

Low Interest Rates and Wider Spreads Providing Greater Opportunities for Fixed Income Interval Funds

By Jennifer Banzaca

Credit investments can be seen as an insurance policy, and the best time to make these investments is right after a great deal of dispersion and volatility in the markets, as we saw in 2020.

Following last year's market volatility, spreads are currently widest, and managers and investors are essentially paid to take on more risk right now.

During the Fixed Income Opportunities panel the Active Investment Company Alliance's (AICA) Interval Fund Boot Camp and Manager Spotlight on March 31,

Muhammad Gazi, Product Specialist, and Investment Committee Member of the Griffin Institutional Access Credit Fund, actively managed by Bain Capital Credit, indicated the Fund's management team is finding opportunities across public and private credit markets given the dispersion and uneven recovery across industries and sectors.

"In our view, it's advantageous to be an alternative credit investor following periods of dispersion and market volatility, when spreads are wide, and investors are being compensated to take risk.

Following last year's market volatility, alternative credit spreads appear attractive relative to other fixed income securities."

Gazi noted there are a number of potentially intriguing opportunities across alternative credit that may allow for enhanced income generation relative to traditional fixed income. Further, spreads remain wide relative to what has been observed over the past few years which may present a compelling entry point for investors. "This is even more pronounced in the private credit markets where lenders are benefitting from higher yields and stronger covenants when compared to deals executed pre-pandemic.

"We believe that this is an excellent environment for actively managed strategies. The ability to selectively

allocate to markets, industries, and credit instruments may provide opportunities for enhanced returns moving forward.”

Andrew Fox, an Investment Strategist at Lord, Abnett and Co., said his firm is focused on “discarded optionality”. “We’re looking at finding good solid credits that are going to pay us our interest, they’re going to pay us our principal, and be able to roll over the debt.”

Fox noted some examples would be regional gaming, such as Native American casinos and sovereign nations, which haven’t been forced to shut down during the pandemic and can remain operating.

“They’re survivors. They’ll be okay. They’re not doing great, but they can service their debt,” Fox stated.

Consumer loans is another interesting opportunity space, Fox said, with the most recent stimulus funding directed at the consumer, which resulted in a 20% increase in consumer income that can get out to the market quickly.

In the post-COVID-19 market, companies are coming back to the market looking to raise capital and grow their businesses, which Gazi said presents an opportunity for managers to underwrite capital with potentially attractive pricing and covenants.

Julianne Woodson, a Managing Director and a product strategist in BlackRock’s global credit business, said 80% of their credit interval fund’s private credit exposure was deployed post-Covid, which had the benefit of better pricing, stronger deals and structures, and covenants at the time.

“We’re seeing a lot of companies come to the table looking for capital for a range of purposes, across re-financings, growth or M&A, and that’s an area that we are super excited about and very focused on,” Woodson noted.

As managers look at various opportunities in the credit market, Kevin Petrovcik, a Senior Client Portfolio Manager for Invesco’s Global Senior Loan group, said ESG is becoming a more significant consideration.

Petrovcik said Invesco started incorporating ESG into its credit analysis in 2013, and over the years investors started demanding more quantitative data on companies’ data, data that isn’t available in the private credit markets.

Invesco created an ESG rating methodology that allows the firm to track how portfolio companies are following ESG mandates over time.

The rating methodology allows Invesco look at how involved is ESG in firms’ investment

processes and ultimately refuse to lend to people because of their lack of ESG commitment or agree to lend based on a company implementing certain ESG initiatives in the near future.

“When evaluating companies, our analysts have three key metrics when determining credit ratings; the probability of companies defaulting, the recovery in the event of default and the company’s ESG rating.”

Woodson agreed that ESG is a more important part of company analysis now.

BlackRock has been pushing bank loan issuers to release information via an ESG questionnaire.

“We take the contents of that questionnaire and our credit research analysts and our broader team analyze what that means for an ESG score. We’re taking in data and using that data to enhance our analysis.”

Woodson said because certain ESG data may not be available on the private market, BlackRock will engage directly with companies and input the data collected into their proprietary scoring system.

“Every time a deal comes through the investment committee, there is an ESG component we’re assessing through the lens of E, S, and G individually with different materiality factors. We are essentially self-

scoring so that we know where our portfolio is, and we know where our underlying credit stands from that perspective. To us and our investors, that’s incredibly important.”

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