High Times (Last of a Series)

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What has been described as “massive” new issuance in the high-yield market led to the most deal volume for May ($48 billion) since 2003, according LevFin Insight’s Matt Fuller.

As our *Chart of the Week* depicts, cash inflows to bond funds totaled over $35 billion in the past nine weeks, per Refinitiv Lipper. That includes the top three weekly inflow numbers ever recorded.

In contrast, retail loan funds witnessed *out-flows* of $18 billion in March and April alone, and negative cash for eight of the past ten weeks.

What’s behind these contrasting dynamics? We spoke to several senior credit portfolio managers for answers.

“One driver is obviously thirst for yield,” one source told us. “Libor is down, and Treasury rates are essentially zero. But another factor is the Fed. They’ve announced plans to support fallen-angel bonds. Specifically, they’re buying ETFs of bankrupt issuers like Hertz, JC Penney, and Neiman Marcus. That gives fund managers cover.”

The central bank’s message to investors is clear: We will support select companies on the front-line of the COVID-19 battle, even if the debt is highly leveraged. “Those companies,” the Fed chair said in a recent meeting, “have now lots of cash on their balance sheets. They’ve been able to avoid layoffs. That is the point of all this.”

Matt Fuller provided further color on fund flows. “An analysis of the bond investor mix shows about half were ETF managers,” he said. “This is significant because much of their strategy involves hedging, and market timing. That’s a different outlook than longer-term value credit shops.“

Another senior PM offered his perspective on the relative value between loans and bonds. “It’s tricky looking at indices and benchmarks,” he said. “There’s stuff going on behind the scenes. Everyone is buying on technicals, and ignoring fundamentals.

“Also loan ratings are skewed to stretch single-Bs. And fallen angel bonds are yieldier than loans right now. Look at the secondary loan market. Index names have plateaued in the mid-90s. There’s not a lot supporting higher valuations.”

Back to LevFin Insight’s Matt Fuller. What indicators do you check to assess high-yield? “Obviously the Treasury market is a prime signal, along with the overall yield curve,” Fuller said. “Also public equities and oil prices.

“The HYCDX is also an excellent index that includes default swaps for 100 North American corporates. It was up 2.438 points last week – a 2.6% gain for the week, and now is up another 4.188 points so far this week, for a 4.3% gain. The synthetic market index at 101.688 is up 16.7% from the nadir of 87.125 on March 23.”

What are your predictions for where this crisis goes from here. “Nobody really knows,” Fuller said. “The manager of our building sent a memo around regarding when the building was opening up again. It essentially said, ‘We’re working on it.’ That’s a pretty fair summary for what everyone’s thinking about the situation today.“