BlueBay's Farley: Lots Of Market Events, Limited Good Investment Opportunities

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Chuck Jaffe, in this episode of The NAVigator podcast interviewed Duncan Farley, portfolio manager at BlueBay Asset Management, manager of the BlueBay Destra International Event-Driven Credit Fund. Read the Q & A below as Duncan says that the many headline events affecting the market aren't all buying opportunities. The best opportunities in event-driven investing come from good companies with bad balance sheets or difficult circumstances, where the interval fund structure allows management to ride them back to good health, generating above-market returns in the process.


Duncan Farley

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

CHUCK JAFFE: Duncan Farley, a portfolio manager on the BlueBay Destra International Event-Driven Credit Fund is here, and oh yes, there are lots of events driving the credit markets these days, welcome to The NAVigator. This is 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 in the right direction. And today it's pointing us to

Duncan Farley, a portfolio manager at BlueBay Asset Management who helps to oversee the BlueBay Destra International Event-Driven Credit Fund. It's a closed-end interval fund with the A shares trading under ticker symbol CEDAX, and you can learn more about it by going to DestraCapital.com. To learn more generally about closed-end funds, interval funds, and business-development companies go to AICAlliance.org, the website for the Active Investment Company Alliance. Duncan Farley, welcome to The NAVigator.

DUNCAN FARLEY: Yeah, great to be with you.

CHUCK JAFFE: Duncan, event-driven credit, it is not necessarily something that people know that much about because, hey, if you were to look up the BlueBay Destra International Event-Driven Credit Fund on Morningstar.com for example, you'd see that there's only two or three funds in the entire investment category. So let's talk a little bit about what goes into it, and also why international with event-driven credit? And then we'll move forward to get more on the structure and beyond.

DUNCAN FARLEY: So look, event-driven credit covers many things, but I like to simplify most things in life and I think what essentially we're doing on the fund is we're looking for mispriced assets or mispriced risk, and hopefully as we go through the session we'll talk about some examples that bring that to life. But we're essentially looking for events that are arising from multiple different things, things that we're seeing in the market at the moment. So these can be idiosyncratic in nature, they can be economic cycles, sector stress, think Covid obviously a classic example of causing a lot of stress across a lot of spaces. They can be secular changes or illiquidity in markets. All of which are combining to misprice assets and misprice risks that we're looking to take advantage of is the good, broad way of explaining what it is we're doing across multiple different strategies.

CHUCK JAFFE: It would seem that we do have a lot of events right now, because credit cycles, interest rates rising, inflation coming back. How much of the things that you're looking at are big and broad, how much are they individual to specific companies issuing credit, things along those lines? And are we particularly active right now in terms of there's a lot of events coming together at one point, or is that just a bad assumption by somebody who reads a lot of headlines?

DUNCAN FARLEY: The great thing about this fund to my mind is the fact that it can rely on both sets of examples. So a lot of what we do is in the private space, and very idiosyncratic.

Sure, economic cycles will force more of these opportunities out, but there's always a steady flow of ideas from the private space. Obviously the public markets are very much more dependent on general markets and general trends. We've seen a lot of losers during Covid, but we've probably seen a surprising number of winners as well to that cycle and both offer opportunities to us at different points in time. Some that are struggling are going on the watchlist of things that we'll look at to get involved in at a point in time maybe in the future. It's a classic looking for the good company with a bad balance sheet. Now that might be now, in which case the opportunity set is there now or it could be in the future. But as I said at the start, the fact that we have the ability to invest in private, less public situations, and I don't necessarily mean, when I say private, things that aren't priced on the screen but just they're not publicly listed equities or debt. [inaudible] more of a public on the run high-yield bonds or loan that have become stressed, distressed for multiple regions. But the fund itself has got five core strategies within it, which if I went through each of them it makes it sound quite complex. But essentially at the one of the end of the spectrum we're looking for those ideas that we were taught are core income, where maybe the return criteria is 10-15%. And at the other end of the risk it's perhaps a full restructuring that's going on where clearly the risks are higher and we're looking for something like a 15-25% return.

CHUCK JAFFE: In terms of generating those returns which are above market levels generally speaking, obviously interval fund structure which curtails liquidity helps when it comes to buying private securities, holding junk bonds, etcetera. I would assume it's going to particularly help in frothy market conditions. If things are as back and forth and as volatile as they seem in credit markets right now, I would assume that this would be a time when the interval fund structure would shine or have the potential to really shine because everybody else is going to be facing the liquidity crunch, right?

DUNCAN FARLEY: Yeah, absolutely. About four years ago when the interval fund structure was brought to our attention, because there isn't such a structure in Europe, believe it or not even to this day, we thought, "Wow, this is exactly what this credit space, investment opportunity space, or asset class rather, requires." Because up until this point we had a choice. We could either go for the open-ended fund that needed to be liquid, therefore they need to match their investment type with their investor base so that if the liquidity event arises that you're about to service them, you don't want to be drawing up the gate. That's a game over for you and potentially there rest of your funds if you're doing that kind of thing. So that has its limitations in terms of the assets or the credit you can invest in. The flipside of that is obviously the more traditional longer term closed-end fund, which by the way are fantastic vehicles for investing in longer term, longer played out restructuring situations, and we'll happily manage those funds on our portfolio. But what the interval fund nicely does is it matches up the opportunity set for the investment, and if you think about the timing of those investments. So our average hold period for an investment is probably anywhere between three months and let's say 24 months. And that quite nicely matches in the liquidity profiles that we're providing investors within the interval fund. Obviously we're giving daily valuations, we're giving daily purchase opportunities. It's a quarterly interval redemption, quarterly distributions are paid, it generates income, albeit it's important to state that we are a total return fund strategy. Good news is a decent chunk of that total return is coming from interest payments and coupons, which obviously enable you to be able to make distributions, if they're not rolled, beyond obviously the capital appreciation we're making. So there's many parts or aspects of the interval fund structure that we actually think is really very well suited for the distressed, special [inaudible] asset class that we're investing in. And as people in Europe start to learn about this, there's a lot of chat about how we can develop similar products over this side of the ocean as well.

CHUCK JAFFE: As you're developing these products, one of the interesting things to me as I looked through this fund is I said, "Wow, it's not really like much else that most people would have," which makes it a great diversifier. But out of curiosity, would you tell somebody to think of this as an alternative to stock, bonds, other alternative investments? How would you tell somebody to think about this? It doesn't really fit into any description in my book.

DUNCAN FARLEY: Well yeah, we certainly describe it as alternative. But yes, it's a credit fund, there's no doubt about that, and I realize a lot of investors don't have access to maybe the more alternative part of the credit market. Sure, there's multiple high-yield funds out there, there are plenty of leverage loan funds that people get involved in. But the ability to invest in the stressed and distressed part of certainly the European part of the credit market is pretty few and far between for individual investors to do so. So this vehicle gives access to a market something that's pretty different. It is international, as you mentioned. The team and myself are London based, but BlueBay does have offices around the world including in the US. And on occasions we will use the resource of our colleagues in the US on some of the investments, and the track record there on the fund is littered with US investments, but we're predominantly European focused. So we really think we're giving investors an opportunity to get into an asset class that perhaps they wouldn't otherwise be able to access in a structure that provides them with the flexibility that we think suits them and suits us.

CHUCK JAFFE: Let's talk about a couple of events and how they've affected things. Covid, it's a financial event but I don't think people think, "Oh wow, what does that do to the credit market?" But talk about how that has played into your strategy.

DUNCAN FARLEY: Yeah, okay. Well, let's take a good example, there's a company called MPC Containers, it's an owner of 70 container ships, feeder container ships. So they're sort of the smaller ones, they might not go across the Pacific or the Atlantic but they do a lot of the coast work around Asia, the Caribbean, and in Europe. Now this market along with many other parts of the container ship market was oversupplied, frankly too many ships built over the last 10-15 years ahead of the demand that was required. Now we've been following this name through the debt for many years. We know the management well, we knew the strategy, and we also thought it was a good company but obviously it needs the market to be there to generate the returns that we need. So just at the outset of Covid, company's struggling, had 100% of its fleet on spot rate, sub $10,000 a day, company needed to raise some more capital. And we just felt that the pricing of that capital, which by the way came at one [inaudible], the shares, and today the shares are trading at 29 [inaudible] as context. We just felt, look, the underlying value of the fleet was much greater than the stock and the debt price was implying, so we participated in that private placement and we continued to buy the stock after that. Now, where did Covid come in to this? Well, obviously who would have thought that we'd all be sitting at home ordering every possible good that we could think of because we couldn't spend the money going anywhere? So as we've all seen, suddenly the supply chain started to clog up, the ships coming from the Far East were off the ports of the West Coast in the US and apparently elsewhere. And this drove day rates for the ships, because they're no longer so available, through the roof. So today if you want to charter one of these ships on a daily basis, then you're probably paying $70,000 to $80,000 a day, seven to eight times more. But more importantly this company was able to then start terming out its charters to two, three years at $40,000 a day. So this is a Covid winner. What Covid did was essentially accelerate that demand supply and balance. So we spotted what we thought was a mispriced asset and we recognized an event, a credit event that was going to drive the performance of the business. Hopefully that's a good example of the type of subinvestment that we undertake.

CHUCK JAFFE: It's a great example, and I wish we had more time. But the good news is the events keep happening, so we'll just have to have you back on The NAVigator some time down the line. Duncan Farley, thanks so much for joining me.

DUNCAN FARLEY: It was a pleasure.

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