

# The future of fixed income

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Fixed income has been transformed by advances in market structure, trading technology, and portfolio design—and the pace of change continues to accelerate. These developments are expanding what the asset class can deliver for institutional investors.

While fixed income has long played essential roles, including generating income, hedging equities, and mitigating downside risk, today it is becoming a cornerstone of outcome-oriented investing. Enhanced tools and more precise building blocks now enable investors to address challenges such as matching complex liabilities, navigating inflation, and managing duration and credit risks, allowing for more tailored, client-driven exposures.

This evolution is still in its early stages, and its importance will only grow as institutions seek more precision, resilience and efficiency in their portfolios. To fully harness fixed income's expanding capabilities, asset managers need the scale to invest in technology and market access, the skill to interpret data and design solutions, and the experience to apply them consistently across market cycles.

## The forces driving change in fixed income

Investors may be familiar with evolutions in equity markets including expanding use of electronic trading, data, and index strategies, as well as declines in trading costs and fees. Fixed income is following in equities' footsteps in all these regards.

The changes transforming fixed income analysis, trading, and management are laying the groundwork for investors, working closely with asset managers, to target specific investment outcomes more precisely and efficiently.

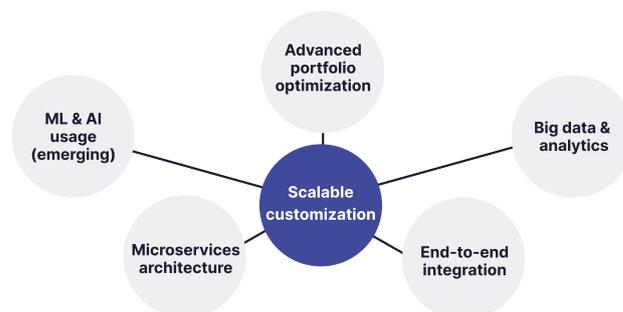
Key trends include:

*Evolutions in market structure and trading mechanisms.* The bond market is becoming more electronic, transparent, and liquid—a far cry from its traditionally opaque, dealer-centric structure. Electronic trading now accounts for more than 65% of trading in US Treasury and European government bonds and roughly half the trading of investment grade corporate bonds. Sectors such as high yield, convertibles, leveraged loans, and emerging market debt are earlier in the electronic adoption journey, but all are moving toward greater electrification.

Fixed income markets' traditional structure presented challenges and limitations, including asymmetric information between buyers and sellers, episodic liquidity, and pricing and execution that hinged on dealer relationships. The widespread adoption of electronic trading platforms has introduced real-time pricing and "all-to-all" trading among diverse networks of counterparties. These and other innovations—including portfolio trading, AI-based composite pricing algorithms, and automated execution tools—improve liquidity, enable small-block trading, and make execution faster, broader, more efficient, and more reliable. Such improvements make index investment strategies practical in segments where they previously were not. They also lay the groundwork for asset managers to target more specific exposures in modular building blocks.

*Technological advances.* A dynamic ecosystem of fast-developing technologies—including AI and machine learning, advanced portfolio optimization, big data and analytics, and end-to-end integration—is enhancing fixed income managers' capabilities. Together, these developments make it possible for managers to tailor risk exposures more

## Tech Makes Scalable Customization Possible



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precisely and implement changes more efficiently, supporting customization at scale.

Managers can now integrate real-time liquidity, value, and risk metrics at the individual security level. Portfolio management platforms analyze multiple risk dimensions simultaneously, suggesting and identifying the most efficient risk-matched bonds while controlling for factors including liquidity, idiosyncratic risk, and trading costs. Together, these technologies enable managers to create scalable portfolios aligned tightly to specific constraints, fiduciary mandates, and regulatory frameworks, while expanding the range of investable instruments.

As technology has leapt forward, bond-market information has increased exponentially. More frequent trading across multiple platforms covering more of the fixed income market, paired with more robust technology, creates a wealth of data investors can use to understand market dynamics and position accordingly.

*The explosion in index strategies.* The dramatic growth of index-oriented fixed income strategies, particularly ETFs, has increased investors' market access and ability to source liquidity. Institutional investors now routinely blend index exposures with active or thematic portfolios in a "core-satellite" approach (more on this below). In this framework, ETFs can help improve efficiency and liquidity by serving as core beta positions, acting as vehicles for tactical allocations, or facilitating transition management.

*An expanding definition of "active."* The definition of active fixed income used to be relatively clear and simple: Active managers would evaluate and select individual securities based on their assessment of fundamentals such as cash flows, earnings, and balance sheets.

Today the definition has broadened, and the boundaries around "active" have blurred. Investors are increasingly aware that long-term value creation is driven more by big-picture decisions such as tactical asset allocation, strategic allocation targets, and the choice of benchmarks, rather than just security selection.

Meanwhile, the exponential growth in data has given rise to systematic active fixed income strategies that are challenging the hegemony of fundamental active management. Like systematic equity strategies, systematic fixed income methodologies employ factor-based security selection, rules-based portfolio construction, and disciplined rebalancing. They can deliver replicable and scalable return profiles with risk characteristics tailored to clients' needs.

By foregoing fundamental analysis and using technology to process

mountains of data quickly, these strategies can provide differentiated sources of excess return complementing traditional fundamental active management. Indexing frameworks increasingly include systematic active elements, as in the case of enhanced indexing and rules-based strategies.

The shift in the definition of "active" positions allows investment managers to add greater value. Investors can partner with them to engage in systematic portfolio engineering, code more complex objectives and guidelines, and harness big data and technology to automate trading, perform attribution, and otherwise enhance investment operations. *Demand for efficient, scalable customization.* Investors are under pressure to maximize their resources. They want asset managers to operate more efficiently while providing ever-greater customization.

Greater efficiency and greater customization may seem like contradictory goals. Experienced asset managers can reconcile them by harnessing the evolutions described above to disaggregate fixed-income exposures into building blocks, then blending or optimizing those building blocks to pursue specific objectives or outcomes. Modular portfolio design architectures that use ETFs, separately managed accounts, and overlay mechanisms, enable managers to construct tailored solutions at scale.

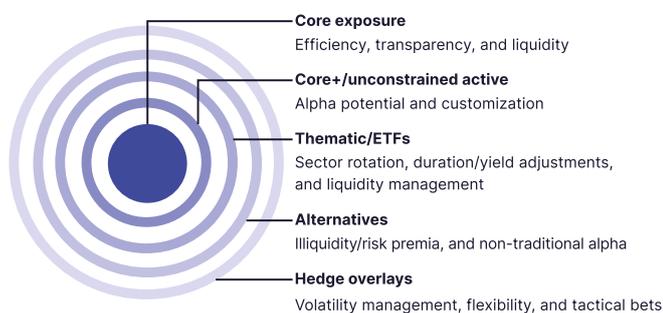
The ability to tailor fixed income portfolios precisely, without sacrificing efficiency, positions fixed income to play more expansive and ambitious roles. Investors and asset managers are partnering to build fixed income portfolios that can achieve targeted outcomes: matching complex liabilities, hedging specific risks, meeting demanding return targets, securing specific exposures, and more.

That work involves tailoring exposures across several dimensions—alpha and beta, liquidity and illiquidity, public and private—in proportions aligned to an investor's objectives and constraints. Many asset managers are employing next generation core-satellite structures to deliver the right balance of exposures. These structures construct core exposures out of reliable, cost-effective index strategies and other building blocks, complemented with satellite allocations that seek alpha, make dynamic or thematic tilts, and/or fill specific niches.

### The future of fixed income management

Fixed income's evolution is ongoing. A range of new developments will continue to push the asset class forward in the years ahead, supporting greater precision, efficiency, transparency, and customization.

### The New Core-Satellite Portfolio



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- AI and predictive analytics will expand the frontiers of portfolio modeling, scenario analysis, and optimization of portfolio exposures.
- Tokenization and distributed ledgers will reshape how markets function, reducing friction and costs, increasing transparency, paving the way for fractional securities, and reducing settlement timing and risks.
- Direct indexing and customized benchmarking will help align portfolios more precisely with criteria such as credit quality thresholds and duration targets.
- Index ETFs will become more prominent vehicles for sophisticated strategies, as investors favor their cost-effectiveness, agility, and transparency.
- The integration of public and private credit markets will help satisfy investors' need for more holistic yield solutions.

Managers will need three essential qualities to harness fixed income's potential: scale, skill, and experience.

*Scale.* Scale provides the counterparty relationships necessary for access to liquidity, favored pricing, and the full range of deals; the efficiency that comes with high trading volumes; the breadth to provide a comprehensive array of building blocks across the full range of market segments; the financial wherewithal to invest in leading people and technology; and access to data, the lifeblood of effective investing.

*Skill.* Skilled managers can harness evolving capabilities and information to create increasingly precise, efficient, transparent exposures, craft them into modular building blocks, and deliver scalable custom solutions.

*Experience.* Bespoke portfolio solutions can succeed only in the context of trusting partnerships with strong, open communication and information sharing. It takes asset managers decades to build the culture, infrastructure, and track record necessary to earn this level of trust.

These observations inform our vision for the future of fixed income. We believe that in the years ahead, fixed income management will center on clients, focusing on tailored solutions to their specific challenges. A growing set of building blocks will make this transition possible by providing liquid, transparent, reliable, precise, and efficient exposures.

These building blocks will increasingly capitalize on changes in market structure and technological advances to harness known, persistent factors that drive outperformance. In the process, they will bridge the dichotomies that traditionally defined fixed income management, particularly the divisions between active and index and between public and private.

Meanwhile, advances in the technologies used to evaluate, trade, and manage fixed income will continue to drive transparency, simplify complexity, and enable ever-greater precision. Ongoing improvements in technology and changes in market structure also will increase liquidity and allow for more efficient portfolio construction.

As these developments converge, fixed income increasingly will reside at the heart of solutions to investors' challenges. To capitalize, investors will need to partner with the right asset managers—those that have the breadth, depth, and know-how, across the full range of fixed income markets and segments, to tailor comprehensive solutions aligned to specific outcomes. In the future of fixed income, asset managers that combine scale, skill, experience and fiduciary integrity will be best positioned to help investors achieve their full range of objectives.