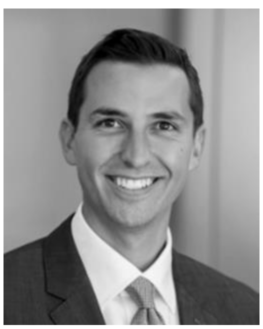
Fixed-Income Investors Must be 'More Creative, More Thoughtful, And Do More Homework'

Friday, January 15, 2021

Chuck Jaffe, in The NAVigator podcast interviewed William Costigan, managing director at Guggenheim Partners and senior member of the active fixed-income team. Read the Q & A below as William says that with real interest rates low and nominal yields on Treasuries at or below zero, investors must look to creatively expand their bond exposure. He calls for investors to be 'more creative, more thoughtful, and do more homework'—looking at, for example, alternative credits—if they are going to be satisfied with returns in the current environment.



William Costigan

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

CHUCK JAFFE: William Costigan, managing director at Guggenheim Partners is here to talk the fixed-income market and his outlook for it in 2021, 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 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. And today it's pointing us in the direction of William Costigan, he is managing director at Guggenheim Partners, senior member of the portfolio management team that's focused on active fixed-income strategies, specifically their core plus multi-asset and short-duration investments. If you want to learn more, GuggenheimInvestments.com is the website. If you want to learn more about closed-end funds and investing in them, go to AICAlliance.org, the website of the Active Investment Company Alliance. Bill Costigan, thanks for joining me on The NAVigator.

WILLIAM COSTIGAN: Thanks for having me, Chuck.

CHUCK JAFFE: Here we are into the new year, but already the new year looks different than what we expected it to look like. Because well, nobody expected the Georgia election to turn out quite the way it did. Nobody expected the unrest that we've seen politically. And all of this plus stimulus and what that might do to inflation and more is certainly going to impact fixed-income. So let's start with I guess the most recent headline that we at least intuitively would think might impact fixed-income, that being the Georgia election result giving us a democratic controlled government, from president through Senate to the House. How is that likely to impact what's happening in credit markets and with interest rates?

WILLIAM COSTIGAN: Well Chuck, that's a great question; 2021 was supposed to be the year of returning to normal, and the first few days of 2021 has been but normal. You mentioned the surprise outcome in the Georgia Senate election, excitement in the capital to say the least, and all the drama around there. But the two long-term takeaways that we've seen as a result of the Georgia election have to do with both rates and credit. On the rates side you're seeing the reflation trade pick up steam, interest rates are backing up, meaning going higher, yields going higher, bonds going lower. And of course on the credit side, Guggenheim's highest conviction view is that spreads are going to continue to grind tighter. That's really informed by powerful backstop from the Fed, and that's aided by a very low yield environment that is forced investors both here in the U.S. and abroad to search for yield and to go lower in credit quality. All that is causing spreads to continue to grind tighter. So I think the big implication from the Georgia runoff and the democratic controlled Congress and soon to be White House, is that spreads are likely to grind tighter as stimulus is more likely under a unified controlled government, knowing that the Fed is also always waiting in the wings to backstop spreads if needed be.

CHUCK JAFFE: But if stimulus is more likely, historically the offshoot of stimulus – not just in this country, but anywhere in the world where stimulus happens – is inflation. Nobody's really calling for much inflation, maybe a little bit short-term from some of the guests that I've talked to on my show. But nobody's really saying, "Hey, we're going to have a spike in inflation," at least not for a while. When does it start factoring in, when do we start seeing it? Because I suspect that long before I see inflation in my job, you're going to see it in yours.

WILLIAM COSTIGAN: Absolutely. Well Chuck, if you go back to 2008 during the Financial Crisis, the Fed's balance sheet going into that crisis was around a trillion dollars. And then through what was unprecedented at the time, the Fed doubled that balance sheet to two trillion dollars. And about every economist in the country predicted mass inflation as a result of that balance sheet expansion. And over 10 years post-crisis, the Fed continued year in and year out to undershoot it's 2% inflation target. And then fast-forward to now, if we think about the Jackson Hole meeting of the summer of 2020, the Fed essentially talked about a reworked policy framework where inflation is not going to be a key concern of their dual mandate, which as we all know, the dual mandate being full employment and price stability. Their number one concern is full employment, and not just in an economic definition of is full employment 4%, 3.5%, 3%? It's do people have the jobs of their dreams? And so with this revised framework and de-emphasis on inflation concerns, you're going to see continued stimulative policies, which is one of the reasons we believe at Guggenheim that spreads are going to continue to grind tighter. That said, inflation will come when it comes, but I think it's fair to say that the Fed alone cannot stimulate inflation as they've tried really for the better part of two decades and have failed to achieve their targets.

CHUCK JAFFE: So that gives us the outlook there, but more broadly, your expectations on the big picture for fixed-income this year, and what is it making you do in terms of how you position portfolios?

WILLIAM COSTIGAN: Yeah, absolutely Chuck. So when you think about last year, the story was beta compression. One thing our firm did well was we were defensive going into 2020, we re-risked the portfolios beginning in mid-March, and have been riding that beta trade tighter, and that's worked out quite well. When you look at 2021 and beyond, the story's going to have to be about going beyond a benchmark, because we have an environment where spreads have tightened considerably, even though we think they'll continue to grind tighter. And rates are at such a low absolute level that the nominal yields on Treasuries are near zero, and the real rate of return after inflation of Treasuries is negative. So that's really going to force investors to have to be more creative, more thoughtful, and quite frankly do more homework when it comes to investing in fixed-income. One area that we have a lot of expertise in and knowledge on is the structure credit market. That's an area, whether those are CLOs, esoteric ABS, whole business securitization, cellphone tower securitization, any number of examples there. That's a category where spreads tend to be perpetually wider than their corporate counterpart, meaning there's a higher yield or coupon attached to them. But oftentimes they have a floating rate component, so you don't have that duration risk which has been painful for the first several days into this new year. And so the positioning for 2021 in fixed-income is going to be about beyond the benchmark and solving the core conundrum through active management and niche markets, where you have a yield pickup but you're not taking on the commensurate duration or credit risk. And that's going to be the most important I think for many fixed-income clients.

CHUCK JAFFE: When you consider the closed-end fund perspective, and I recognize that as a portfolio manager you're not thinking about it like the end-user. But for our audience of closed-end fund investors, if they're able to get different fixed-income assets at different discounts, should they factor that in? I mean, if I'm looking at one type of bond investment or fixed-income investment versus another, but oh by the way, I'm looking at how big the discounts are in closed-end funds, would that change? Should that affect where somebody's going to be directing their money, or at least how they're thinking about it?

WILLIAM COSTIGAN: Well Chuck, price matters, and there's no question that premium discounts has always been an important analysis in evaluating a closed-end fund. So there's no question that's true. But what also matters a lot, and a lot more now than even last year, is the quality of the manager. And so sometimes there's a reason that managers trade at premiums when it comes to the closed-end space, and it's often because they've been able to consistently deliver superior risk-adjusted returns. And so while premium discount is one factor doing to analyze when making a choice, I think it's also important to understand the manager's track record. And not just in periods of bull market, but also how they fair in drawdowns, I think that's a very important feature.

CHUCK JAFFE: Bill, great stuff. Thanks so much for joining me to talk about.

WILLIAM COSTIGAN: You got it, Chuck.

CHUCK JAFFE: The NAVigator is a joint production of the Active Investment Company Alliance and Money Life with Chuck Jaffe. I'm Chuck Jaffe and you can check out my show on your favorite podcast app or at 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 Bill Costigan, managing director at Guggenheim Partners. You can learn more about him, the firm, and its funds at GuggenheimInvestments.com. The NAVigator podcast is available every Friday, please subscribe on your favorite podcast app and join us again next week to learn more about investing with closed-end funds. Until then, stay safe everybody.

Recorded on January 14th, 2021

To request a particular topic for The NAVigator podcast please send an email to: TheNAVigator@AICalliance.org

Click the link below to go to the home page of Active Investment Company Alliance to learn more: https://AICalliance.org/

Disclosure: *Listed closed-end funds and business development companies trade on exchanges at prices that may be above or bellow their NAVs. There is no guarantee that an investor can sell shares at a price greater than or equal to the purchase price, or that a CEF's discount will narrow or be eliminated. Nonlisted closed-end funds and business development companies do not offer investors daily lliqudity: often on a small percentage of share on a quarterly or semi-annual basis. CEFs often use leverage, which can increases a fund's risk or volatility. The actual amount of distributions may vary with fund performance and other conditions. Past performance is no guarantee for future results.*