



Credit Continuum

October 2019

Dovish monetary policies may create potential opportunities for credit investors

September's economic data confirmed the declining trend in the global manufacturing sector amid persistent trade tensions and related uncertainty, and we believe we are now seeing the first signs of spillover into the service sector and employment.¹

From a regional standpoint however, we believe near-term risks appear much higher in the eurozone, which appears more vulnerable than other parts of the world.

The US is being supported by a resilient consumer sector and, with inflation remaining low, real disposable income continues to move higher.² Combined with looser financial conditions, we believe US economic growth is likely to remain positive, albeit slightly below trend.

While the weaker macroeconomic backdrop is increasing pressure on corporate balance sheets, the situation appears manageable as interest coverage ratios (a measure of a company's ability to meet its interest payments) remain high thanks to lower interest rates and limited spread widening.³

Against this backdrop, we believe central banks are likely to continue to provide support; dovish monetary policies are firmly in the vanguard across developed and, increasingly, emerging markets.⁴

We expect the Federal Reserve to pursue its "mid-cycle" easing with another 25bps cut in October, while the European Central Bank is also likely to implement another rate cut in December, in our view.

1. <https://www.marketwatch.com/story/eurozone-manufacturing-pmi-drops-in-september-to-worst-level-in-nearly-7-years-2019-09-23>; <https://www.cnbc.com/2019/10/03/september-ism-non-manufacturing-index-at-52point6-vs-55point3-est.html>

2. <https://tradingeconomics.com/united-states/services-pmi>

3. BofA ML Credit Strategy report 'Assessing corporate credit vulnerabilities; in search of optimal leverage, 14th October 2019

4. <https://www.ft.com/content/b8709ca4-e8f8-11e9-85f4-d00e5018f061>



Michael McEachern, MBA

Portfolio Manager & Head of Public Markets

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.

As most of the macro uncertainty is impacting equities, we expect investors are likely to seek safety in fixed income; we believe carry strategies make sense in a low interest rate environment and can provide protection against rates volatility.

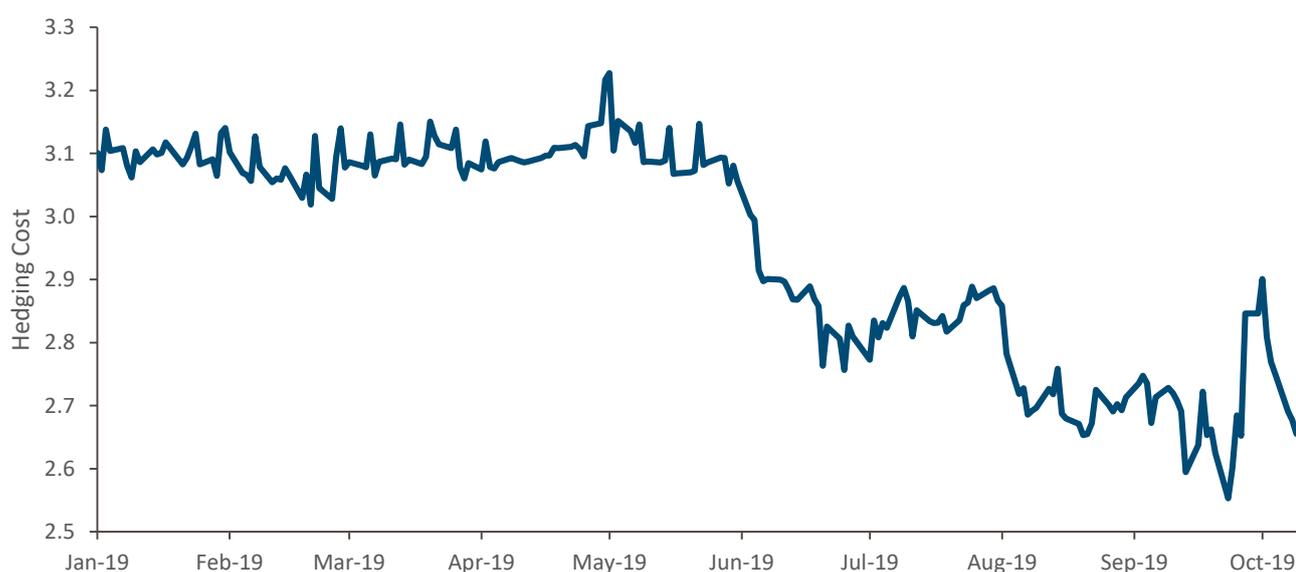
For credit investors, over the past few months the US dollar has weakened sufficiently to create opportunities in US dollar denominated assets for euro-based investors in our view (Fig.1).

We continue to see opportunities in US BBB rated corporates which we believe have solid fundamentals and are unlikely to be downgraded. We also continue to see value in subordinated financials whose issuers have a senior investment grade rating.

For investors in multi-asset credit portfolios, we see potential opportunities in being positioned for slower growth data by increasing exposure to higher-quality, longer-duration corporates, highly-rated, shorter-duration credits and cash and US Treasuries for liquidity purposes.

However overall, we believe market participants should remain vigilant and look for an improvement in corporate fundamentals to compensate for growing macro risks.

Fig. 1 Falling Hedging Costs May Create USD Opportunities for EUR-Based Investors



Source: Bloomberg EURUSD 3 Month Hedging Cost Index, as of 9th October 2019. The index shows the three-month euro hedge cost for dollar-based investors on an annualised basis. This is based on the assumption the investors sell dollars to buy euros in the spot market and simultaneously sell euros in the forward market to buy back dollars.

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