Perspectives Podcast

“Yield Games: Bonds, Swaps and Strategy”

Transcript, 5 June, 2025

ADAM BASS INTRO

This is MSCI Perspectives, bringing to light insights and analysis that help global investors tackle today’s challenges. I’m your host, Adam Bass, and today is [insert date].

In this episode: inflation, interest rates, trade disruption—and beneath it all, a fixed income market adapting at speed. With Treasury auctions stirring unease and a dramatic shift in how global investors are positioning, it’s no surprise that bonds are back in focus. But the questions are bigger than just "what to buy." They’re about what tools to use, what risks to hedge, and how to think long-term while volatility seems to dominate the short term.

Or as our first guest, MSCI’s global head of fixed income and derivatives, George Harrington put it.

Harrington, George 1:23

Yeah, it's certainly been a really dramatic, you know, start to the year with the volatility that we've seen across markets. And yes, for sure, the equity, you know the equities get the headlines all the time, but when we go back to you know, the sort of the kick.

Of the tariffs on on Liberation Day and we saw the activity that went on in the market, obviously equities, you know took.

A pretty significant hit, but that was followed by.

By some very sharp selling in the US Treasury market, especially in the longer end of the curve.

And that's really what started to raise alarm bells.

And I think that, you know, for the administration, you know, there was a lot of pressure on, you know, on the on the tariff policy as a result of that because there was unexpected selling that you know really started to accelerate. And just even you know in the.

Last week.

You know, with the with the introduction of the big, beautiful bill and.

And the expectations on what impact that may have certainly on deficits, you know that's caused you know, a second round of concern in terms of, you know, what is, where is the, where is the economic policy going and what does it mean for you know, the credit quality.

Of the United States and will some of the traditional buyers of U.S. Treasuries, you know, start to, you know, start to move away.

We've had some positive auctions since then, which is, you know, allayed some of the concerns.

But now you're also seeing some more negative reactions regarding, you know the you know how it's going to affect the deficit longer term.

And so I think that's going to be a big focus of the market and you know, even even I think you guys know well, you know we're in a headline driven you know market right now where there's a lot of reaction.

So I think that the the debt policy of the US is going to become.

Almost. You know, one of the things that the markets watching.

Intraday for you know hints of changes to you know to to the policy.

ADAM BASS

Our second guest today

Haede, Marc 1:14

OK.

Ready.

All right, i'mark. Heda based out of Frankfurt, Germany here. And my role at MSCI is I am the global product manager for MSCI fixed income indexes.

ADAM BASS

Built on that idea around the impact on fixed income in particular

Haede, Marc 1:55

Well, Adam, the headline tariff risk has actually been dominated by equity levels, but also by treasury yields in the recent past. However, stress in the fixed income markets is also evident in the mispricing of bonds relative to the curve to the yield curve, right.

So dislocation metrics such as this, they have increased by 30 to 50% since the start of the.

Tariff turmoil and this indicates that there are maybe.

Rising frictions in pricing and liquidity in the bond market.

So although overall levels remain below.

Levels of previous crisis the speed of this move is unusual, comparable only to the speed that we saw back in the COVID crisis and then further back 2008 in the global financial crisis.

So let me give you you know 2 examples, one on the corporate bond market.

One of the treasury market in the corporate bond market, a sharp spike in dislocation during the COVID crisis, caused the Federal Reserve to intervene as a buyer of corporate bonds.

Whether similar intervention will be necessary this time around, the tariff war remains to be seen and in the treasury market the recent dislocation it may be linked to unwinding of so-called basis trades commonly cited as.

As potential drivers of treasury market instability, so for fixed income portfoli managers, these developments they signal both accelerating liquidity risk but also opportunities especially for those who can quantify and act on the dislocation signals.

So the question is, what comes next, the current term?

What is caused by rapidly changing macro outlooks?

Caused by abrupt tariff policy changes.

So if the uncertainty around the tariffs persist, markets may continue to deteriorate.

And it's plausible that market dislocation could continual continue its unusual rapid increase.

Now finally, and I go back from pure fixed income, let's take a little bit of view on multi asset class Mac portfolios. Economists all over the world have cut growth forecasts recently and also.

Here they are raised.

Their inflation expectations since that US tariff announcement at the beginning of April and for so-called multi asset class Investors.

The key question is how these shifting macroeconomic expectations could affect asset prices and how that effect compares to the recent sell off. Our research has provided investors with a framework.

To assess precisely that.

The portfolio impacts of these three macroeconomic scenarios, we won't have time on this podcast today to go more into detail, so I would invite our our listeners of this podcast to look up our research page and you'll find.

A wealth of information and amongst those these three macro scenarios for a multi asset class portfolio.

ADAM BASS

George? Any thoughts on that?

Harrington, George 4:03

Yeah.

I think from a risk standpoint, I think that there is just a tremendous amount of caution in the market, right.

So there's there's no question that you know, there's been some reallocation to cash while there's, you know, really unclear.

You know unclear direction in terms of where that's going, but I think the bigger, the bigger you know sort of fear out there that's lurking.

Is that again, you know non-us holders.

Of U.S. Treasuries, and especially longer and treasuries, you know, may start to shy away, you know, from the asset class now and to the extent that happens, that's going to mean for for the US domestically rising long term interest rates and that's going to affect you know the.

Mortgage market.

You know, student loans, car loans, every everything will be affected by that.

So it really reverberates through.

Through the economy, you know very, very loudly and very quickly.

And also keep in mind, we've had been in an extremely low interest rate environment for a very, very long time.

Obviously you know that started changing with inflation during the last US administration. You know, rates started rising significantly for the first time in a long time, you know, but that was not because of that was not because of sell offs.

That was really inflationary, inflation driven and then also the Fed was it was in an interest rate rising environment.

Now the Fed is steady and is holding fast.

Despite pressures to do otherwise.

They're they're holding because they do have their eyes clearly on inflation related to the tariffs, but again, that selling, you know that core selling of long dated U.S. Treasuries.

While you know while the holders, the traditional holders you know have always been have been there for, you know, for decades that really again sort of shakes the foundation in terms of where we're.

ADAM BASS

We'll dig in further in terms of liquidity risk and some of the other concerns for investors in a bit. But, sticking with the big picture for now, I'd like to bring in our third guest, head of fixed income and multi-asset class research at MSCI, Jarrad Linzie. While he doesn't necessarily disagree with his colleagues, he has a somewhat different perspective on the impact of this instability.

Linzie, Jarrad 1:53

Yeah. Thanks for that, Adam.

Now look, the the reality is yes.

The US is no longer has a a a a rating from any of the major credit agencies, but I don't think this really shaken up anything in terms of overall global markets.

So in fact, the US makes up about 25% of global fixed income as it stands right now.

And if we start to look at fixed income as a whole and how it's managed about?

15%.

Of assets are actually index within the fixed income space, but when you start to even look at active strategies, those tend to be very closely index aligned where 60 to 80% of those are beta exposures.

So when you start to look at the overall framework, this probably means that 3/4 of fixed income.

Is still aligned to benchmarks in itself, which effectively means that they're going to have structural allocation toward U.S. Treasuries now. If you start to look at fixed income and you see 33 trillion in fixed income AUM, the more recent downgrade, yes, you know, but there's still a.

Of confidence and and what we've also seen from investors in itself is that there's been probably more a shift toward short dated bonds.

But when I speak to any of our asset owners and asset managers, they're still core allocations to treasuries. And even when we think about it from a sustainability perspective, there's still allocation toward the US and in treasuries in general.

So I do think that.

As it stands today, yes, there there's been a bit less sponsorship on the last auction, but I think it's a little bit too early to kind of just go out and say that there's going to be less demand moving forward, just because what the US or what us?

Treasuries mean for overall fixed income market in itself.

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AI-generated content may be incorrect., PictureBass, Adam   4:04 in Jarrad interview

Thank you.

That's that's it's an interesting perspective and definitely speaks to some of the the headline risk versus what may actually be underlining. And just to be clear.

You're hearing that same those same thoughts from clients that they see this maybe how should I put it as a as a blip more than a structural change?

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Linzie, Jarrad   4:29

Yeah, because from from clients, they're they're not even looking at the day-to-day.

They're looking at more about strategic allocation, so they're not even thinking about things tactically. They're looking at yields.

They're looking at exposure.

They're looking at diversification. So in their mind this is more of a maybe a tactical thing that you can kind of get in and out. But from their perspective, they're thinking about fixed income more strategically over the next 5 or 10 years.

Hence why I think it's a little bit too early to.

Really say or if the jury is out, that there's going to be less demand for foreign sponsorship moving forward.

ADAM BASS

Jarrad's take rests partly on this idea that about 75% of the fixed income market is aligned to benchmarks, indexes. This notion relates to a point that came up when I was speaking with Marc, in terms of the significant shift of fixed income investors from active to passive strategies and why it may be happening, especially when it comes to those with a focus on sustainability and climate.

Haede, Marc 14:52

Yeah. So the the acceleration from active to passive input in particular in fixed income.

Is, is is definitely happening.

And and specifically for those benchmark to MSCI sustainability and climate indexes.

And it is.

I think it is driven by a couple of of key factors.

Number one is cost efficiency.

Everybody knows that passive strategies typically have a lower management fee compared to active strategies.

And this cost efficiency in particular is appealing and the fixed income space where margins are even tighter than on the equity side, #2 is transparency and simplicity. Passive investing offers greater transparency and simplicity, so investors know exactly what they are getting. If they replicate an index because.These strategies aim to, you know, give them the performance.Of a specific exposure with a specific overlay.#3 is what we call performance consistency.Passive strategy is often provides more consistent, more cohesive performance relative to the market benchmark.Now again, it depends a little bit on the specific implementation I mentioned the the broad spectrum in my last answer.

So you have low tracking error versus medium or even high tracking error.

Sustainability and climate indexes but.

But by and large, a passive strategy will give you this performance consistency and then finally there is across the board, even though maybe the momentum has slowed down in some parts of the world, a little bit over the last, call it three years, but still there is an.

Increased demand for sustainability integration. There's a growing demand for.

Integrating environmental, social governance and climate factors into.To institutional investors, investment strategies and MSCI sustainability and climate indexes, they offer a very efficient way for investors to align your portfolios with these goals. And while benefiting from you know, passive investing and and last but not least, there is also certain regulatory and market trends. So,

Reg?Changes that are increasingly favoring sustainable.And climate conscious investments and this has led to.Surge in demand for indexes that incorporate these factors.Now, last but not least.

You know, take a little bit of a sidestep here and and honing in on a on a different subject, the fixed income market has undergone and keeps undergoing also a rapid technological change. If you think about it, electronification of bond trading is, is really making its way in.

Into the into the market and it has made it already.

So it's it's.

It's being used.

In in large scale and then in addition to that, this is close to my heart at MSCI and our heart, you know, with the with the Berea brand that we have the the risk models and the portfolio optimization and so on. We you know, clients today benefit from.

What I call next generation portfolio management tools, they enable investors to efficiently replicate bond indexes in a much better way.

Than that was possible.5-10, fifty 20 years ago.So these are drivers. These these factors, collectively they contribute to the significant growth in assets Benchmark to MSC is indexes per say fixed fixed income indexes per say and specifically msci's sustainability and climate fixed income indexes.

Haede, Marc   19:12

Yeah. So it is a good question because ultimately if you, if you think about how can passive.

Strategies be ultimately implemented by an investor. The most. I would say the the, the two most common ways is either with a passive mandate, so an asset owner hands out or gives out a mandate to an asset manager and and is asking that asset manager to to Rep.

The index and then they so.

So this would what what we internally call SMA is separately managed.

Account and the other is an ETF, right?

And so we see both happening.

We probably see.

In continental Europe and in APAC, a little bit more the mandate route happening and then we see in, in, in, in, I would say in northern parts of Europe and to a certain degree also in some countries in continental Europe, the ETF route.

Out. So where clients say look, I I like the idea of having.

A daily or even an intraday tradability feature with my investment that that that lets me allocate, you know, run tactical allocations in a very quick, easy and cost efficient manner.

So those are the two really the the two major implementations, passive mandates and ETFs, a third one that we we are seeing on the rise is from you know from investment banks from from fixed income.

Sell side or you know structuring desk is D1 solution such as a total return swap or a basket trades.

This is.

I think this is complementing the mandates and the ETF instruments.

ADAM BASS

With that as background, the next logical question here seems to be, "What have fixed income investors actually been doing?" Or to put it another way, what do we see if we follow the money?"

Linzie, Jarrad 8:54

Yeah. So what what we've seen is?

There's been definitely some flows out out of the US.

But again, this is more of a tactical thing.

But what I do think that it's open up an allocation toward emerging markets pretty substantially.

So it's interesting because when we look at the performance of, let's call it dollar denominated markets across US, high yield emerging markets.

And treasuries, the performance is not very different across the board now.

There's definitely differentiation when we think about the overall volatility year today. But if we start to just take a step back and think about performance in U.S. government bonds, we're up 2 1/2% year to date.

Investment grade credit is about 2 1/4% high yield is at 2 3/4% year to date and EM sovereigns is roughly in line with us. High yield and EM corporates.

Let's call it roughly around 2.6%.

So the overall return spectrum is fairly tight, but when you let's if we come back to emerging markets and your question on emerging markets and I think the demand is really going to come into play with local markets more than anything because that's where most of the INT.

Is going to and interesting enough, a lot of emerging markets, local market products today are hedged.

But where we see the demand is really coming in around the FX. And when we look at the US dollar being down 8% so far this year, it's basically a tailwind for EM and obviously.

Em local markets being the main beneficiary of that.

Now I think you know historically EM local markets and primarily FX has been an underperformer due to the FX component.

But when you when you start to think about overall volatility and alpha generation, then you know FX and and where where the dollar is today, FX becomes a real structural allocation and meaningful way to provide a bit more.

You know alpha and outperformance.

In our overall portfolio, but with all that being said, I'm keen to see how the market kind of repositions these head strategies into potential unhed strategies to go back and grasp the alpha or the volatility within FX markets in itself, because naturally a weaker dollar is going to.

Mean more positive out performance for emfx as a whole?

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Bass, Adam   11:53 from Jarrad interview

The the FX trade, not to oversimplify it, was all about the strong dollar.

And now that that seems to have been shifting, it's a it's a different ball game, is that?

Am I understanding that correctly?

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Linzie, Jarrad   12:03

That that is correct.

So the the, EM, the EM trade.

So there there's 22 scenarios here when we think about emerging markets, there's dollar denominated emerging markets.

But then there's also local currency.

Now the dollar denominated market has been around for a very, very long time.

And in that that's kind of transcended into local markets and the idea here was to kind of double dip from an investor perspective where you get rate return or credit local credit return.

Plus the return of that fax and when.

Ian local markets actually came to fruition.

There was a huge amount of demand because FX EM FX has performed so well.

But then there was a 10 year, maybe even a bit longer than that period where Emfx was the dog of the performance.

And now, because the dollar was strengthening so much.

And now when you see that the dollar is actually weakening.

It provides more of an allocation toward EMFX, where you can kind of go back to those happy days where if you ever run, let's call it an efficient frontier model, you have a good allocation toward EM local markets because of the double dipping where you.

Have the rate return or credit return and the FX component providing alpha generation opportunities.

Harrington, George 15:22

Yeah. So it's hard to.

It's hard to compare sort of the developed market debt and the and the EM debt.

So EM activity you know is is relatively strong, but generally you don't.

You won't necessarily see a switch from DM to EM debt per southeast.

I mean there can be.

You know the flows can.

The flows can definitely, you know, sort of switch direction a bit, but they're almost they're almost different asset there. Certainly different sub asset classes.

But the asset class is almost act independently from one another, certainly in the government debt market, the the ex U.S. trade is absolutely become more popular.

So people are looking at, you know the, you know, when you look at the credit quality of the United States, obviously just a few weeks ago, we had the Moody's downgrade, you know, now the US has been downgraded from AAA by all three of the major.

Us rating agencies.

Moody's was not the first to move on that. They were the last to move.

And therefore, no question that you know, domestic investors, international investors are looking at the entire, you know global debt.

Global developed market, I should say global develop market debt and they're looking at they're looking for other safe havens.

You know, obviously they're not.

You know, it hasn't been a fire sale out of treasuries, but they're certainly balancing much more than they than they have previously.

Picture 81, Picture

Bass, Adam 16:48 from George inteview

What about in other areas of the debt market? Then if you say that's government debt?

A person in a suit and tie

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Harrington, George 16:52

Yeah, yeah.

So I I think that I mean from from a credit issuance standpoint, the thing you know that we luckily have not gotten into you know as a result of the tariffs or the downgrade or the new tax policy, we have not had you know a difficulty in Li.

In credit, you know, and when you talk about, you know, the major financial crisis is, you know that we've seen, you know, going back to the global financial crisis and and certainly and crisis is before that.

Credit crunches are are.

You know, you know, almost always a component of it where liquidity dries up.

Issuance dries up the ability to the ability to get out of positions becomes difficult and expensive.

We have not experienced that which is, which is great. So the health of the corporate credit market remains, you know, remain strong. The demand remains very strong. So new issue.

Is having no problem getting placed.

People are having no issue getting out of secondary.

The market is evolved so much.

Much and my, you know, my career before MSCI, I ran.

You know, I ran different trading businesses for Bloomberg and for Tradeweb who are both our major players in the in the electronic trading place, electronic trading space.

Sorry and you know that the evolution of that market of electronics trading for first governments, but then it but then into corporate credit and then into you know the derivatives underly.

ING for much broader market.

Efficiency. Things that used to trade by appointment over the phone now have you know much deeper liquidity from many different players.

The evolution of what's happened with the sell side, where the traditional sell side in terms of liquidity provision have been joined by new entrants. You know such as you know Citadel flow traders Jane St. and and jump trading many, many others.

It's changed dramatically and therefore, you know, while we're seeing, you know.

A lot of volatility in equity prices, a lot of volatility in you know in the treasury market and the longer in the longer end of the treasury market, the corporate credit market you know has maintained a a tremendous amount of efficiency. And I do believe that the elect.

Of the market is a part of that, and then certainly the increasing breath of liquidity providers is also a major factor in that.

ADAM BASS

There's that idea of tech again, that Marc raised earlier when he was talking about the shift to passive investing for fixed income investors. And unless you thought we'd get through an episode without raising the idea of AI, I simply note here that, regardless of macroeconomic and geopolitical situations we find ourselves in, it seems certain that the world of investing is not going back to a pre-AI world. And if it pleases our coming AI overlords, let's turn now to another area of the market getting a lot of attention recently, derivatives and how investors have been using them to address volatility and other risks. The world of futures, options and other strategies with a dependency on other assets.

Harrington, George 8:36

Yeah. So I mean, we're in a period of significantly significantly higher volatility than we have been for really going back to the, the, the beginning of the COVID crisis. So with that, you know the markets have been you know very, very low volatility. If you look at the.

VIX index you know below certainly below 20 below 15 and 12 at times.

And then we've had this, this massive shock, right? That's come in.

From the tariff standpoint, what that has resulted in is a great deal of activity. You know, in the, in the list of derivatives markets and also very specifically for MSCI.

So looking at, you know, some of our numbers we've seen you know very, very strong activity in some of our largest futures contracts. You know emerging markets, you know incredibly, incredibly active.

EFA, incredibly active in terms of overall throughput of of trades.

So yeah, really really stepped up quite a bit as a result of that.

Again, I think people are looking at sort of the the ex U.S. trade.

So that's been a that's been a big driver. Iifa of course is is world ex US and Canada.

So we've seen, we've seen significant significant flows there.

We've also seen sharp pickups in the open interest of those futures contracts, and there's no question people are absolutely.

You know, placing, you know bets and they're also hedging existing positions.

That allows for a bit of diversification away from the US and we're seeing that on our, you know, on ICE which is our US based exchange partner as well as UX who's our major European exchange partner.

So it's definitely a global global phenomenon that's going on and we're seeing similar activity at both of our major exchange partners.

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Bass, Adam   10:30 from George interview

And are you seeing differences in preference between the exchange traded versus over the counter instruments?

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Harrington, George   10:38

OTC and your OTC has always been a a huge area for MSCI.

For MSCI derivatives, so every major bank in the world, you know their, their trading desk, their D1 trading desks, all have partnerships with us for for OTC product creation, OTC is a bit of an opaque market.

There are some, you know, there are some reporting that goes.

Into BIS, you know, into other sources where you can.

Sort of gauge what's going on on the equity on the equity OTC market, without question, activity is definitely up in terms of overall trades, unlike futures where you get a sense of direction. You know, you don't get that, you know in OTC because the reporting, the reporting is.

Not there, but without question.

The balances are the balances are definitely rising and you know again enlisted, we've seen such strong pickups in activity.

There's no question that you know, OTC.

We believe.

You know, it's also rising.

Linzie, Jarrad 5:43

Well, it's it's interesting because as a starting point.

There's not a lot of credit futures that exist in fixed income today.

Now we have a few credit futures that we've recently launched.

About a year ago, that spans investment grade and high yield dominated in both dollars in euros.

But there's not a lot of credit future activity.

As it stands today, most of the derivative activity within fixed income is going to be remain within the CDX market and that's what what what everyone looks at, despite there being a huge amount of tracking error toward underlying bond portfolios in itself now.

The When I talk about CDX, the the interesting part is.

And you talk about some of the the volatility within the derivative framework, is that when you start to compare daily volumes and derivatives and and let's call, it's going back to CDX?

Comparing Q 12025 volumes versus Q 12024 so year over year, the trading volumes have actually tripled year over year based on the datasets that we have. And when we look at.

The the daily numbers today it's roughly in the range of 16 to 17 billion US and if I had to be very frank, I would expect a larger increase in Q2 year over year, but we have yet to see those numbers as of yet.

Bass, Adam 7:37 from Jarrad inteview

And and what is? What is all that tell you in terms of how clients are managing risk right now?

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Linzie, Jarrad   7:45

So what that tells me is that there's obvious concerns. There's concerns for defaults, there's concerns of liquidity in itself, because these instruments tend to be very liquid, but they need to figure out ways to hedge out maybe some of their unliquid allocations in their portfolios in itself, but.

I think overall it says that there is concerns, there's uncertainty.

And they do want to make sure.

Or that they look to hedge any potential default risk in their respective portfolios.

Harrington, George   11:45

Yeah, I think that. So you know in the US at least we have data that comes from the from the CFTC called commitment of traders data, the commitment of traders data.

You know what we're seeing is versus the last, you know, major volatility shot going back to going back to the onset of COVID again where you saw we saw a huge volumes, but open interest went way down, right?

People were selling, selling, selling, closing out positions, closing out positions.

They weren't really getting short the market.

But they were just they were just trading, trading off this time. We're actually seeing rising open interest.

So we're seeing very high volume but rising and the cot data is very balanced between buyers and sellers.

So I think what that suggests is number one, the, the the health of the market is very, very strong, right.

So we're not, we're not getting overextended long or short.

We're seeing more usage and therefore people are being taking advantage of the hedging tools.

That are out there for them to protect.

Their portfolios, which is also a great sign.

I think we're also seeing some transition of OTC into listed activity.

Listed futures are generally traded at a lower price point than OTC. Depending on where funding cost may sit, but for sure it's a. It's a more efficient trade.

And you see that in global markets around the world, you know, MSCI obviously has has a time.

But if you look at, you know, the S&P in stocks and Nikkei and whatnot, another another products, you know they're seeing, you know they're seeing increased activity as well with a higher volatility.

So yeah, I think that it certainly means that there's more defensive positioning going on, but that the markets also reacting you know, very strong in a healthy and efficient way to the to the volatility.

Harrington, George   13:57

And another trend that's been happening in the, you know, in the ETF market over the last few years are the derivative strategy ETFs that have become, you know, much more popular.

So they're basically, you know, income strategies that are protected by, you know, by options, you know, from downside risk.

But but the but the use of those strategies really requires you know.

A very active underlying market and you know in options markets around the world, you know you know we have definitely seen that in these you know these derivative or option driven ETFs are becoming more popular.

ADAM BASS

OK. So, we've got global concern related to U.S. tariffs uncertainty, a bit of at least a tactical move of money outside the U.S. as a reaction to that uncertainty, as well as the decline in the US dollar and an uptick in the use of different hedging strategies, including derivatives.

But I promised you at the top of the program that we'd look beyond the short term and talk about longer term trends as well. And if the short term comes down to the word, volatility, the long term is about customization.

Harrington, George   20:08

Yeah, no, it's it's absolutely a a major factor in terms of the direction of the market. And just to be you know.

To look at the trends that we've seen know in equities from an ETF standpoint, you know that are not that fixed income is now very, very quickly following along you know fixed income ETFs have, you know grown very, very significantly looking at the major providers, you know black.

And Vanguard and others. The expectation amongst those firms is that you know that will continue to be.

You know, a major, a major push.

For growth, growth of fixed income product in the ETF markets.

So I think that will continue. And then in terms of the you know the customization, you know the well known benchmarks, the Bloomberg aggregate benchmarks, the JP Morgan emerging market benchmarks, the the ice Slash Bank of America High yield benchmarks, I think those spaces are are pretty well.

Saturated, right? No one's looking for, you know, a new AG index.

Per southeast.

But what they are looking for is they're looking for customized solutions.

And certainly in our fixed income business, our fixed income index business that is that is our sweet spot.

We're working with clients all over the world that are looking at fixed income benchmarks that they want to customize.

They want to customize whether it be target dates they want to look at.

A multi asset class index that blends fixed income and equity.

Or they want to look at sustainable solutions. And I know that that's obviously something that that's gotten, you know.

Under some pressure, but without, without question, you know, we continue to find clients in the US and Europe, in AIPAC, you know that are very, very focused on those type of solutions and that's definitely something that you know we continue to compete for and win new business in.

That customized fixed income space.

Picture 91, Picture

Bass, Adam 22:13 from George interview

And where did derivatives fit into this equation?

Picture 92, Picture

Harrington, George 22:17

Yeah. So I mean fixed income and derivatives are at a collision point right now.

So what we have seen is that, you know, in the fixed income markets, obviously the interest rate markets have had derivatives for a long time. You know U.S. Treasuries and and you know other global global fixed income asset classes have very, very deep liquid futures markets option markets.

Underly those as well.

So that's been there for a long time. The credit side of the equation really has been.

And you know, heavily underserved, you know, the evolution of credit default swaps and credit default swap indexes.

CDs indexes you know that's where many market participants you know really go to to hedge credit risk.

They're inherently problematic, mainly because of the fact that it's not a bond index, it's a CDs index.

The correlation to, you know, the standard bond indexes is relatively low.

The the default process is very very messy in terms of determining you know how you refactor the the CDs index. You know there's conflict of interest problems as well that that have that have haunted those but they, but they are the standard and they are extremely liquid from.

A trading standpoint, you know which you know, which is why they're widely used.

Credit futures is a new evolution in the market.

MSCI, you know, has partnered with market access and ICE.

In the development of our first credit indexes, liquid credit indexes and then we launched the Futures on ICE. There's other competing products in the market.

Your excess product CME has product as well.

Cboe has product, but you know what we've done is we've designed a highly liquid.

Tradable index that we've launched a future on top of that, we think absolutely has the ability to really become a major factor.

In credit hedging in the space.

So it's still early days.

The products are newly launched.

There's a lot of onboarding going on around them and also the overall credit future picture is still in its early days, but the client specifically and the banks, you know, recognize the efficiency of these products.

And there is a lot of activity around being ready to, you know, be the, you know, the early adopters of these credit new credit.

Credit futures.

Haede, Marc 6:36

Yes, Adam, I mean, as you know, MSC has MSCI has a rich suit or fixed income standard indexes across credits and rates in global developed and emerging markets. But above and beyond those market cap weighted indexes, we also have many off the shelf indexes with sustainability and or.

Climate risk overlays and many clients appreciate the availability.

Of such standard indexes because they allow them to analyze risk and return behavior.

Capacity, replicability and so on and so forth. But you asked me to talk about customization, not standardization, standard indexes.

So it's also true that in nine out of 10 client meetings.

The the engagement decline engagement it leads to a customized solution.

After all, every investor is at their specific point in the transition journey.

Some have just started, while others are considering a decarbonization strategy in the near future.

Any so and objectives as well as constraints. They vary from investor to investor.

Now I would like to break down the customizations the customization projects.

Into two categories.

Number one is a top down approach whereby clients ask us to modify a standard index methodology according to their preferences.

This could be, for example, loosening or tightening certain exclusion thresholds or decarbonization trajectories.

In contrast to this, other investors want to start with us on a blank sheet of paper.

Such a bottom up process.

Starts with a profound understanding of investors, goals and their constraints, and then matching those with the rich set of ingredients that MSCI can bring to the table.

For example, sustainability and climate metrics, bond or bond issuer specific data index construction techniques, hedging overlays and so on and so forth.

At the end of the day, we design bespoke solutions that help asset owners reach their financial and non financial goals.

Haede, Marc 9:39

OK. So in Europe, let me start with Europe.

In Europe, the appetite for sustainable investment solution, it remains solid, specifically in the segment of pension funds, insurances, public institutions, central banks and so on.

And it is.

It is very similar.

Maybe a little bit more fragmented across APAC because that region as a whole is just more heterogeneous.

But the majority of investors are in the process or at the beginning of transitioning their fixed income portfolios.

For many, this transition is centered around climates, supplemented by specific sustainability overlays, such as ESG ratings or exclusions based on on business involvement screens, controversies, global norms, and so on.We also observe an increasing interest to include sustainable development goals Sdgs into the portfolio, hence index construction methodology.Now if we want to dive a layer deeper into this, the next question is then for the specific climate overlay. What does it look like and what are the options? There's a wide spectrum of implementations. Some investors tend more towards tilting approaches, so excluding only a small number.

Of issues and issuers, such as producers of controversial weapons, to name an example.

Before then, adjusting the security.

Ways in the index in favor of, for instance. For example lower emitting companies.

The benefit of such an index hence portfolio is relatively low tracking errors versus market portfolios and modest increase in turnover and the fact that most of the bonds in the universe and without most of what an active manager would call alpha opportunities are retained.

At the other end of the spectrum.Indexes which are part of the EO taxonomy, such as Paris, align benchmarks, PAB or climate transition benchmarks. Ctb are preferred by some investors, in particular in Europe.Now those like PAB and CTB indexes, they are much stricter.They have significant exclusions, hence the starting portfolio. Would, you know, shrink by 30-40, sometimes 50%.And they apply a certain relative and a certain year on year decarbonization rates.Now I want to come back to my point that I made on customization. The reality for many asset owners lay in between these two ends of the pole and on top. Many of our clients are interested to learn how their portfolios.And their way of investing can help to finance energy transition.

So those are clients who want to embed forward-looking measures like science based targets or msci's, proprietary and innovative low carbon transition scores into the methodology. This is this is very more and more in focus here.

Haede, Marc   13:13

No, we see.

We see a very similar pattern in in APAC, I think so.

By the the wide range.

Of implementation possibilities that was just eluding to right, so that wide range is used across the board in EMEA and in and in APAC.

So of course, like I mean again I go back to the point in APAC.

You have like markets.

Who are you know, in the in Australia and New Zealand, which have maybe you know, some more similarities than than the UK market and then you have markets in the northern part of of of APEC like Japan and Korea where at the margin you know other sustainability and.Climate preference preferences are pursued, but.Again, this this this wide.Range of of index methodologies, standard and then in particular customized.It really allows even such a large region to, you know, to being serviced properly.

ADAM BASS

It's worth noting that this move toward greater customization is alive and well across many asset classes, and we'll continue to follow on this program. But, as we approach the end of this episode, I can't help but return to the fact that, despite everyone's best intentions, it's simply very hard to hear anything beyond all the noise of the moment.

Harrington, George   24:58

Well, yeah, as I think I said earlier in the in the podcast that you know, we're we're in a headline driven place, right? So and there's so much going on now around around economic policy, monetary policy, fiscal policy as we as we talked about, it's just it's so.

Difficult to tell. You know the direction of things.

You know, and how these changes, you know when when they're announced, whether they'll be adopted, whether they'll be lawsuits.

Fight them.

That will win or lose, or what?

Not so.

I do think that, you know, a really strong hedging program for any investor retail institutional is going to become more and more important and therefore, you know I think we've got some of the things that we're doing that MSCI is doing, you know, in the derivative space on.

The equity side where we have such a massive, you know, massive offering of products, you know both in standard indexes and factor indexes.

I was just looking at Min Vol into the the open interest on our min Vol futures has gone up, you know dramatically.

So I think that that's going to be you know a a big factor. I think customization for sure.

Will, you know, will maintain as a, as a as a huge area of demand, both in the creation of custom baskets or customization on the indexes themselves.

Or a mix of the two is what I certainly would expect.

And then as I just touched on with the credit, with the credit derivatives and credit futures.

I think that you know hedging for as I said earlier, we haven't seen a lot of pressure on the credit markets yet. If that becomes a factor, people will absolutely be looking for hedging tools. And I think that will, you know, they'll, they'll they'll do much more with.

Those credit futures, as as we start to see that.

ADAM BASS CONCLUSION

That's all for this week. Many thanks to George, Marc and Jarrad and to all of you for listening. Remember, you can find more insights into fixed income and derivates on the research and insights pages on MSCI.com.

Next up on the program, we shift gears to look at another issue that continues to challenge investors, the shifting landscape of debt, specifically as it pertains to real estate, and the faceoff between buyers and sellers.

Until then, I'm your host Adam Bass and this is MSCI Perspectives.