ANALYSIS

Credit Continuum

15 June 2020

Road to Recovery

Monetary stimulus measures and high levels of cash continue to support spread tightening between now and year end.

The rally in credit markets has continued in May given Federal Reserve and European Central Bank support measures and the hope that economic activity would resume as COVID-19 lockdowns are slowly phased out to varying degrees in most countries.

In this context, credit returns were strong, particularly US high yield outperformed all segments of the US fixed income market followed by loans and investment grade corporates. It appears that the surprising rebound in employment in May, although still at its highest level since the Great Depression, fueled enough hope of economic recovery, overshadowing widespread social unrest in the US to support credit markets.

The month of May has seen record flows in both high yield and investment grade corporates, further demonstrating the strength of the Fed's plan in our view. High yield has experienced record new issuance while investment grade posted its second highest new issuance month on record. Many companies, even the ones more impacted by COVID-19, have taken advantage of open capital markets and issued debt to shore up liquidity in their balance sheet to weather the coming months or to refinance upcoming maturities.

We believe that the continuous monetary stimulus provided by the extensive packages approved by both Fed and ECB together with and excess of liquidity, which is reaching record high levels, are reinforcing the tightening of spreads and the return to positive territory for total returns between now and rest of the year. (Please see Fig. 1 on the next page)

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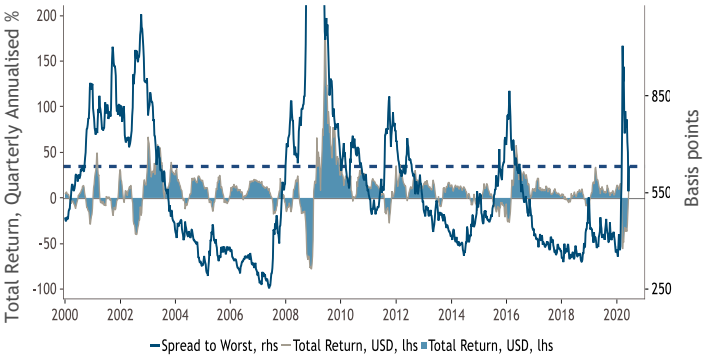
Michael manages the Muzinich Global Tactical Credit strategy. Prior to joining Muzinich in 2012, Michael was president and Head of the High Yield Division at Seix Advisors, Inc. At Seix Advisors, he was the founding partner of the high yield strategy that grew to over $13 billion under his leadership. 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.

In April, we noted in our Whitepaper Long Term Valuations Can't Be Ignored, that if history is a guide in terms of return expectations, markets can recover quite quickly after a significant widening of spreads. In our view, the total return outlook has been historically positive when spreads have reached crisis levels.

Fig. 1 Spread to worst for US High Yield and rolling 3mnth total return annualized



Source: ICE BoFA US High Yield Index (H0A0) as of June 14, 2020.

We believe that while companies are providing little forward guidance, the market will likely not focus on Q2 earnings numbers, as investors are looking ahead to 2021 and the companies that will survive because they have sufficient liquidity. In our view, credit selection will be important and the resilience of a company's balance sheet to prolonged economic uncertainty due to a potential second wave of COVID-19, renewed trade tensions between US and China and upcoming US presidential election, will be key in our credit analysis.

Important Information

(H0A0)The ICE BofA ML US High Yield Index tracks the performance of US dollar denominated below investment grade corporate debt publicly issued in the US domestic market. Qualifying securities must have a below investment grade rating (based on an average of Moody's, S&P and Fitch), at least 18 months to final maturity at the time of issuance, at least one year remaining term to final maturity as of the rebalancing date, a fixed coupon schedule and a minimum amount outstanding of $250 million.