From the Top
Muzinich Credit Opportunities takes a tactical approach to global credit.

UNDISCOVERED MANAGER

Laura Lallos

In every issue, Undiscovered Manager profiles a noteworthy strategy that hasn't yet been rated by Morningstar Research Services' manager research group.

In the early part of his investing career, Mike McEachern built his bond expertise asset class by asset class. Starting out in private placements and working as an analyst in high-yield, investment-grade, and even municipal bonds, he developed an expertise in the bottom-up fundamental analysis that underpins his strategy today.

"Ultimately, when you're in credit," he says, "you have to understand the risk inherent in any corporate bond."

But McEachern began gravitating toward a top-down themed approach in the late 1990s. The Asian financial crisis had started to affect the U.S. markets, he says, and "that cemented the idea that it's very important to understand the interconnectedness of your broader exposures."

He recalls a seminal experience when working at an insurance company in Louisville, Ky.: "The people I learned from had a total-return mindset. They were great mentors. There was something of a mini-energy crisis, and one of the portfolio managers immediately put all $140 million of her airline bonds up for bid in one decision. That was a critical incident in my career. As a result, I'm not incremental; I'm a decisive decision-maker."

In 1997, McEachern landed at New Jersey-based Seix Investment Advisors, where he built a high-yield team from scratch and became president of the firm. After 14 years, when some of his partners were retiring, he decided it was time to broaden his reach.

That's where Muzinich & Co. came in. The privately owned firm, founded in New York in the late 1980s, had expanded to London a decade later and aimed to be a premier global credit boutique. With the support of George Muzinich, who fostered an entrepreneurial environment, McEachern saw an opportunity to build a business.

Muzinich also provided the bottom-up research support necessary for the wide-ranging, top-down strategy McEachern wanted to implement. The Global Tactical Credit strategy launched at the beginning of 2013, shortly after McEachern joined the firm. The multi-asset strategy—which includes a U.S. mutual fund version, Muzinich Credit Opportunities Fund MZCSX—aims to outperform Libor by 3% to 5% over a full credit cycle, with annualized volatility of 5% or lower.

Silvercrest Asset Management didn't hesitate to sign on. Silvercrest, a New York-based Registered Investment Advisor with $22 billion in assets under management, had engaged McEachern to manage a high-yield portfolio when he was at Seix and then followed him to Muzinich.

"We invested in Muzinich Credit Opportunities Fund on day one," says managing director Ian Smith. "We had confidence in Mike's investment acumen and expertise. He has an extraordinary trading instinct that has helped deliver great risk-adjusted results, and Muzinich has global reach with a great deal of breadth and depth in terms of analytical resources."

Free Range Within Limits

The fund can invest in the United States, Europe, and emerging markets and can allocate to investment-grade, high yield, and loans. Morningstar classifies it in the multisector bond category, and McEachern says some clients allocate it to a multisector sleeve intended to be less correlated to other fixed-income investments. But the strategy's appeal is versatile. Some pension plans and insurance companies slot the fund in as a conservative high-yield approach. Other institutional clients deploy the fund more as a core holding, measured against the broad Bloomberg Barclays U.S. Aggregate Bond Index.

Smith says that Muzinich Credit Opportunities serves well as a core holding for some Silvercrest clients precisely because of the unconstrained nature of its strategy, particularly in today's fixed-income market: "The team can seek value wherever they see it. There is a lot of appeal in that flexibility in an environment where interest rates remain near 70-year lows."

McEachern makes decisive use of that flexibility. For example, the fund had more than 40% of assets allocated to high yield in late 2017 and was down to under 25% a year later. Meanwhile, bank loans went from an allocation of 13% to 0%. The team won't stretch for yield, and bank loans have much less asset value than the high-yield universe overall.

The team generally looks at valuations and spreads over a six-month to one-year period to determine when to sell. When the portfolio's overall return is trending close to negative 50 basis points, McEachern is quick to cut whatever is holding it back—for example, the fund portfolio has rotated in and out of the volatile energy sector several times. This past September, McEachern started cutting duration a little because rates were bouncing around. (The strategy's duration guidelines are zero to 6 years, with 3.5 years its neutral stance.)

While this is a long-only strategy—with derivatives used only to hedge against risk and volatility at times—McEachern points out that the tactics reflect his hedge fund experience: "If credit is expected to perform poorly, we can go to the sidelines in cash or Treasuries to await better opportunities." The fund's cash stake was under 5% toward the end of 2019 but was as high as 15% in mid-2013.

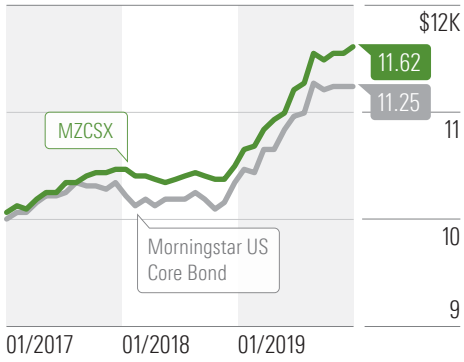
Conviction is also expressed in security selection. The top 10 names made up about 25% of the Credit Opportunities fund at the end of October. But liquidity is key to this tactical approach. Anheuser-Busch InBev, the largest name at 4.3% all together, was spread out over several issues. Overall, the portfolio held about 175 issuers and 240 issues. The biggest concentrations tend to be investment-grade, as were nine of the top 10 names. (The tenth, Bausch Health, is secured high yield.)

The fund's investment-grade stake hit a high of more than 60% in 2019—it's been as low as zero, back in 2013. Recently, strong inflows into U.S. investment-grade coupled with limited issuance in U.S. high yield created "a strong technical backdrop" for this stake, McEachern says.

Mike McEachern, head of public markets at Muzinich & Co., and lead portfolio manager of Muzinich Credit Opportunities Fund.

Muzinich Credit Opportunities Fund MZCSX

Growth of $10K



Morningstar Category	Multisector Bond
Morningstar Rating	★★★★
Expenses (%)	0.60

Source: Morningstar Direct. Data as of 12/31/2019.

A significant chunk went to BBB bonds, which grew from a 26% stake at the end of 2018 to 55% in October. In the fourth quarter of 2018, spreads were widening across most global credit, investment-grade, and high-yield markets. Selectively taking advantage of that trend, the team identified highly leveraged companies that were hard hit when funding costs increased, including AT&T, CVS Health, and Cigna. In the plus column, these companies have robust business models and are in noncyclical sectors—and were taking action on debt reduction.

"I love to find themes in credit where the management team is aligned with the bondholders for once, as opposed to the stockholders," says McEachern. He says that similar opportunities arose after the global financial crisis of 2008 and the European debt crisis in 2011, when companies shored up their balance sheets.

This kind of strategy requires agility, and Muzinich makes a conservative assessment of capacity at around $7 billion for commingled assets. With about $2.5 billion under management in the U.S. open-end fund and its UCITS counterpart, however, there is still room to grow.

A Winning Team

Russell Investments, a global investment consultant and asset manager headquartered in Seattle, began monitoring McEachern at Seix and has been covering his current strategy since its inception. Yoshie Phillips, senior research analyst with Russell, says, "We liked his approach of focusing on absolute return with downside protection. We viewed his market outlooks as sensible, hence developed a strong interest in the strategy."

The fund has not disappointed. Its Morningstar Rating of 4 stars at the end of December indicates its strong risk-adjusted returns relative to peers. Its 4.9% annualized return from its early 2013 inception through 2019 compares with 3.4% for the category average and 2.8% for the Aggregate Index.

The fund isn't likely to lead in rallies, but its risk protection in rough times has bolstered longer-term returns. That came into play when bond markets were roiled in 2015. The fund's Supra Institutional shares were up 1.5% that year, even as its typical peer in the multisector bond Morningstar Category lost more than 2%. (McEachern says that the fund had only 5% in energy, the worst sector that year.) Performance was boosted by another sound defensive play in 2018, and the fund stayed competitive in 2019, driven by the BBB play and a ramped-up stake in emerging markets.

The Credit Opportunities fund is not yet rated by Morningstar's analysts, but all its share classes receive a Morningstar Quantitative Rating of Bronze, bolstered by Above-Average People and Process scores and relatively moderate expense ratios. Moreover, the UCITS version of the strategy, available to U.K. and European fund investors under the name Muzinich Global Tactical Credit, has received a Morningstar Analyst Rating of Bronze. (The U.S. fund takes substantively the same approach, though McEachern notes that the UCITS fund has a loan maximum of 10%.) While Morningstar's analysts are cautious about assessing a firm that has grown and expanded into new areas in recent years, they note the strengths of this strategy's experienced team and sound process.

Louise Babin, a Morningstar senior analyst based in London, points to the interplay between McEachern's top-down approach and Muzinich's fundamental research: "We have been impressed with McEachern's dynamism in making asset-allocation changes in opportunistic markets, whilst playing to the company's strength in credit analysis," she says.

Russell's Phillips also emphasizes the importance of the team to the process: "Mike is the key risk allocator, but he doesn't micromanage. What distinguishes Muzinich is the performance-oriented corporate culture. It's a flat organization that empowers individuals, and that shows in the idea generation and investment profits."

The strategy's broad purview requires specialized support for individual credit selection. "I focus on portfolio positioning, looking at average credit quality, duration, and yield, and manage volatility," says McEachern. "I couldn't do what I do without the PMs and the analysts. I try to delegate as much as I can so people can grow."

When he came to Muzinich, McEachern helped finish building the global investment team, which today has 15 portfolio managers and 25 research analysts in London, New York, and a recently opened Singapore office. Five of those portfolio managers comanage Credit Opportunities under McEachern's lead, each lending his own area of expertise: Anthony DeMeo on U.S. investment-grade; Joseph Galzerano on U.S. high yield; Warren Hyland on emerging-markets credit; Torben Ronberg on syndicated loans; and Thomas Samson on European credit. The analyst team averages an industry tenure of 14 years and is headed by Andrew Jenkins; to retain expertise, the firm supports a dedicated career path for analysts.

With portfolio managers and analysts in different parts of the world, "the challenge," says McEachern, "is to make sure communication is crisp and real-time." However, the London and New York teams have been working together since the early 2000s and have established systems such as twice-a-week portfolio manager meetings via video and the monthly asset-allocation group meeting. The majority of Muzinich's strategies are invested in differentregions, which requires almost daily contact to assess relative value across global credit.

Play Hard to Work Hard

Technology facilitates transatlantic communication, but face-to-face interaction remains important. McEachern and his New York colleagues travel regularly to Europe, both to collaborate with their counterparts and because more of Muzinich's client base is located there.

This travel for work meshes well with McEachern's passion for surfing, and he tacks on weekend excursions when he can. "I love Portugal, because it reminds me of the California and Mexico coasts —but not as developed and sort of raw. When I can, I sneak away to surf south of Lisbon, to the Algarve, or north to the Porto area. I have clients in Australia, so I've surfed Bondi Beach and Manly Beach."

McEachern grew up all over because his father was a pilot in the Navy. The family eventually settled down in San Diego, near the beach. He started surfing in seventh grade and continued through high school and college at the University of California, San Diego. He was also an avid collector with a wide range, from coins to egg cartons. Those enthusiasms more recently led him to begin collecting vintage surfboards.

"About five years ago, I noticed that the boards I was riding back in the '70s are collectible. They are now vintage—so unfortunately, I'm vintage!" laughs McEachern. "The transparency of the market is still very low, and the bid/ask is wide. But it's a lot of fun because of the nuances: who made a board, who rode it, what condition it's in."

He links his avocational interest to his ultimate career choice: "My innate interest in collecting is one reason I gravitated toward managing money. It's neat to be able to make comparisons and relative value judgments, whether it's in bonds or some other asset class."

McEachern also enjoys traveling with his wife, Cynthia, including visits to their grown children —two daughters on the West Coast and a son in the Army infantry who is now stationed in northern Italy. Cynthia's charity and art interests round out the couple's activities.

He expects this well-rounded lifestyle to keep him on the job past the age when others consider retirement. "It's important to not get so wrapped up in work that it becomes stressful," he says. "I like balance. I dream of being able to surf into my later years, so I try to stay fit."

McEachern's diverse interests jibe well with his approach to investing. "I'm in a great position because I can look at everything and pick and choose from a broader universe than most people." MI

Laura Lallos is managing editor of *Morningstar* magazine.