ANALYSIS

Credit Continuum

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Michael manages the Muzinich Global Tactical Credit strategy. Prior to joining Muzinich in 2012, Michael was president and Head of the High Yield Division at Seix Advisors, Inc. At Seix Advisors, he was the founding partner of the high yield strategy that grew to over $13 billion under his leadership. Previously, Michael served in various research and portfolio management capacities at American General Corp. and at Capital Holding Corporation. He earned a BA in Management Science from the University of California, San Diego and an MBA from Rice University.

On the Recovery Path

Positive fundamentals chart the way to recovery, but we remain vigilant.

An assumption that seems to be supporting markets right now is that there will be a global recovery, and resultant acceleration of activity, some time in 2021. Whilst in the short-term we still have negative headlines, the long-term view looks a lot more positive, which is where, it seems, investors are focused. This can give additional confidence for investors to discount these issues and go into the market. However, we believe some of the short-term problems are not necessarily disappearing, and in some cases are extending, which we can see with the new COVID-19 variants, vaccine efficacy, and distribution problems. In our view, there is a growth expectation reality gap. It appears the markets are worried that they will miss out on the expected global recovery, which we see in high valuations and tight spreads. It is as if they are front-loading expectations for the second half of the year, in order to dismiss real-time concerns now.

The fiscal stimulus discussion in the US is going through the reconciliation process, potentially reassuring investors' risk sentiment as only a simple majority will be required to pass further stimulus which increases the probability for the initial plan to be approved. We see that fundamental trends continue to improve in credit markets. We observed practically no defaults in January, and credit migration turned positive i.e., there were more upgrades than downgrades, and some former fallen angels turning into rising stars in 2021.

This observed fundamental improvement trend is helping to test the tight valuations. We believe the selling pressure which would usually be triggered at this time is suppressed, due to positive technical factors and the continued demand for yield. January's record issuance in US High Yield ($55.7 bn)[1] was met with high demand and did not prevent spreads from tightening. We expect this to continue in February.

We believe it is important to be conscious of tight valuations, and attentive to stock selection. The large rally on low quality credit has already happened, in our opinion, and the idiosyncratic risk on stock selection should be front of mind. The focus should be on quality High Yield exposure with relatively short duration, whose technical factors, we think, are the most compelling.

We observe that being invested remains paramount, with a focus on stock selection and a clear view of the risks that are still ahead is also key.

[1]Source: JP Morgan as of January 31st, 2021.

Important Information