Calamos' Freund: Rates Could Be As Range-Bound As Stocks For A While

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Chuck Jaffe, in this episode of The NAVigator podcast interviewed Matt Freund, co-chief investment officer/head of fixed-income strategies at Calamos Investments. Read the Q&A below as Matt says he expects interest rates to settle in and remain stable for quite a while before trending down; he expects more volatility in longer-term bonds, which will make it harder for investors to get comfortable lengthening duration ahead of rate cuts that, under good circumstances, should arrive in 2024. Freund also discusses the private credit market and Calamos' new closed-end interval fund, the Calamos Aksia Alternative Credit and Income Fund (ticker CAPIX), which just opened this week.

Matt Freund

The podcast can be found on AICA's website by clicking here: https://aicalliance.org/alliance-content/pod-cast/

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CHUCK JAFFE: Matt Freund, co-chief investment officer at Calamos Investments is here and we're talking fixed income and private credit markets now on The NAVigator. Welcome to The NAVigator, where we talk about all-weather active investing and plotting a course to financial success with the help of closed-end funds. The NAVigator is brought to you by the Active Investment Company Alliance, a unique industry organization that represents all facets of the closed-end fund industry from users and investors to fund sponsors and creators. If you're looking for excellence beyond indexing, The NAVigator will point you in the right direction. Today we're pointed in the direction of the bond and credit markets with Matt Freund, co-chief investment officer and head of fixed income at Calamos. You can learn more about Matt and the firm, and about a brand new interval fund the firm's involved with, it's going to be part of our discussion today, by going to Calamos.com. And if you want to learn more about closed-end funds, business-development companies, and interval funds generally, check out AIC Alliance website at AICAlliance.org. Matt Freund, it's great to have you back on The NAVigator.

MATT FREUND: It's my pleasure.

CHUCK JAFFE: The stock market has proven itself to be range-bound, and now fixed income, well, it's not really range-bound but the expectation is that the rate hikes have stopped and the rate cuts haven't started, which kind of does mean that we expect fixed income to be a bit range-bound, don't we?

MATT FREUND: It depends on which interest rates you're talking about. So I totally agree, the Fed is done or largely done, could they hike one more time? Sure, but we don't think so. We think they're done and that they're going to stay here for quite a while at this level. The longer end of the markets though, that's kind of interesting, they've gotten ahead of themselves. As we're speaking, rates are 360, a little bit more on tens, which is obviously discounting a decline in inflation and a future cut in rates. So I do think there's more volatility to come in longer curves, but to your point, the Fed is largely done hiking, most likely will pause and stay here for quite a while before rates trend down.

CHUCK JAFFE: So if it stays here for quite a while before rates trend down, should anybody be getting a little bit longer out the yield curve? Because on the one hand, yes, we have the inverted yield curve that's made so many headlines, on the other hand, the wrong time to get longer on the curve is when rates have started to come down already, right? You want to lock in your longer term rates as best you can, so are we at that sweet spot yet?

MATT FREUND: No, I think you should start to. This is actually one of, I think, the hardest times for investors. So look, going out for a year or two, short-term bonds type investments, I think that's pretty easy. Our short-term bond mandates have a pre-expense yield of 5.5%, 5.75%, in that area, a duration of around two years. We think that's great risk-reward. However, if something breaks in the economy, if there's another shock, war, Covid, you tell me the reason, you're going to notice that rates on the frontend decline very quickly and that you are going to lose income because rates are declining without much total return to offset that. The longer end of the curve, if I told you that, "Look, the hard landing is coming sooner than we think," I think you're going to get some appreciation out of 10 and 30-year paper, especially quality paper.

CHUCK JAFFE: So let's talk about the paper that you find most attractive right now in these market conditions. Because Calamos, you have suite of closed-end funds, and whether it's the stuff that most people look at or it's convertibles and junk and the rest, there's a lot of different opportunities. Where are you finding the best opportunities right now?

MATT FREUND: So when you think about fixed income broadly, you should be asking yourself, what problem are you trying to solve? Again, if you're looking for a hiding place with as much current income as you can generate, again, the curve is very inverted with front-end T-Bills yielding, 5.10, if you're willing to go to September, you can get 5.30-5.40 on those T-Bills. So that's a lot of yield without much risk, and it's a good place to hide. If you're looking for the hedge, again we would encourage you to start thinking about ten-year investments, longer in the curve but specifically within the markets we do think high yield has a really nice setup. The pushback is, "Matt, don't you always think that?" and you're laughing but it's true, high-yield spreads are clearly wider than they were year ago before the rate hikes started where things were exceptionally low. We had the Fed balance sheet pulling all spreads down, and they can certainly widen, so it's not a slam dunk where they're at the top of the range but we think the risk-reward looks pretty good. We do like loans, we like floating-rate instruments and are somewhat barbelled in our more aggressive portfolios. And within the quality space, within the IG space, again you don't have to be a hero and make huge bets. I think keeping exposure to different parts of the curves, maybe not the 30-year part of the curve, I think that there could be more volatility, especially with the debt ceiling, having money throughout the curve, quality corporates. Again we went from no yield to plenty of alternatives, and we think that investors should be diversified in that environment.

CHUCK JAFFE: Have closed-end fund investors recognized that opportunity? I mean, if somebody looks at closed-end funds generally, they were hit pretty hard, but now the market being range-bound we would expect that discounts would narrow. But as I look at Calamos' offerings, you are across the spectrum, you've got a number of funds that trade not just at premiums but at big premiums, you also have a couple that are trading at double-digit discounts. So is there is a disconnect between what you're seeing and what investors are seeing as they invest in closed-end funds?

MATT FREUND: Let me not speak to Calamos specifically but what we're seeing broadly. So leverage is a double-edged sword, it works beautifully when short rates are lower than long rates, especially if funds are borrowing in the floating-rate space. It is less constructive when the curve is inverted like it is today, where the costs of that leverage might be above what you're seeing those portfolios earn. So I do think you have to look at whatever closed-end funds you're invested in, what sort of leverage they have and where that leverage is from. I will tell you at Calamos, and hats off to the team, we have diversified our leverage sources. We have some that is locked in longer parts of the curve, we have some that is at a very attractive spread but based on the floating rate, so we've tried to again practice that diversification that we talked about previously. So I do think that that's one of the things that is weighing against the industry a little bit, but again, when you think about the funds there that that might be more of a problem for, some of the muni funds, again we don't offer them, but I think there you have the costs of leverage higher than what these funds are earning. Our funds, we've really targeted the convertible space, the hybrid space, where we have combinations of high yield and equity and converts, higher expected returns where the leverage is still constructive.

CHUCK JAFFE: Well, another area that you are targeting now is private credit. Just this week Calamos announced that it is partnering with Aksia to launch the Calamos Axis Alternative Credit and Income Fund, a closed–end interval fund, it's going to trade under ticker symbol CAPIX, and this is the full spectrum of everything out there in private credits. Like if you want to be a private credit investor, this is soup to nuts, global, in one thing. Why this fund now?

MATT FREUND: So when you think about, and we've been looking at the private space for some time, we were really searching for the right partner with the right expertise and global reach, and we think we found that in Aksia. In terms of our approach, one of the mistakes that I see investors make is thinking they're more expert or smarter than they really are. When I talk to people who are looking specifically at real estate credit, international credit, EM credit, mortgage-backed credit, you know, look, I do this full time and it is unclear to me how you can have such conviction as long as they are buying in for. So we are taking a much more flexible approach, we're going to go where the opportunities best present themselves. So that's number one, number two, it is becoming a more global world as you said, so we're not limiting ourselves exclusively to the United States, and I think that that'll be a great growth trajectory. In terms of why now? So I got my start in private credit working for MetLife back in the late 1980s, a lot of the things that we did back then that we thought are cutting edge are now so plain vanilla, so boilerplate, so in the market that they'd really be embarrassing to talk about. But that's what private credit does, it gives you first-mover advantage in asset classes and in spaces where you were being paid attractive spreads for risks that investors are working to get a handle on. So we partnered with a world-class partner who sees all aspects of the market, so we think that that is absolutely the way to go. We are not smart enough to know which box within the private credit space is going to be attractive a year from now, two years from now, five and 10 years from now, so we want to be flexible and we want to be global in our approach. And we think that that is going to lead to strong and lasting returns throughout the cycle.

CHUCK JAFFE: And of course the interval fund structure allows you and Aksia to take that long lens look and not worry that the money's going to go out based on short-term thinking by shareholders. And I guess the other side of this is not really correlated to any of the other things you offer, so for somebody who's looking for diversification, this is a true addition not only to the lineup of funds but it doesn't really have any overlap with anything you're doing.

MATT FREUND: Yeah, I would agree. We really wanted to create protections, these are for long-term investors, interval funds broadly, not just ours. If you're going into an investment like this, we think it makes a lot of sense, we think it is great for long-term investors and will outperform for the cycle. If you're looking to day trade it, if you're looking for a trade to catch a short-term swing in the market, it's not a vehicle for you. So by giving up some of that liquidity, you are gaining access to corners of the investment markets which are really right now reserved for institutional investors who know how to manage their liquidity and have done so for decades. So we think this is a way of giving investors access to asset classes that were reserved and out of their reach, we think it's going to lead to attractive returns for the risk at the cost of reduced liquidity. And I think that's an important part to bring up, if you're thinking you're coming in, again, for a short-term trade, it's not the vehicle for you.

CHUCK JAFFE: Well, we are short term in terms of our timing here, Matt. This has been great, thanks so much for giving us your outlook and giving us some insight into the new fund. We'll talk to you again on The NAVigator down the line.

MATT FREUND: My pleasure, thanks.

CHUCK JAFFE: The NAVigator is a joint production of the Active Investment Company Alliance and Money Life with Chuck Jaffe. And yes, that's me, check out my hour-long weekday podcast at your favorite podcast app or by going to MoneyLifeShow.com. To learn more about interval funds, closed-end funds, and business-development companies generally go to AICAlliance.org, the website for the Active Investment Company Alliance. They're on Facebook and LinkedIn @AICAlliance. Thanks to my guest Matt Freund, co-chief investment officer and head of fixed income at Calamos Investments. Learn more about Matt, Calamos, and the firm's new closed-end interval fund, the Calamos Aksia Alternative Credit and Income Fund, ticker CAPIX, at Calamos.com. The NAVigator podcast is new every Friday, follow along on your favorite podcast app to make sure you don't miss an episode. We look forward to bringing you more closed-end fund talk next week, and until then, happy investing everybody.

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