Nuveen's Chintapalli Sees Big Opportunities In Global High Yield

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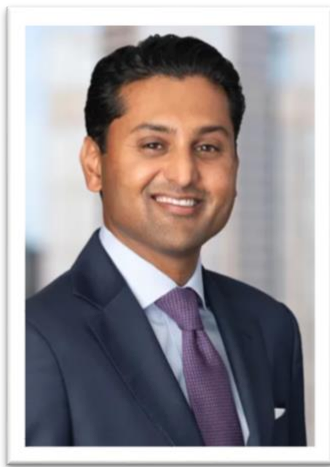

Chuck Jaffe, in this episode of The NAVigator podcast interviews Ravi Chintapalli, Client Portfolio Manager on the Global Fixed Income team at Nuveen. Ravi says that the bond market has seen a structural change in the market for below-investment grade or junk bonds. Chintapalli says investors think of junk bonds as it was in times like 2007, when nearly one-third of the paper was teetering on the edge of default; today, however, only 10 percent of the below-investment grade paper carries those same low ratings, and default risk is much lower than in the past. As a result, investors can expect high-yield bonds to live up to their promise, with 7 percent income levels moving forward, and some extra risk cushion in the many cases where the bonds are selling below par.

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

CHUCK JAFFE: Ravi Chintapalli, client portfolio manager for the Nuveen Global Fixed Income team is here, and we're talking about below-investment grade credit markets around the world, this is 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 representing the full spectrum of the closed-end fund business from investors and users to fund sponsors and creators. If you're looking for excellence beyond indexing, The NAVigator will point you in the right direction. And today we are discussing

global fixed-income markets with Ravi Chintapalli, client portfolio manager on the fixed-income team, the Global Fixed Income team at Nuveen. You can learn more about the firm and its closed-end funds at Nuveen.com/CEF. Learn more about closed-end funds, interval funds, and business-development companies generally by visiting AICAlliance.org, that's the website for the Active Investment Company Alliance. Ravi Chintapalli, thanks for joining me on The NAVigator.

RAVI CHINTAPALLI: Thanks Chuck, pleasure to be here.

CHUCK JAFFE: We're talking below-investment grade credit, in plain English, that's junk, but I want to start with just an outlook for that sector of the market. Because here we are watching interest rates start to come down, but when interest rates went up we didn't see what we would have expected with junk bonds, which is rates go up, we normally think junk gets junkier, more defaults. If we didn't have the defaults then, are we at a spot right now where junk is not junky at all?

RAVI CHINTAPALLI: That's very interesting, Chuck. In fact, I think the structural shift that you've seen for the below-investment grade or junk bond and junk loan world in the US and globally really saw a pretty significant shift from a risk factor perspective. I look back and think back to what we saw as a composition for the market in 2007, you had 30% of the high-yield market in the US rated CCC, today that stands at about 10%. More than 50% of the high-yield market is rated BB, and in fact the default risk historically for BB-rated credits has been near zero when you look back over the last 20 years plus. So today when we think about, yes, you're right, rates spiked pretty aggressively over the last couple years, why was default risk more muted? And it's truly a function of the cohort of quality that exists in the below-investment grade high-yield space today.

CHUCK JAFFE: That cohort of quality, help us understand return expectations in a market that is watching rates fall, if maybe slower than the market has seemed to expect would be falling.

RAVI CHINTAPALLI: That's right. Another key factor that we think about when you should be assessing or thinking about when investing in below-investment grade credit, the major risk fact that you're exposing yourself to is credit risk. When you think about the interest rate risk factor, it's really not the driving factor. So high yield was naturally insulated from the deterioration on price that typically comes from more longer duration, higher grade securities. High yield typically has a duration of about three years as compared to more

investment grade or the broad aggregate bond index of about six years. At the same time today, you still have that fixed-rate coupon that is getting a benefit from, as you said, a falling rate environment. Importantly, because base rates have elevated so much, the yield on the high-yield market today stands at about 7%, so pretty elevated as you think about what we kind of experienced as fixed-income investors in the zero percent rate environment that we all experienced for many, many years post-Global Financial Crisis. So we think about 7% income levels, plus average prices being below par, can lead to some incremental total return opportunities that exist out there, especially for active managers in credit risk.

CHUCK JAFFE: That price below par, is that basically an extra cushion against the risk that we're talking about?

RAVI CHINTAPALLI: It is. Naturally fixed income in general, not just below-investment grade credit, it's an asymmetric payoff as we know. Typically you're lending money at par, along the way until maturity you're hoping to get paid income based on the coupon rate, and you're hoping to get paid back at par. When you're investing in below-investment grade credit, we must be mindful of the fact that you are taking credit risk, i.e. default risk or not getting paid back at par. So as prices move away and lower away from par, the symmetry is now starting to move to a more balanced approach.

CHUCK JAFFE: High yield has been a tough sell for a while because a lot of folks felt they weren't being paid for the risk. You've talked about the anticipated returns and that you have an extra measure of safety now because of where they are trading, but is the best high yield market that you're seeing the domestic market? Or is high yield different enough that you are getting paid a premium potentially or just finding better values internationally?

RAVI CHINTAPALLI: That's right. We actually think taking a more diversified approach and not everyone is set up to be able to identify from a security selection or a bottom-up sector specialist approach to investing in below-investment grade credit to allow them to have a broader scope of opportunities. The emerging market debt space is a key component of one way to access the global high-income market, which is in JGH, our closed-end fund that we're talking about today, has an allocation of about 25% to emerging market debt. What does that offer you? It offers the ability to identify sovereign risk and corporate risk from a bottom-up dedicated investment team focused only on emerging market debt securities and analysis. Instead of just forcing capital into US unsecured CCC risk at 9-10% type of yield levels, why

not take some exposure to sovereign risk of places like Ivory Coast in sub-Saharan Africa? Here's a country that during Covid had to go to the INF, get some extra financing, with that financing from the INF comes increased oversight. Now we're talking about the potential for increased oversight reducing actual drawdown risk. Separately looking at something like Mexico, Mexico at a sovereign rating is actually investment grade, there are larger companies within the country of Mexico such as large energy companies, airlines, industrial companies with large amounts of free cash flow and ability to service their debt obligations, here's a way to access non-US corporate risk from a country that also has a high-grade sovereign rating. This broader investment landscape to us can help again reduce the potential for downside volatility from just having a more singular or passive approach to just the US high-yield market.

CHUCK JAFFE: One of the interesting things that people would notice if they went to take a look at a chart on Nuveen Global High Income, again ticker symbol JGH, is that at least since 2022 when the market was struggling, it has been relatively correlated, like you're up about 20% this year, which for a bond fund, even a junk bond fund, people go, "Well, considering where the market is, that's pretty good," 21% last year when the market was up about 25%. So it has been highly correlated for a while now with the stock market, do you think that continues? And given the characteristics of junk, is this a case where you might want to go towards high yield to goose your yields, but you don't really want to think about it the way you think about every other income fund, especially now where the correlation is this high?

RAVI CHINTAPALLI: The correlation is absolutely accurate. Credit risk and below-investment grade high yield is mostly correlated to the equity market because you're taking corporate risk, it's not really correlated to the broad investment-grade space. Those return numbers that you mentioned, importantly, I think the active approach, the broader landscaping defining high levels of income and total return potential, the returns for JGH have significantly outperformed the broad global high-yield market as well. Let's not forget the fact as when you're lending to companies at the debt levels, you are inherently taking less risk than equity because you have a prioritization within that capital structure to get paid first. Now you're going to get paid first on the broadly syndicated loans or the top of the capital structure, but unsecured risk sits ahead of actual equity risk, so I would argue, yes, while correlation of returns is very similar to the equity market and that is probably going

to continue, your absolute downside risk in the event of default is much more protected than owning equity risk.

CHUCK JAFFE: And again, we don't consider default to be a high risk at this point in the market, which is just one more reason to be looking at it, correct?

RAVI CHINTAPALLI: That's right. The way you lose in below-investment grade credit in high yield is exposure to too much loss-given default, that's where active management is critical. There's no way to truly hedge credit risk in our markets. Yes, there's broad based indices, whether it be credit default swaps on individual names or CDX on the broad index, but you can see the dispersion over time, there's no perfect hedge. The only way to hedge credit risk, have a large team of analysts dedicated to their subsectors, do the work, talk to management teams, talk to sovereign issuers of debt, understand the dynamics of cash flow, and then position portfolios accordingly.

CHUCK JAFFE: Ravi, great stuff. Thank you so much for joining me on The NAVigator to talk about it.

RAVI CHINTAPALLI: Thanks Chuck, absolutely pleasure. Appreciate it.

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