# Barings' Feeley: Rate-Cut Cycle Will Make High-Yield Bonds More Attractive

Friday, October 4, 2024

Chuck Jaffe, in this episode of The NAVigator podcast interviewed Sean Feeley, part of the U.S. High Yield Investment Group at Barings. Read the Q&A below as Sean says he believes that with the bulk of interest rate adjustments happening at the short end of the yield curve, a wave of refinancing of shorter-term debt is coming, and that this typically makes high-yield investments look more attractive. Feeley expects the economy to avoid a recession, with strong balance sheets contributing to a soft landing situation that plays out into 2025.

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

**CHUCK JAFFE:** Sean Feeley, portfolio manager for the US High Yield Investments group at Barings is here, we're looking for what the shifting interest rate environment means for the global high-yield market, 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 entire closed-end fund business, from users and investors 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 looking in the direction of high-yield investments, because we're joined by Sean Feeley, he's part of the US High Yield Investment group at Barings, which means that among other things, he's a portfolio manager on the firm's closed-end funds; that's Barings Global Short Duration High Yield, Barings Participation Investors, and Barings Corporate Investors, their ticker symbols are BGH, MPV, and MCI respectively, and you can learn more about the firm and its funds at Barings.com. To learn more generally about closed-end funds, interval funds, and business-development companies visit AICAlliance.org, that's the website for the Active Investment Company Alliance. Sean Feeley, welcome to The NAVigator.

**SEAN FEELEY:** Thank you very much, good to be here.

**CHUCK JAFFE:** So we have obviously seen rate cuts, and as recently as a week ago we got a new read on inflation, which seems to suggest that we're actually going to see a rate cutting cycle because there will be multiple. What does that shift interest rate environment do for global high-yield investments? What are you seeing happening in this environment for global high yield?

**SEAN FEELEY:** Yeah, I would say that the bulk of the interest rate adjustments is going to be at the short end, so at the long end you should still expect to see Treasury yields, 3.5-4%, which means as the market refinances short-term debt, coupons will go higher, which makes high yield more attractive. Typically at coupons or yields of 7% or better, the market performs pretty well.

**CHUCK JAFFE:** One of the things that didn't happen when rates went up that we normally would expect is that we didn't see some sort of rash of defaults, we didn't see a lot of change on the default level. And now we're going to see interest rates come down, so in the high-yield market, anybody who was on the verge of default, getting a bit of a reprieve. Is this going to make high-yield that much safer and/or more attractive as rates come down?

**SEAN FEELEY:** It should make it more attractive because many of the companies in the high-yield market have floating-rate debt outstanding so their interest costs will go down, so that'll increase their ability to service some debt, but also keep in mind that many of the companies that are in high yield have already been grappling with the expectation of a recession, and so they've been managing their balance sheets pretty conservatively. Leverage levels are low, credit quality's at an all-time high, over 50% of the market is BB rated, but also because of that mindset default rates have been coming down, and we don't expect default rates to move back up meaningfully anytime soon.

**CHUCK JAFFE:** That's interesting to me. Some folks that I've talked to who have said they thought there might be a big of a hangover, that in other words when rates came down, those corporations that had been hanging on might be exhausted and it might be too late. In other words, they would feel the effects of the Fed having waited this long. You don't think that there's going to be any sort of debt hangover that way for the ones that were on the edge?

**SEAN FEELEY:** I do not. I think that there's a smaller portion of the market that whether interest rates are going lower or staying the same, they have some credit issues, but it's well known in the market, it's a small part of the market, CCCs are now only about 10% of the market, it's one of the lowest ratios we've seen in the history of the high-yield market, so most of those companies will have no problem getting financing, we've seen many of them do it already over the last 12-18 months. There are certainly some distressed names, a lot of it is in media and telecom, they will figure things out one way or another, many of them do have weak balance sheets and they may have to work on a deal with creditors, but like I said, it's not a meaningfully high part of the market and they've been struggling for years and it's well known in the market.

**CHUCK JAFFE:** As I hear that, given everything you've said and the fact that we're at a time where the high-yield portions of the market and the number of things that are below investment grade or smaller, investment grade is the biggest it's ever been, do we have a supply-demand issue here? Are we going to see an interesting supply-demand imbalance, because that could radically change pricing in returns, couldn't it?

**SEAN FEELEY:** That is true, although I'll say that the duration of the market is the lowest it's been in some time, the effect of duration of the US high-yield market is around three, and if you look at the maturity wall over the next, say two to four years, the vast majority of that is BB and B issuers, and they will not have any meaningfully challenging issues with respect to refinancing their debt. There are some lower level CCCs that have some refinancing needs, so that will be something that the market will have to overcome, but as I said before, it's a small part of the market. Because the market is so short dated, you're seeing a lot of debt get refinanced or called, and if that is not refinanced in the high-yield market, then the high-yield market will shrink. But we've seen it start to grow again after a period of shrinkage, and I think that because of that high turnover that has been happening and is expecting to continue to happen, managers continue to have an abundance of cash in their funds and it's harder and harder to reinvest that cash because everyone has cash too and so there's a lot of competition in the bond market for deals, new issues in the secondary market, so that technical aspect should be with us for some time. Now that could change if we see fallen angels, which we don't expect. In the investment-grade market it's a little bit different, there's a lot more supply, there are more BBBs in the investment-grade market than previously, that has actually been a good area for us to exploit because you can get spreads equivalent to BBs with BBB-rated names, and they're bigger and have more financial flexibility and better relative value.

**CHUCK JAFFE:** So as we put it all together, I want you to peer into your crystal ball, which for all people in your position is somewhat murky, but what do you see happening over the next year to two years given changing market condition, the likelihood that this rate cutting cycle is going to be extended at least through next year, and is there something that investors should specifically be looking out for? Because you as a fund manager and a portfolio manager, you have one level of concerns, but is there a place where that translates down to the end user?

**SEAN FEELEY:** If you look at the past, the expectation of 200 basis points roughly of rate cuts, that level of rate cut, and if you look back in 2001 and 2007, that has triggered a recession, that's one thing that the market is concerned about. The rates market is telling you there should be some level of recession risk built into your strategy, but if you look at how equities have performed since the Fed cut, and if you look at how commodity-centric countries' currencies have performed, they've depreciated, not appreciated, including the US, so that tells you that the fundamental picture's pretty good. Corporate balance sheets are really strong, bank balance sheets. I think this situation is a little bit different than previous cycles, and I believe that we're going to be in a soft landing scenario into 2025.

**CHUCK JAFFE:** Generally we've talked high yield here, and you're part of the high yield group, the Barings Global Short Duration High Yield Fund is just one aspect of what you guys are doing. When it comes to how that fits in with what Barings does when it comes to high yield, give us an understanding just a little bit of the global view and everything you're doing beyond the fund.

**SEAN FEELEY:** It is a global strategy, so I have the ability to buy European securities, US securities, leveraged loans, high-yield bonds, structured product, we have strong expertise in all facets of the high-yield market, and so those are really good levers to pull in different market conditions. Earlier in the year we were investing more so in loans, now we're emphasizing more in bonds because yields are better, loan interest carry is supposed to go down with the move in rates, so I'd say with respect to our fund, the ability to access a wider opportunity set than just the US is a huge advantage.

**CHUCK JAFFE:** And are there parts of the world beyond the US right now that look particularly attractive?

**SEAN FEELEY:** Well, in the case of Europe, the European market right now has a little less yield on a foreign currency adjusted basis than the US, it's a higher quality market, it's a shorter dated market, so we've been emphasizing more on opportunities in the US for now, but that could change, it just depends on how these markets evolve, so right now we favor the US over other markets.

**CHUCK JAFFE:** Sean, great stuff. Thanks so much for joining me on The NAVigator to talk about it.

**SEAN FEELEY:** Thank you very much, appreciate it.

**CHUCK JAFFE:** The NAVigator is a joint production of the Active Investment Company Alliance and Money Life with Chuck Jaffe. And yeah, I'm Chuck Jaffe, and I'd love it if you'd check out my show on your favorite podcast app or by going to 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 Sean Feeley, he's part of the US High Yield Investment group at Barings, a portfolio manager on Barings Global Short Duration High Yield, Barings Participation Investors, and Barings Corporate Investors, their ticker symbols are BGH, MPV, and MCI respectively, and you can learn more about the firm and its funds at Barings, B-A-R-I-N-G-S, Barings.com. The NAVigator podcast is new every Friday, make sure you don't miss an episode by subscribing or following along on your favorite podcast app, and if you like us, leave a review and tell your friends, because that stuff really helps. We'll be back with more closed-end fund fun next week, and until then, happy investing.

*Recorded on October 4th, 2024*

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