ANALYSIS

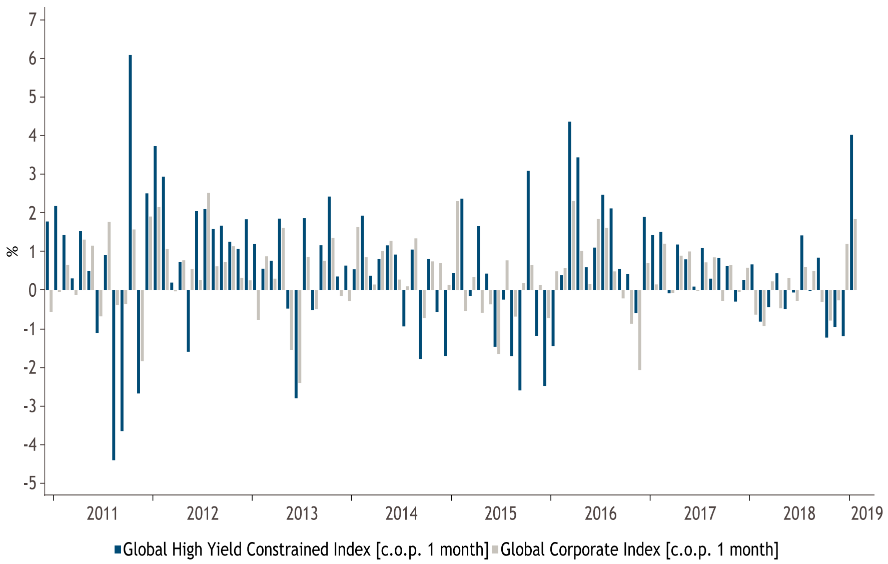
Credit Continuum

February 2019

While the recent rebound in financial markets has provided opportunities, risks remain

After a troubled end to 2018, risk assets had a robust start to the year. Global high yield did particularly well, producing the second strongest monthly performance in seven years and all but erasing cumulative fourth quarter losses. [1]

Fig. 1 – Performance of Global High Yield



Sources: ICE BAML Global High Yield Constrained HW0C hedged in USD and ICE BAML Global Corporate Index, G0BC hedged in USD, as of 31 January 2019.
c.o.p – change of period.

1. Source: ICE BofA Merrill Lynch Global High Yield Constrained Index (HW0C), as at 31st January 2019.

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Michael manages the Muzinich Global Tactical Credit strategy. Prior to joining Muzinich in 2012, Michael was president and Head of the High Yield Division at Seix Advisors, Inc. At Seix Advisors, he was the founding partner of the high yield strategy that grew to over $13 billion under his leadership. Previously, Michael served in various research and portfolio management capacities at American General Corp. and at Capital Holding Corporation. He earned a BA in Management Science from the University of California, San Diego and an MBA from Rice University.

January's picture was in sharp contrast to December, where the technical environment became completely dislocated from corporate fundamentals. Issuers returned to the market in January, although at lighter levels, highlighting companies were in no hurry to refinance.

The Federal Reserve's monetary policy about-turn also soothed wary investors, with more dovish rhetoric indicating a pause in their current cycle.

These positive drivers resulted in a change in mindset, as reflected by increased inflows in fixed income. [2]

However, looking ahead, we believe the macroeconomic environment remains in doubt. While the most recent US Purchasing Manager Index (PMI) rebounded in January, the service sector fell. [3]

PMIs globally are on a downward trajectory, especially in China and the European Union. Meanwhile Europe is contending with a growing number of idiosyncratic challenges, such as in Germany, while the Italian economy recently entered a technical recession.

At this juncture, perhaps the key question is whether this slowdown will end during the first quarter or will the weakness continue and, if so, where?

While it is difficult to predict the future, we are closely monitoring the ongoing US/China trade war discussions as well as consumer confidence in Europe, which should provide some insight into the potential direction of the global macro economy.

Our assessment is that, while there are valid concerns about slowing economic growth, credit spread widening has been more than sufficient to compensate investors and draw them towards more fully invested credit positioning.

However, we are in an uncertain environment which requires a delicate balancing act of weighing up risks against opportunities.

2. Source: ICE BAML Global High Yield Constrained HW0C hedged in USD and ICE BAML Global Corporate Index, G0BC hedged in USD, as of 31 January 2019.
3. Source: https://tradingeconomics.com/united-states/manufacturing-pmi , https://www.reuters.com/article/us-usa-economy-ism/us-services-sector-growth-hits-five-month-low-idUSKCN1P11H1
https://www.ft.com/content/6506a854-24f1-11e9-8ce6-5db4543da632;
https://tradingeconomics.com/euro-area/manufacturing-pmi