Symphony Nuveen's Holzenthaler On The Disconnect Between Equity And Credit Thinking

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Chuck Jaffe, in The NAVigator podcast, interviewed Lawrence Holzenthaler, investment analyst at Symphony Nuveen. Read the Q & A below as Lawrence and Chuck discuss high-yielding investing in a low-rate environment, noting that equity markets are more optimistic than the broad corporate credit market and how average credit investors see risk very differently right now when compared to the typical equity investor. Holzenthaler adds that closed-end junk-bond and floating-rate funds now are a way to 'buy discounted assets at a discount,' which should make them attractive to bargain-conscious investors.

Lawrence Holzenthaler

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

CHUCK JAFFE: Lawrence Holzenthaler, investment strategist at Symphony Nuveen is here and we're talking high-yield investing in today's low-yield environment now on 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 that represents all facets of the closed-end fund industry, from users and investors to fund sponsors and creators. If you're looking for excellence beyond indexing, The NAVigator's going to point you in the right direction. Today we're going to be pointing in the direction of

high-yield, because my guest Lawrence Holzenthaler, he is with Symphony Nuveen. Symphony Asset Management, a subsidiary of Nuveen, sub-advisor for Nuveen's high-yield funds and floating-rate funds. If you want to learn more, you're going to go to Nuveen.com. If you want to learn more about closed-end funds and closed-end fund investing go to AICAlliance.org, the website for the Active Investment Company Alliance. Lawrence Holzenthaler, thanks for joining me.

LAWRENCE HOLZENTHALER: Thanks for the invite, I appreciate it.

CHUCK JAFFE: As I hinted at just in introducing you, low-yield environment but we're talking high-yield investing. High-yield is a little more tied to the stock market than the bond market, but we've got a stock market that, well it's been sending messages very different from what anybody has been hearing from the economy itself. Same thing applies to the bond market. Where is the high-yield market right now relative to everything else?

LAWRENCE HOLZENTHALER: Technically high-yield bonds as well as senior loans, floating-rate loans, leveraged loans, they're all the same thing, they're basically the debt of below investment grade companies. And you're exactly right, typically these assets fall into the fixed-income world. Probably the question that I get asked more than any other is, what do you think the Fed is going to do and what do you think the yield curve is going to look like in six months? Actually, what I spend most of my time focused on is credit risk, which is as you mentioned, it's much more akin to equity risk. If you think about it, the risk you have if you buy a below investment grade bond or a loan, is that for whatever reason the company isn't able to service their debt, so spreads and prices within these markets actually tend to track equities pretty closely. So between February 20th and March 23rd, you had pretty significant volatility within both markets alongside of equities, and at this point, the S&P 500 has more than retraced all of the loses seen in February and March. Interestingly enough, if you were unfortunate enough to have bought the S&P 500 on February 20th, you're actually back in the green at this point. If you look at high-yield and loans or even investment grade corporates for that matter, they've retraced - if you look on a spread or price basis - anywhere from maybe 75-80% of the losses. In other words, they have not gotten back to where they were in February. So the credit market is still pricing in an elevated level of risk versus let's say, February 20th, which was the high for the equity market. Versus the equity market is in effect, back to par, to use our vernacular. That in my mind represents a disconnect. Even if I

look at investment grade corporate bonds, they've only retraced maybe 90% of those losses. So the equity market seems to be feeling a lot more optimistic than the broad corporate credit market, which I think is worth noting even if you don't have any exposure to corporate credit, that the average credit investor is thinking about risk a bit differently than the equity investor.

CHUCK JAFFE: How does that then play out? Because we're waiting to see when the stock market gets reconnected. But if the bond market is not connected, if you're also looking at numbers that you know are skewed and particularly when you start talking about below investment grade, it's tough enough with even the big name companies when they're making quarterly reports that are disjointed from what you would have seen in the previous quarter or the previous year. We know that those numbers are going to be a little whacky for at least a year ahead, is that making a more challenging environment? And are we getting any better payouts as a result of that? If we're having more challenges, are we at least getting better rewarded for taking them?

LAWRENCE HOLZENTHALER: That's what I find most interesting, is you have all this uncertainty in the world, and if I think about equity investments, equities are as we always say, they're the first loss risk in a capital structure. So equities make the most money when things are going well and they lose the most money when things aren't going well. Where we sit, whether it's senior loans which are typically first lien, it's almost like the mortgage on the house so it's the top part of the capital structure. Or even junk bonds, which are typically unsecured although they can be secured, they typically sit above the equity within a company's capital structure. And one of the things I, as a former credit analyst and now a credit strategist, really like generically about this asset class any day of the week is I have a maturity date so I know in effect, if the credit remains intact, I know when I'll get my money back so to speak.

And there's default loss risk in these markets clearly, but I know the maturity date, I have a current income stream, so I have fewer variables that determine my outcome relative to the equity markets. And again, the correlation is very similar. So to see credit spreads feeling more uncertain than the equity markets or equity valuations is worth noting. And again, one of the things I should mention is, within the equity market what's really led the gains recently, there's been a lot of focus on large cap growth stocks. But even if I look at some of

the more out of favor areas, small caps, value stocks, they've still actually done slightly better than credit since either the March 23rd low or the February 20th high. I think that's just very notable for one. And two, there's a lot of uncertainty everywhere, and I think it's important to understand within credit you have the same amount of uncertainty you have in the equity market, default rates are likely to remain high for quite some time. All the things that are impacting, whether it's investor sentiment, consumer sentiment, the kind of lack of transparency within corporate earnings, all those factors are still at play within the credit market. The difference is the structure of bonds and loans is such that I have a maturity date, I have an income stream, so I just have fewer variables to digest. And that's something too that is worth nothing in the sense that you can go in and figure out with a little bit of math, what do these valuations, whether it's spreads or prices, what do those valuations imply about future default rates? We call it an implied default rate. Which is basically taking the price of a bond or a spread on a bond and kind of translating that using a little bit of math, into what's that price telling me about future default rates? And in a lot of cases what you have is you have implied default rates that exceed what people are actually forecasting in terms of default rates, and that still exists today within corporate credit.

In other words, you have folks who would say to you on the one hand, "Yes, defaults are going to remain high, corporate earnings really need to be scrutinized," but the prices of these bonds or the prices of the loans, or more accurately, the spreads are kind of compensating you for that risk. So that's also a framework, I think, that is very helpful for investors right now. That I can go in and do a little bit of math and understand what is my kind of universe of possible outcomes depending on the coronavirus, the consumer, how quickly things bounce back? And all of that will get baked into default rates, which could remain high if the economy remains weaker, or could improve dramatically if all of a sudden sentiment and consumer confidence begins to rebound faster than people think. But again, it all goes back to the same variables equity investors would look at. Which is everyone's paying very close attention to the economy, payroll numbers, job numbers, consumer confidence, those are all things that are going to impact what happens to future credit spreads.

CHUCK JAFFE: Quickly here, you put all that together, does that mean that ultimately we're not only getting assets at a discount, but if we're buying high-yield in a closed-end fund, that that could make it a particularly attractive way to own this?

LAWRENCE HOLZENTHALER: I think that's absolutely correct. With a closed-end fund today, you're in effect buying a discounted asset at a discount to its net asset value, so it's kind of double the discount. Which in my mind could potentially create double the opportunity if you can pick the right collateral and pick the right funds.

CHUCK JAFFE: Well Lawrence, this was great. I wish we had more time but we'll just have to have you back in the future. Thanks so much for joining me on The NAVigator.

LAWRENCE HOLZENTHALER: Thanks again for having me, Chuck.

CHUCK JAFFE: The NAVigator podcast is a joint production of the Active Investment Company Alliance and Money Life with Chuck Jaffe. I'm Chuck Jaffe, and please check out my show on your favorite podcast app or at MoneyLifeShow.com. To learn more about closed-end funds, interval funds, business-development companies and more, go to AICAlliance.org, the website for the Active Investment Company Alliance. They're on Facebook and LinkedIn @AICAlliance. Thanks to my guest, Lawrence Holzenthaler, investment strategist at Symphony Nuveen. Learn more about him and the firm at Nuveen.com. The NAVigator podcast is available every Friday, please subscribe on your favorite podcast app and join us again next week. Until then, stay safe everybody.

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