# BlueBay's Farley On Zagging While The Credit Market Zigs

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Chuck Jaffe, in this episode of The NAVigator podcast interviewed Duncan Farley, portfolio manager at BlueBay Asset Management, which runs the BlueBay Destra International Event-Driven Credit Fund. Read the Q&A below as Duncan discusses how his fund produced a 20-plus percent gain during one of the worst years ever for the bond market, and how the fund can avoid regression to the mean thanks to market conditions – buoyed by the changing interest rate environment – that if properly managed have the potential to keep delivering double-digit returns.

Duncan Farley

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**CHUCK JAFFE:** Duncan Farley, portfolio manager for RBC BlueBay Asset Management is here, and we're talking about zagging while the credit market zigs now on The NAVigator. This is

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's going to point you in the right direction. And today it points us across the pond in the direction of England, from where I'm joined by Duncan Farley, portfolio manager for RBC BlueBay Asset Management, subadvisor for the BlueBay Destra International Event-Driven Credit Fund, it's ticker symbol CEDIX, and you can learn more about it at DestraCapital.com. You can also learn more about closed-end funds, interval funds, and business-development companies generally at AICAlliance.org, the website for the Active Investment Company Alliance. Duncan Farley, it's great to have you back on The NAVigator.

**DUNCAN FARLEY:** Thanks Chuck, I always enjoy our sessions. I think this is the fourth time I've been on your show, and hopefully the listeners are starting to understand a little bit more about what we're doing over here.

**CHUCK JAFFE:** I think they are. And yes, it is the fourth time you've been on The NAVigator, and I should have let everybody know that that's not the anniversary we want to talk about, the one we want to discuss is the five year anniversary of the fund, which has delivered a 12% annualized return since its inception and ranks at the top of the peer group for continuously-offered closed-end interval funds over the last five years. So let's start with how have you done it? Is there a secret or is it just the market favoring your small slice of the credit world?

**DUNCAN FARLEY:** There's probably no easy answer to how we've done it. I think as I've said before, the fund is very uncorrelated to other markets, to other asset classes, and our performance hopefully is a good demonstration of that. It's a multi-strategy fund, there's always something going on in our world, and our job, which is not easy, is to make sure that we identify and pick good investments within the sectors that we look at. It's true that we've made some good calls on some sectors that were lagging, didn't perform well, things like energy and shipping. But generally speaking, we've made our money through a multitude of different investments with good returns, and importantly we haven't got too much wrong. We've not lost money on investments, and that's down to our process, where we start every

investment decision with, “How could this go wrong? Let’s make sure we protect ourselves on the downside.” The winners will always look after themselves, you’ve got to make sure if you have a loser in there that you don’t lose too much money when you invest.

**CHUCK JAFFE:** How do you also avoid regression to the mean? Because 2022 was a terrible year for bonds in general, and yet it was a great year for your fund, you were up 21%. Having had that kind of performance, the thing about active management is always, doesn’t it regress to the mean? How do you avoid that? Obviously process is part of it, but is there more?

**DUNCAN FARLEY:** Yeah, you’ve got to remember that we’re primarily targeting debt instruments that are trading at big discounts, at low prices. So as I say to everybody, you buy a bond or your buy a loan, it’s pretty asymmetric. Even if you buy a loan at 60 cents, yeah, you might be able to make 40 cents if everything goes to plan, but you could also lose most of your 60 cents. So we make sure that our entry point either is close to the asset as possible or is at a point where it couldn’t get much worse, we’re creating the asset at multiples that seem pretty attractive to us. Europe’s a pretty big place for us to fish around, there’s a $7 trillion bank debt market, there’s a $2 trillion high-yield leveraged loan market, so even in a benign world there’s always plenty of opportunities for us to source those instruments and investments. It’s not easy what we do, I mean, we have to tend, if you’re targeting the mid to high teen returns, you can’t expect it to be simple, and it certainly isn’t simple. But there’s always, as I say, something happening, something for us to look at, and we’re nimble, we’re active, and we’re busy. I mean, we’re probably no busier now than we’ve been since the fund started.

**CHUCK JAFFE:** How does the changing interest rate environment and much higher interest rates impact what you’re looking at? Is it creating more opportunities or less? Is it making bigger opportunities?

**DUNCAN FARLEY:** Personally I think it’s massive, to be honest. I go back to a period where high yields was high, when I started looking at the European high-yield market back in the late nineties deals were coming at 10-12%. Then after the GFC and cheap money, we haven’t lived in that world, there’s been nothing, high-yields is trading close to 5%. So the opportunity set just from a general investment standpoint certainly for us was less. Today we’re in a different world. Regardless of whether government rates return to 2% or 1%, I

think there's no doubt that the cost of finance for those companies, lower rated, small or medium sized companies, has gone up. And frankly, with many of their balance sheets, they're just not going to be able to support that high rate. And so what we're seeing today is owners of those businesses, whether it be private equity or whether it be families, have big decisions to make, they can run with as much debt. So they're either going to have to put in more equity or they're going to have to hand over the keys to investors like ourselves. And so we'll see, instead of the classic amend and extend that we've seen for the last five years, we're already seeing a lot more situations where companies are recognizing that the debt needs to come down, and the only way for that to happen is through a restructuring, and that's our bread and butter let's say. That's one of the strategies that we have, I guess, our bread and butter within the fund. So look, it's not getting easier, I would never say, it's never easy to do what we do, but there's certainly a bigger pool for us to fish from at this point in time which is great. But I will make the point, I often try to make the point, it doesn't need a major recession for this to happen, the leverage of a lot of companies is already a problem regardless of what happens from here.

**CHUCK JAFFE:** Is it making things happen faster? Like event-driven trades, as you've described them in the past, and maybe we should have you describe them a little bit here again, but event-driven trades are you sort of see something happening and then there's a timeline. Given higher interest rates, higher inflation, all those other sorts of things, is that speeding up the timeline at all?

**DUNCAN FARLEY:** No, I think we're going to have a mix here, I would say. There is definitely going to be a bigger incidence of distressed and defaulted structures. We will inevitably see default rates run at higher levels than they have been over the next couple of years, but my personal view is that we won't see a spike in default rates to very high levels but we'll just have sustained periods of higher defaults. Now what does that mean in terms of your question on timeline? Well, look, some things will recover very quickly. I mean, obviously the macro backdrop will have an impact on that, but there'll certainly be some trades that we'll do where it's a quick turnaround and actually we might be able to make returns in six to 12 months. But I think for the by and large, particularly with the restructuring pure distressed rate, which I remind our listeners is only part of the strategy of the fund, the timeline for that is likely to be more like 18 months to 36 months. I think the other point to make is that

doesn't mean that it's totally illiquid by the way, because even though a situation might be private, and I think I've touched on this before, it doesn't mean that there's no liquidity, it's not a tradable instrument. So today on our fund we sit with a very, very small amount of very illiquid paper, I would expect that to increase in time but still with a decent amount of liquidity in it. So there'll be a mix, but probably things will take longer to play out, partly driven by the economic backdrop as well.

**CHUCK JAFFE:** You mentioned the private versus public opportunities and the illiquid stuff, et cetera. You said you might expect some of it to increase in terms of private, but is the better opportunity moving forward more on the public side or private side?

**DUNCAN FARLEY:** Look, I think they're both busy, to be honest. We've probably had, there's been a higher amount in the public space. If I look at the pipeline today, I mean, our watchlist, from a little bit perspective, our watchlist of names is nearly 300 today, a year ago it was around 70 or 80. And they're a mix, well, most of them are public, but we are seeing a slight increase in some of the private situations arising. Part of that would be driven by what their private credit funds decide to do. If they can self-help and sort themselves out, then a lot of our investments, maybe we don't see much of that. But as we suspect that some of their investments, some of their portfolio companies get into difficulties, then maybe we'll see a steady stream of those come into the markets as well. But look, we're agnostic, it doesn't make any difference to us whether it's public or private, the fund structure allows us to invest in both and we'll look to both asset classes as they arise.

**CHUCK JAFFE:** Well, and it doesn't make a difference to us if the times are good or bad, we will turn to you. Of course with your fund the times have always been good, but we'll hope that that continues and that we'll pick it up again the next time we chat on The NAVigator. Duncan Farley, thanks so much for joining me.

**DUNCAN FARLEY:** Thanks Chuck.

**CHUCK JAFFE:** The NAVigator is a joint production of the Active Investment Company Alliance and Money Life with Chuck Jaffe. Yup, that's me, and you can check out my show on your favorite podcast app or by going to MoneyLifeShow.com. To learn more about interval funds, closed-end funds, and business-development companies go to AICAlliance.org, the website for the Active Investment Company Alliance. They're on Facebook and LinkedIn @AICAlliance. Thanks to my guest Duncan Farley, portfolio manager for RBC BlueBay Asset

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