InvestorDaily

Tuesday 30th July 2013

Investor Weekly News

Investors missing credit mis-pricing opportunities

Wednesday, 17 July 2013 | Staff Reporter

Investors are increasingly looking to take advantage of credit premiums after missing a golden opportunity in the aftermath of the global financial crisis (GFC), according to a US-based credit investment specialist.

New York-based Shenkman Capital Management says the extreme mis-pricings in non-investment grade credit sparked by the Lehman's collapse, and the broader global financial crisis delivered an opportunity "that was as short-lived as it was spectacular".

With pessimistic expectations about borrower defaults, few investors took advantage when spreads were at their widest, but as corporates repaired their balance sheets and the threat of further defaults abated, investors became less cautious and invested at lower spreads, the firm stated.

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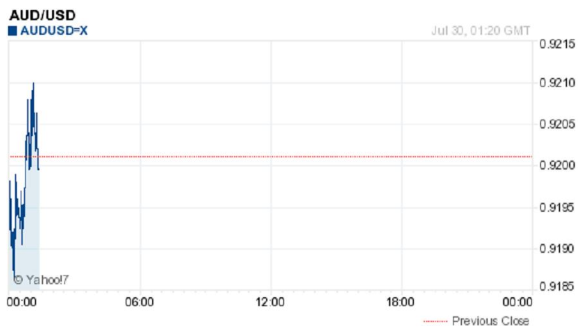

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Investors are now seeking to diversify their portfolios to exploit credit premiums available and to reduce risk by allocating across the non-investment grade credit spectrum, according to Shenkman.

“The behaviour of sub-investment grade asset classes in response to interest rates, credit conditions and euity markets can differ, ” said Shenkman senior vice president and portfolio manager Ray Condon.

“The duration of banks loans is typically less than 0 days, coupons are adjusted on a uarterly basis providing a hedge against rising interest rates and their relative seniority in the capital structure and protective covenants means that recovery rates have historically been uite high. ”

e said high yield bonds are comparatively more sensitive to interest rate changes and ranking in the capital structure makes them more vulnerable to sell-offs triggered by worsening credit conditions.

“owever, they generally benefit from slightly better spreads and greater liuidity than loans. Further, convertible bonds typically have shorter duration and therefore, are less sensitive to rising interest rates," he said.

“owever, they behave more like euity when the prices approach conversion. Actually, they have been more closely correlated with euity returns but with less risk. ”

According to Shenkman, the different responses of the various asset classes to changes in interest rates, the credit cycle and euity market returns means that a skilful investor can potentially deliver attractive returns and reduce volatility by combining and dynamically changing their exposure to these asset classes.

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