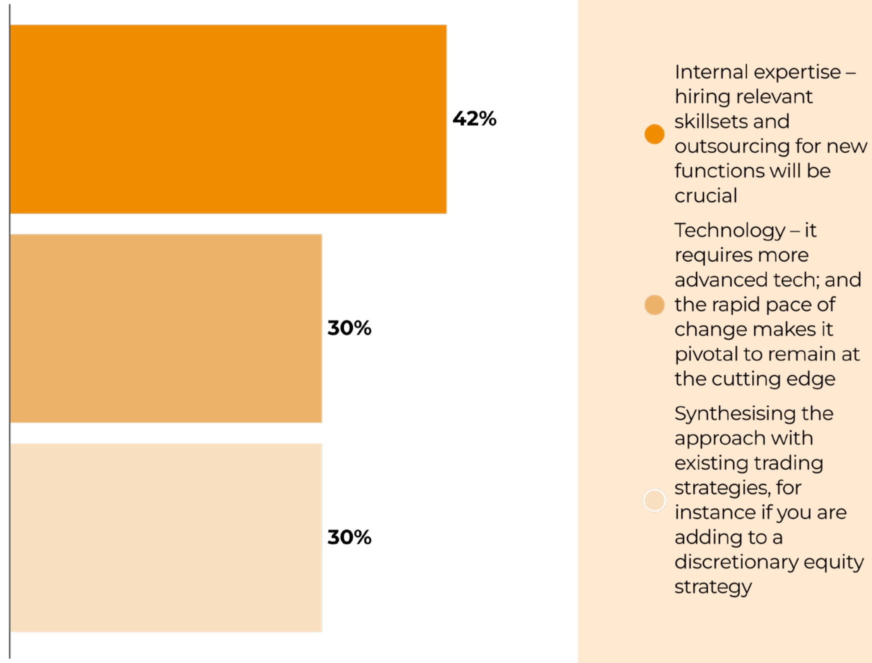
Where could the challenges lie? For 42% of the Hedgeweek audience, having enough internal expertise was the top issue.

"Internal expertise is seen as a difficulty, but as public credit and equity markets become similar in their liquidity and ease of execution, the systematic equity skillset becomes more relevant to credit," says Hayes. "It means you don't necessarily have to be a fixed income veteran to succeed in the space."

MSCI is seeing demand from both managers and investors, the latter often looking for transparency insights around performance. "On the buyside, clients can get some of the basic building blocks for their portfolio management and signal construction off the shelf from us."

He adds: "Something that might have taken a year or two to build, they can build in a matter of months. It is an exciting time for the strategy."

Figure 3 What difficulties or challenges could arise when launching systematic fixed income strategies?



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KEY TAKEAWAY

A growth in investment opportunities combined with rapid improvements in technology, speed and performance are driving a sharp increase in systematic fixed income trading by hedge funds.