

SYSTEMATIC INVESTMENT GRADE CREDIT STRATEGY

The Opportunity

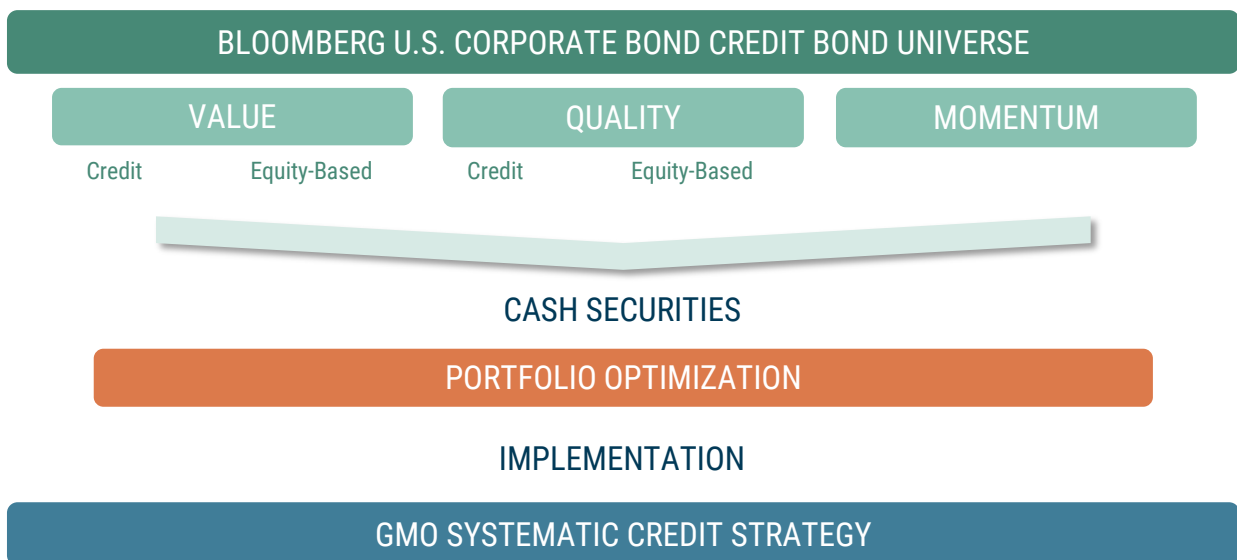
The U.S. investment grade credit market currently stands at \$4.9 trillion in non-financials, reflecting a three-fold increase in its size since 2009. As a component of broad U.S. fixed income indices, investment grade corporate credit now stands around 30% of notional market capitalization. Investment grade corporate credit spans all major sectors and offers relatively lower default risk and higher quality access to corporate balance sheets across the global economy. At GMO we have developed quantitative corporate credit capabilities that allow us to deliver alpha through systematic approaches that can be customized to any part of the investment grade universe.

The GMO Solution

GMO's Systematic Investment Grade Credit Strategy is an active corporate credit strategy that seeks to generate alpha through factor-based models for credit selection. The Strategy allocates to value, quality, and momentum captured through proprietary fair value models, measures of changes in default risk, and momentum signals derived from credit and equity assets. Environmental, social, and governance (ESG) factors are considered a component of the quality pillar at GMO, and the portfolio targets an ESG profile higher than that of the Bloomberg U.S. Corporate Index. Risk is managed through quantitative portfolio construction methods that control for overall benchmark spread, duration, ratings, sector concentration and risk characteristics.

SYSTEMATIC CREDIT DESIGN

A journey into credit



SYSTEMATIC CREDIT: BOND ALPHA ENGINE

Create a blend of value, quality, and momentum

VALUE



- Cheaper priced securities revert over time to their fair value
- Merton's option pricing model – Moody's KMV fair value spread
- Proprietary regression model of OAS regressed against firm fundamentals

ESG AND QUALITY



- Create a default risk-based metric that is issuer specific
- GMO's proprietary equity quality factor combination
- Incorporate ESG scores – quality reflecting tail risk in the portfolio

MOMENTUM



- Cross asset price and spread momentum

LIQUIDITY



- Incorporate liquidity costs in simulation and TRACE/volume data in implementation
- Combination of portfolio and line trading for execution

PORTFOLIO OPTIMIZATION

GMO's Systematic Credit framework offers a means of managing investment grade credit that can be customized based on a number of factors, including ESG-related components, ratings composition or tolerance, focus on specific parts of the maturity spectrum and the opportunity to combine investment grade and high yield credit exposure. These “building blocks” can be applied in a variety of ways to design a custom portfolio that meets a client's specific objectives. This modular framework can be easily extended to euro, global, or otherwise custom definitions of the global investment grade credit universe, and as such serves as the foundation of many of GMO's fixed income solutions.

Modular parameters set to investment objectives

OBJECTIVE

Maximize expected return subject to tracking error penalties

RISK MODEL

Build risk factor model incorporating exposures to corporate sectors, OAS, OASD, size, etc.

CONSTRAINTS

Turnover, number of names, sector exposure, spread duration, rating

OUTPUT

Optimal portfolio of bonds with representation across issues, issuers, and sectors

Several key features differentiate the GMO Systematic Investment Grade Credit Strategy:

- **Systematic Credit:** Systematic credit strategies draw on GMO's innovative research and quantitative investment expertise across both fixed income and equity asset classes to invest in investment grade and high yield corporate credit.
- **Innovative Approach:** GMO's quantitative style is distinct in this space, offering a differentiated and complementary solution relative to the platform of broad investment grade credit managers.

- Nimble: GMO's approach can be tailored to different investable universes and calls on the same themes of value and quality that pervade our organization. This approach allows us to adjust our solutions to consider various parameters and meet multiple objectives.
- Trading and Implementation: GMO has deep trading capabilities in both synthetic and cash bond securities. The same team trades all investment grade and high yield corporate credit, taking advantage of shifts in issuance and credit quality (e.g., fallen angels and rising stars).

The Client Fit

The GMO Systematic Investment Grade Credit Strategy is an appropriate fit for clients seeking:

- Investment grade corporate credit exposure that is managed in a systematic, risk-mitigated way and can be customized to handle specific guidelines on duration, maturity, sector concentration, ratings, etc.
- Alpha delivered through exposures to value, quality, momentum, and well-articulated sources of risk premium in corporate credit with specified exposures to duration, sector concentration, and credit rating, among other dimensions of credit risk.
- ESG integration – ESG considerations can be targeted explicitly within portfolio construction and systematically evaluated to inform design. The portfolio can be screened relative to the benchmark and biased toward specific ESG objectives such as carbon intensity, GHG emissions, or the overall profile.
- Opportunities to combine investment grade corporate credit exposure with GMO's capabilities in emerging market debt, rates and currencies, and other sectors of credit such as securitized, high yield or distressed credit, and the ability to construct such solutions using systematic portfolio construction methods.
- To complement fundamental or other fixed income styles with a quantitative and customizable approach to meet their portfolio objectives.

Who We Are

Founded in 1977, GMO is a global investment manager committed to delivering superior performance and advice to our clients. Our sole business is investment management, and we are privately owned, which allows us to maintain a singular focus on achieving outstanding long-term outcomes for our clients. Offering solutions across multi-asset class, equity, fixed income, and alternative strategies, we are grounded in a common philosophical belief that a long-term, valuation-based approach will maximize risk-adjusted returns. We also believe that material ESG factors will be determinants of success of the companies and countries in which we invest, and that integrating ESG into investment processes can improve our long-term results. Known for our willingness to challenge the status quo and our creative approach to investment problems, we candidly share our market views and take bold, differentiated portfolio positions when conditions warrant them.

The Team

GMO's Systematic Credit/LDI team is co-managed by Jason Hotra and James Donaldson. The team is cross-asset in nature, drawing on expertise from both equity and credit quantitative research to inform the Strategy. Team members have advanced training in finance, economics, physics, math, statistics, and computer science – experience that they draw on in the development and implementation of GMO's systematic credit strategies

RISK

Risks associated with investing in the Strategy may include Market Risk - Fixed Income Investments, Credit Risk, Illiquidity Risk, Derivatives Risk, and Short Sales Risk.