



# Opportunistic Investing in a Dynamic High Yield Market

Investment flexibility may enhance risk-adjusted returns.

June 2021

## KEY INSIGHTS

- Policy responses to the coronavirus pandemic should continue to create a conducive backdrop for leveraged credit in the near to medium term.
- Bank loans should offer some degree of insulation from interest rate risk while providing attractive income in a low-yield fixed income opportunity set.
- Selectively participating in special credit situations, when value and a competitive advantage exist, is an important part of our approach.

With the economy continuing to recover from the global pandemic, we believe investors could benefit from a potential allocation to below investment-grade credit. Equity valuations appear somewhat stretched after a rally that began more than a year ago, meaning that returns could be more subdued going forward. In our view, the high yield market, including bank loans and distressed credit situations, remains an attractive option for investors seeking meaningful income in a relatively low-yield environment.

Policy responses to the pandemic should continue to create a conducive backdrop for below investment-grade, or leveraged, credit in the near to medium term. Unprecedented fiscal stimulus has provided meaningful support for the economic recovery, while the Federal Reserve and other major central banks have committed to accommodative monetary policy with a focus on real

economic growth and improvements in the labor market.

We believe significant progress in vaccine distribution—roughly 50% of the U.S. population had received at least an initial dose of a vaccine by the end of May—could have powerful effects on consumer sentiment and behavior. At the corporate level, declining distress and improving fundamentals should result in a lower default rate in 2021 and 2022.

### Ability to Invest Across the Capital Structure

We believe our investment approach is somewhat unique in that we can dynamically shift exposures based not only on our views of value across capital structures and industries but within companies' capital structures as well. Our holdings reflect high-conviction names gleaned from our combined global high yield and bank loan credit research team, which should allow us



**Rodney Rayburn, CFA**  
*Portfolio Manager, Credit Opportunities Fund*

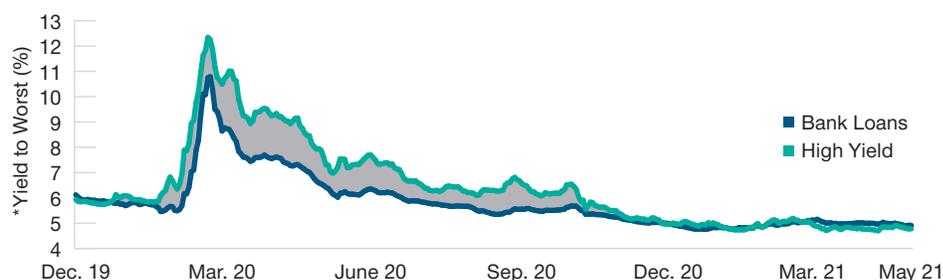


**Jason Bauer, CFA**  
*Sector Portfolio Manager*

“Our holdings reflect high-conviction names gleaned from our combined global high yield and bank loan credit research team...”

## Flexibility to Pursue Relative Value

(Fig. 1) High yield bond and bank loan yields



As of 31 May 2021.

**Past performance is not a reliable indicator of future performance.**

\*Yield to worst shows what income requirements will still be met even in the worst scenarios excluding defaults.

Source: J.P. Morgan Chase & Co.

High yield represented by the J.P. Morgan Global High Yield Index; bank loans represented by the J.P. Morgan Leveraged Loan Index.

“Our ability to flexibly allocate to bank loans should offer some degree of insulation from interest rate risk...”

to identify inefficiencies and pursue relative value<sup>1</sup> across both asset classes.

Specifically, we evaluate the full capital structure of a company, allowing for investment in positions outside of traditional high yield bonds, including bank loans and, to a lesser extent, equity or equity-related securities often tied to an existing credit position. However, we are willing to maintain a larger allocation to “core” high yield when risks appear skewed in favor of a more balanced approach.

### Bank Loans Offer Low-Duration Profile and Attractive Yields

The post-pandemic macro environment has led to higher intermediate- and long-term Treasury yields as investors contemplate whether a broad economic recovery could trigger inflation, bringing greater attention to interest rate risk, often measured by duration.<sup>2</sup> Our ability to flexibly allocate to bank loans should offer some degree of insulation from interest rate risk while providing attractive income in a low-yield fixed income opportunity set.

The floating rate feature of loans—where coupons adjust based on a short-term benchmark rate—gives them a low duration profile, which means that they should perform well relative to other fixed income asset classes as rates increase. Given their shorter duration profile and seniority in the capital structure, we believe the loan asset class is a more defensive way to add exposure to below investment-grade names while also providing attractive income.

If the Federal Reserve remains on hold for the next year or two, we believe loan investors should be fairly compensated with solid income relative to other fixed income alternatives. On the other hand, if inflation picks up and the Fed is compelled to normalize rates earlier than anticipated, bank loan coupons will reset higher. We believe that the potential resiliency of loan income in differing rate scenarios contributes to the attractive value of the asset class.

### Special Situations Could Provide Competitive Advantage

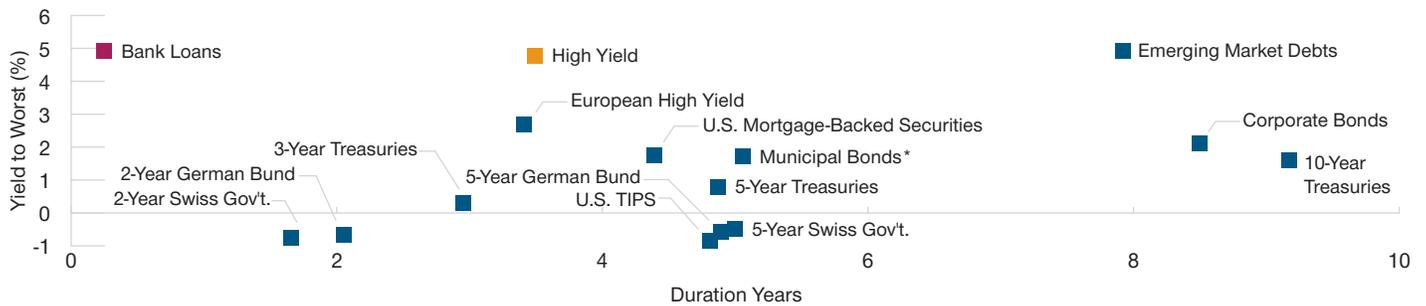
The breadth and depth of our global credit research platform allows us to

<sup>1</sup> Relative value determined an asset's value by considering the value of similar assets.

<sup>2</sup> Duration measures a bond's sensitivity to changes in interest rates.

## Compelling Yield/Duration Profile

(Fig. 2) Duration and yield across asset classes



As of 31 May 2021.

**Past performance cannot guarantee future results. Yield and duration are subject to change.**

\*Taxable-equivalent yield assuming a 40.8% tax rate.

Sources: J.P. Morgan Chase & Co., Bloomberg Index Services Ltd., Bloomberg Finance, L.P., and ICE BofAML (see Additional Disclosures). Bloomberg Barclays Indices: Corporate Bonds: U.S. Corporate Investment Grade Index; Municipal Bonds: Municipal Bond Index; U.S. Mortgage-Backed Securities: MBS Index; U.S. TIPS: U.S. Treasury: U.S. TIPS; 2-Year Swiss Gov't.: Swiss Aggregate: Treasury 3–7 Years; J.P. Morgan Chase & Co. Indices: High Yield: Global High Yield Index; Bank Loans: Leveraged Loan Index; Emerging Markets Debt: EMBI Global Diversified Index; 2-Year German Bund: 2-Year German Bund benchmark; 5-Year German Bund: 5-Year German Bund benchmark. From Bloomberg Finance, L.P.: 3-Year Treasuries represented by the U.S. 3-Year Treasury Note in the U.S. Treasury Actives Curve; 5-Year Treasuries represented by the U.S. 5-Year Treasury Note in the U.S. Treasury Actives Curve; 10-Year Treasuries represented by the U.S. 10-Year Treasury Bond in the U.S. Treasury Actives Curve; European High Yield represented by the ICE BofAML European Currency High Yield Constrained Excluding Subordinated Financials Index Hedged to USD.

selectively participate in special situations and distressed names when we identify the potential for value and a competitive advantage in negotiating favorable outcomes. When participating in a restructuring process, for example, we seek to maintain our position in liquid, freely tradeable securities and take an active role on creditor committees in aiming to create value for the positions.

These holdings, while limited in number, can offer the potential for meaningful total return. They can also afford exposure to areas of the credit market that may not be closely followed by traditional buy-side investors and, therefore, could be mispriced.

### Reorganization Plan Supports Holdings Related to Bankrupt Satellite Operator

For example, our investment in a bankrupt satellite operator is a special situation. Our investment team has closely followed developments in this

credit story for several years, and when the company filed for bankruptcy in May 2020, we saw a favorable risk/reward opportunity in the secured part of the capital structure—we only own the company's secured bonds and loans—based on our fundamental view that the value of the core business is sufficient to cover the company's secured debt.

The various parts of the company's capital structure rallied after the firm reached an agreement with some of its creditors and filed a financial reorganization plan that could significantly reduce debt and pay down secured bonds and loans upon exit from bankruptcy. This positions the company to potentially emerge from bankruptcy in the second half of 2021, although this could be extended due to the complex nature of the case. The longer the company stays in bankruptcy, the longer our position likely benefits.



#### WHAT WE'RE WATCHING NEXT

Progress in vaccine distribution, fiscal stimulus, and accommodative central bank policy create a conducive backdrop for leveraged credit. However, sustained levels of inflation could lead the Fed to consider rate increases earlier than previously expected. This is a risk we are monitoring closely.

**Key Risks**—The following risks are materially relevant to the strategy highlighted in this material:

**Fixed income securities are subject to credit risk, liquidity risk, call risk, and interest rate risk. As interest rates rise, bond prices generally fall. Investments in high-yield bonds involve greater risk of price volatility, illiquidity, and default than higher-rated debt securities. Investments in bank loans may at times become difficult to value and highly illiquid; they are subject to credit risk such as nonpayment of principal or interest, and risks of bankruptcy and insolvency.**

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