Farley Of BlueBay Destra International Event-Driven Fund

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Chuck Jaffe, in this episode of The NAVigator podcast interviewed Duncan Farley, manager of the BlueBay Destra International Event-Driven Credit Fund, which Morningstar places at the very top of its peer group over its five-year existence. Read the Q&A below as Duncan talks about how special situations are plentiful in the current marketplace, but the risks associated with those better yields are not so high as to turn off investors who can get 5 percent yields on money-market accounts.

Duncan Farley

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

CHUCK JAFFE: Duncan Farley, portfolio manager at BlueBay Asset Management is here, we're talking event-driven credit 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's going to point you in the right direction. And today it points us in the direction of England, as I'm joined from across the pond by Duncan Farley, portfolio manager for RBC BlueBay Asset Management, which is subadvisor for the

BlueBay Destra International Event-Driven Credit Fund. The fund, which recently celebrated its five-year anniversary, and which has been the top performing continuously offered closed-end interval fund over its five-year existence, well, it's ticker symbol CEDIX, and you can learn about it at DestraCapital.com. Duncan Farley, welcome back to The NAVigator.

DUNCAN FARLEY: Hello Chuck, always enjoy our little short discussions.

CHUCK JAFFE: And let's try to pack as much into this short discussion as we can, starting with the fact that your fund, it's been killing it. It's the top fund of its kind since it opened, 12% annualized gains since inception, but that inception was at a very different time when it comes to the interest rate world, like fixed income was not fixed, it was broken. And now it has been fixed, that puts it in a different place because event-driven credit, it's not the same as, "Let's go buy Treasuries." So what do you say to somebody who's saying, "Do I want to go out the risk spectrum? How far out am I going? Have I missed this chance to do well in event-driven credit?" What's the risk-adjusted return balance in these conditions?

DUNCAN FARLEY: Look, it's a valid question, I think the key message from me would be investors definitely have not missed it. We're, as a team, busier than we've ever been, but it's on the long and the short side. Our watch lists of investable names is growing day by day, and there's two key reasons for that. One, you just touched on, and that's the cost of funding, and the second is the maturity profile for a lot of this debt. If I take the first of those, the cost of funding, simply put, a lot of companies just can't afford to pay the current costs, they've got too much debt. Maybe you want to put it a simpler way, if a company is levered more than four times, it can't afford to pay 10% on its debt balance. There's a great study out, it was a couple of months ago now, by Moody's, which they broke down the US high-yield B3 issuance universe, it's just over 300 names, and they calculated that by December of this year over 60% of those were to have an interest cover ratio of less than 1x, i.e. they couldn't even afford to pay their interest if you use EBITDA as a measure of cash. So there's a lot of head scratching and stress on a lot of management teams and CFOs in particular, which sort of brings to the second point, obviously if your debt isn't maturing for quite a few years out then obviously it's less of an issue today, but as that maturity gets closer, the responsibility on directors to do something about it grows. And if we think about Europe, which is where we are specialized and where we focus, we've got nearly $120 billion of debt that is maturing, well, through the end of '25, in both the high-yield and levered loan markets alone. That is a

huge opportunity set for us, so our job is to go through each of the stressed situations as we identify them and decide when and at what price to invest. So very busy, probably busier than we've ever been, and so pretty excited about the prospects going forward.

CHUCK JAFFE: And I guess that's the question, because event-driven credit is a euphemism for "Somebody's got a problem", obviously there's more potential problems that need to be solved, you're seeing more opportunities but are they good opportunities? How worried are you about the default rate and where it could be moving in times when rates are staying higher for longer?

DUNCAN FARLEY: Look, as I tell a lot of people, the default rate is of interest for those that are investing in high yield. If you're buying into a special sits funds, you're not investing in high yield, there are high-yield issues in there. The closer a company becomes to being distressed or stressed, the lower the price is. The main reason for us not proceeding with an investment is usually the price, we don't think we're getting paid for the risk we're taking, and more importantly, we don't think we're investing at a level that puts us close enough to the downside level in terms of, what would be the recovery for a situation if it were to go wrong? I'm sure I've said to you before that we start all of our investment committee meetings with, "How could this go wrong?" and, "If it goes wrong, what would our recovery be?" And we need to try to make sure that we invest at the price point that is as close to that as possible. In a strong market, where everything's going well, obviously everything tends to trade a little bit too high for us. As we demonstrated over the last five years, that's okay because there's always sectors and pockets that you can find value. At the moment it seems a little bit more widespread, there's quite a bit of stress across a number of different sectors and the prices are getting close to the levels that we would find interesting. So yeah, default rates, nobody wants a particularly high default rate because that suggests that we're in an environment of deep recession and a lot of pain, and frankly, who wants that? What were interested in multi-years of maybe higher default rates, which suggests there are a lot of issuers for us to review and look at that could potentially be interesting investments for us.

CHUCK JAFFE: Where are you finding those? What are the sectors where there are the best opportunities?

DUNCAN FARLEY: I think it is more widespread this time around. Obviously there's not one particular sector that's facing a cost of funding issue, it's across the board. So we, and for

those that follow the fund, will know that although we've got a European focus, we can pretty much go anywhere across multiple geographies, as I say, with that European specialty in particular. But we have in the past had a sort of thematic theme across our investing, and those that follow the fund will know that energy and shipping have been particularly good examples of that. So today, where would I say we would see a similar potential? Definitely real estate, certainly a focus for us. We're seeing a lot of different issuers getting into difficulty, or certainly the price of their debt is trading off, but like every sector there'll be winners and there'll be losers. There'll be those that had good properties, and that doesn't necessarily mean that they own residential not office but there could be good office blocks versus bad office blocks. Our job is to disseminate all the information as best we can for each of these issues and to work out which ones are likely to survive, and as I say, make sure that we invest at the price that pays us for that. Remember, if we're targeting, let's say an excess of 15% return on most of the investments that we undertake, the most important thing is to make sure you don't lose any money. The winners will look after themselves, it's to make sure that you don't get it right, and let's face it, no one gets it right all the time, that you're not hurting your P&L, and the best way to do that is to buy as close as you can to what you perceive to be the downside recovery value.

CHUCK JAFFE: There's definitely a lot of bearishness right now towards the private credit market, et cetera, but also towards the situations that you're looking at in general. So how do you calm somebody who's worried about downside risk? You just said the biggest thing is not losing money, but you still have to find a buyer who's willing to take that chance.

DUNCAN FARLEY: Yeah. I mean, look, your point is easy to say. Look, sometimes it's simple, if you're buying into a story that's very asset backed, you can clearly go out and talk to independent valuers of those assets to get a sense of, what if I have to liquidate this? What's the worst case that would be? First of all, is there any buyer for it or will I have to scrap it? Yeah, we've had these same conversations when we were investing in the energy space and we were looking at offshore vessels and rigs, "Is there any buyers for these assets?" we would ask the valuer, and we use our experience to work out whether that is likely. If we're looking at businesses, clearly it's a case of applying say, more conservative assumptions on the profitability of the business, and then applying more conservative assumptions on the discount rates that you're going to use on its cash flows or the multiples that you're going to

use to value the business, and do as much investigation as you can using all our sources to work out whether or not this is a business that could be sold and what that low case price could be. But again, obviously if you're investing in a business and you're securing your debt or the instruments that you're either providing or you're buying into, you've got to make sure there's good asset backing and you do the same process as before, you go out and value those assets. So there's lots of work that you have to do to get comfortable with that downside, it's not just a case of picking a number out of the air and saying, "That's the price I'm willing to pay." And the bearishness that you talk about creates the price volatility that we look for and the opportunity that we look for, in strong markets, it's harder to find.

CHUCK JAFFE: Lastly, is this more of an opportunity in private credit or public credit?

DUNCAN FARLEY: I think both. We're pretty active at the moment in the public markets because they are big markets, there are trillions of dollars of high-yield bonds and levered loans issued in Europe alone and we're seeing a lot of price moves in a lot of that paper, so that is tending to be where our focus is at the moment. Remember, I always tend to talk about it in terms of liquid and illiquid, some private situations can be quite liquid, we've invested in many bank debts that has traded that has actually been pretty liquid in the market for us to buy and sell out of. Our focus at the moment has been in the more liquid markets, so nearly 99% of the fund is currently defined as liquid, but I would expect over time, as we've seen in the past, there to be an uptick in the amount of some more private situations that come across our path. But at the moment, it's more focused on the public sectors.

CHUCK JAFFE: Duncan, really interesting. Thanks so much for joining me on The NAVigator to talk about it.

DUNCAN FARLEY: Thanks Chuck.

CHUCK JAFFE: You've been listening to The NAVigator, which is a joint production of the Active Investment Company Alliance and Money Life with Chuck Jaffe. And yep, that's me, and you can check out my hour-long weekday show by going to your favorite podcast app or by searching for it at MoneyLifeShow.com. To learn more about closed-end funds, interval 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 Management, which is subadvisor for the BlueBay Destra International Event-Driven Credit Fund, that's a closed-

end interval fund that trades under ticker symbol CEDIX, and you can learn more about it by going to DestraCapital.com. The NAVigator podcast is new every Friday, be sure not to miss an episode by subscribing or following along on your favorite podcast app and we'll be back next week. We hope to see you then, and until then, happy investing everybody.

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