Rieger Report: Taking a Stand on Junk

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U.S. High Yield Corporate Bonds
&
Senior Loans

There is no one black and white way to look at fixed income asset classes. Each of us has different investment time horizons, objectives and risk profiles. When reporting out on bond market segments I like to think of three distinct horizons: tactical use, short term exposure and long term/buy & hold exposure.

My views of the current state:

- **U.S. High Yield Corporate Bonds: Use of this asset class tactically as equity market volatility ripples through to the credit markets makes sense to me. The easiest tactical use is via Exchange Traded Funds (ETFs) and the larger ones tend to have good depth of market. Caution should be exercised if intending to own this asset class for 1 – 2 years as potential recession and default risk could be elevated during that period. I don't see any reason at this time to be a long term buy and hold investor. This perspective might change if and when there is more spread in the equation.**

- **Senior Loans: I am of the mindset to take profits seen year-to-date and get out. Prolonged low rates, weak covenants (investor protections) and an untested default cycle regarding recovery rates are high on my concern list.**

U.S. High Yield Corporate Bonds (Junk Bonds)

Tactical	Short Term	Long Term Buy & Hold

Tactical:
I view junk bonds and in particular junk bond ETFs as good tactical tools while remaining alert for opportunities created by volatility in the very near term. USD high yield bonds are likely to show resilience over the very near term. Rates appear to be held low for a while, demand for yield remains strong and geopolitical risk may keep the USD in a narrow trading range.

Short Term 1 -2 year Horizon:
I don’t like the risk return dynamic of fixed rate junk bonds over this time horizon. Not enough incremental yield to offset the risk of a coming bear market and/or recession. Resulting defaults could manifest themselves during this period. Liquidity can change dramatically. I view this asset class with caution for this horizon.

Long Term Horizon:
At the current tight spreads to investment grade there is little to like here in my opinion. Perhaps it deserves another look when and if spreads widen by another 100bps or so.

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U.S. Senior Loans
(Leveraged Loans, Bank Loans)

Tactical	Short Term	Long Term Buy & Hold

Tactical: Caution

With the Fed holding rates low or perhaps slowing the rise of rates this asset class of floating rate syndicated bank loans loses a lot of it's appeal. I view the returns year-to-date as an opportunity to exit with a profit. If using this asset class tactically, I would prefer to use one of the larger loan ETFs to ensure liquidity in the event I needed to exit. If CLOs slow, I would want to get out quickly.

Short Term 1 -2 year Horizon: Don't do it

Rates may begin to rise in this time frame. However, a recession could put credit stresses on these entities and defaults may rise. If defaults rise, the trend of the last 5 years or so of issuing loans with weak protections (Covenant Lite) for loan holders (investors) will test historical recovery rates.

Long Term Horizon:

At this time, entering the senior loan market via a mutual fund or an ETF with the intent of meeting a long term investment goal is not appealing. In a similar way to fixed rate junk bonds, I would reconsider this view if and when yields are incrementally higher and when the market experiences some defaults testing recovery rates v. the Covenant Lite deals.

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