

Evolution of Institutional Fixed Income Approaches

Fixed Income Series, Part One

Executive Summary

Institutional investors are rethinking the role of fixed income amid evolving market conditions. Traditional core fixed income—typically high-quality bonds benchmarked to indices like the Bloomberg US Aggregate—has long been valued for its stability, income, and diversification. However, the past decade of ultra-low interest rates followed by inflationary shocks has revealed the limitations of this approach. In response, many institutions are incorporating broader alpha-oriented strategies as a complement to core bonds, seeking enhanced income and greater portfolio flexibility to take advantage of opportunities in credit, non-US, and securitized fixed income.

This paper is part one of a multi-part fixed income series and reviews the structural limitations of traditional core and core plus portfolios in the context of the evolving needs of institutional portfolios. Part two will explore one potential solution to these limitations: Multi-Asset Credit.

Core Fixed Income: Strengths and Structural Limitations

Core fixed income remains a foundational component for institutions due to its safety, liquidity, and role in capital preservation. High-quality core bonds (e.g., Treasuries, agency mortgages, and investment-grade corporates) carry minimal default risk, offer deep liquidity, and typically perform well in risk-off environments.

However, structural limitations remain. Yields on core bonds, even after recent increases, often fall short of many institutions' return targets, particularly on a real (inflation-adjusted) basis. Index constraints—such as the heavy government-debt weighting in the Bloomberg US Aggregate (“the Agg”)—create overconcentration in low-yielding sectors while excluding large swaths of the investable credit universe. Sectors such as asset-backed securities, commercial mortgage-backed securities, high-yield corporates, loans, and private credit are underrepresented or entirely absent. This misalignment means core-only strategies may miss out on attractive risk-adjusted (absolute or benchmark-relative) return opportunities.

The table (Figure 1) highlights the annual return variability across fixed income sectors from 2015 to 2024.

Figure 1: Annual Fixed Income Sector Returns

	Bloomberg US Aggregate	Bloomberg US Corporate Investment Grade	Bloomberg US Corporate High Yield	Morningstar LSTA US Leveraged Loan	ICE BofAML US ABS & CMBS	JPM EMBI Global Diversified
2015	0.55	-0.68	-4.47	-0.69	0.81	1.18
2016	2.65	6.11	17.13	10.16	2.71	10.15
2017	3.54	6.42	7.50	4.12	2.84	10.26
2018	0.01	-2.51	-2.08	0.44	1.74	-4.26
2019	8.72	14.54	14.32	8.64	5.89	15.04
2020	7.51	9.89	7.11	3.12	5.20	5.26
2021	-1.54	-1.04	5.28	5.20	0.05	-1.80
2022	-13.01	-15.76	-11.19	-0.77	-7.20	-17.78
2023	5.53	8.52	13.45	13.32	5.55	11.09
2024	1.25	2.13	8.19	8.96	5.96	6.54

Source: eVestment.

No single sector consistently outperforms, and leadership rotates year to year—driven by changing rate, credit, and macro conditions. This dispersion underscores the value of a flexible, multi-sector approach. More rigid benchmark allocations, like the Bloomberg US Aggregate, often miss opportunities or fail to protect in volatile markets. By contrast, allowing managers to dynamically allocate across sectors can enhance risk-adjusted returns and better navigate diverse market environments.

Figure 2: Bloomberg US Aggregate Bond Index Duration



Source: Bloomberg.

Another key risk is duration—the sensitivity to changes in interest rates. Although duration of the Agg has eased modestly since the peak in 2020–2021, it remains elevated at around 6 years today. Higher duration levels for broad debt benchmarks means that core portfolios have been more exposed to rate volatility, as seen in 2022 when rising rates led to double-digit losses. With interest rate uncertainty and tight spreads, core bonds may offer limited protection in adverse scenarios like stagflation or policy shocks.

These limitations do not invalidate core fixed income, but they underscore the potential value of considering complementary strategies.

The Evolving Role of Fixed Income in Institutional Portfolios

For decades, fixed income has been a cornerstone of institutional portfolios—prized for its role in delivering stable income, preserving capital, and mitigating volatility. Core bond strategies, generally composed of government and investment-grade corporate debt, were effective in stabilizing returns, especially during equity drawdowns. From the 1980s through the 2010s, falling interest rates created a bond bull market that reinforced the success of the traditional 60/40 portfolio structure.

However, in the wake of quantitative easing, low interest rates, and the inflation shocks starting in 2022, this paradigm has shifted. The income generated from core bonds became insufficient to meet many institutional return targets. Moreover, the simultaneous decline in both stocks and bonds during recent periods of market stress has exposed the vulnerability of relying solely on core fixed income for downside protection.

As interest rates rose in 2022–2023, bond yields recovered to levels not seen in over a decade. Yields on investment-grade corporate bonds and high-yield debt moved to the 5–7% range by 2024. While this "return of income" is welcome, it does not mean fixed income will return to its prior role unchanged. Institutions are increasingly seeking strategies that can deliver more robust returns and adapt to a wider range of macroeconomic outcomes.

Today's fixed income allocations must do more than simply preserve capital—they must also contribute to total portfolio return. This has led many institutions to explore beyond traditional benchmarks and embrace more dynamic, diversified fixed income strategies.

For a discussion on one potential solution to the limitations discussed in this paper, please see part two on Multi-Asset Credit.

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