



Credit Continuum

ANALYSIS

August 2019

Despite macroeconomic deterioration, we believe corporate credit continues to offer pockets of opportunity boosted by the hunt for yield



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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.

This summer has brought several new features to global credit markets:

- More than 16 trillion assets are now negative yielding ¹
- 10-year German Bund is yielding a record low of -0.65% ²
- US Treasury curve (2-year/20-year) is almost inverted ³
- The Italian BTP 10-year is yielding 1.5% while the 50-year bond 2.7% ⁴

The macroeconomic backdrop continues to be hurt by trade war rhetoric. The recent announcement of US tariffs on a further US\$300bn of Chinese imports (despite reports of a delay) is adding to the uncertainty on the global economic outlook.⁵ This follows disappointing second quarter GDP data in major economies and a worsening in eurozone manufacturing activity, increasing expectations of continued macroeconomic deterioration for the remainder of the year. ⁶

Thankfully job markets have been resilient.⁷ Service sectors have also performed solidly, and private domestic consumption is providing strong support to developed market growth.

From a market perspective, we believe the odds of recession are rising which has fuelled a massive flattening of government yield curves; the 10-year German Bund is trading below the European Central Bank's (ECB) deposit facility rate and the 30-year US Treasury yield is matching the lower bound of the Federal Funds rate of 2%! ⁸

1. Bloomberg Barclays Global Negative Yielding Debt Index, as of 15th August 2019

2. Source: Bloomberg, as of 15th August 2019

3. IBID

4. IBID

5. <https://www.ft.com/content/81f5b184-b4bc-11e9-8cb2-799a3a8cf37b>

6. <https://www.ft.com/content/4d84e028-be58-11e9-b350-db00d509634e>,

<https://www.ft.com/content/46598e0a-af9b-11e9-8030-530adfa879c2>,

<https://www.ft.com/content/7b7c5140-ade2-11e9-8030-530adfa879c2>

7. <https://www.ft.com/content/bebf7008-b51d-11e9-8cb2-799a3a8cf37b>

8. Source: Bloomberg, as of 15th August 2019

Nevertheless, the more sombre perspectives on global growth are being pushed back by global monetary policy easing momentum from central banks.

The US Federal Reserve (Fed) finally cut the official rates at its July meeting and announced the end of its balance sheet adjustments.⁹ The ECB meanwhile has prepared the markets for further monetary easing at its September meeting.¹⁰

Many emerging market central banks, particularly in Asia, are also re-engaging with monetary easing.¹¹ The magnitude of these monetary policy counter measures leaves growth forecasts in positive territory, although at materially lower levels.

We believe this suggests fiscal policy could be activated in 2020 but evolving local political situations in many countries (Germany, Italy, the US, UK) makes this forecast complex and, at the moment, somewhat unreliable.

We have observed that concerns around growth momentum have prevented credit spread tightening in August, while volatility has returned to equity markets - a sign usually associated with widening credit spreads.

In our opinion credit markets should continue to find support, absent a recession, given the global search for yield and generally solid corporate fundamentals. We believe longer duration investment grade bonds could benefit from a continued low rate environment while higher-quality high yield (BB and higher quality B rated bonds) may offer greater spread. We believe well researched emerging market corporate bonds can also offer select opportunities.

^{9.}
<https://www.federalreserve.gov/newsevents/pressreleases/monetary20190731a.htm>

^{10.}
<https://www.ecb.europa.eu/press/pr/date/2019/html/ecb.mp190725-52d3766c9e.en.html>

^{11.} <https://www.bloomberg.com/news/articles/2019-08-07/asia-surprises-with-cuts-in-global-race-to-the-monetary-bottom>

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