BlueBay's Farley: Investors 'Aren't Buying The Dips, They're Selling The Rallies'

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Chuck Jaffe, in this episode of The NAVigator podcast interviewed Duncan Farley, portfolio manager for BlueBay Asset Management and co-manager of the Destra International Event-Driven Credit Fund. Read the Q & A below as Duncan says that today's headlines are driving more companies to distraction and creating the types of problems that he sees as investment opportunities. His fund has taken advantage, posting double-digit gains while most of the market has moved in the opposite direction, and he believes that investors willing to buy discounted credits will be rewarded if they can ride through the macro headlines to hold onto bargain credits until economic conditions improve.

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 of BlueBay Asset Management and the Destra International Event-Driven Credit Fund is here, and while everyone can recognize lots of events going on, we're talking about which ones are investable now, this is The NAVigator. Yes, it's 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 points us in the direction of England, and across the pond I'm joined by Duncan Farley, portfolio manager for BlueBay Asset Management, which oversees the Destra International Event-Driven Credit Fund. It's ticker symbol CEDIX, which you can learn about at DestraCapital.com. And while you're learning, you can get a lot of knowledge about business-development companies, interval funds, and closed-end funds at AICAlliance.org, the website for the Active Investment Company Alliance. Duncan Farley, welcome back to The NAVigator.

DUNCAN FARLEY: Good morning, Chuck. And thanks for having me back on.

CHUCK JAFFE: Duncan, I was joking when I talked about, "Hey, we've got a lot of international events right now," because it's not like you're saying what works best in war. Event-driven is always about what an event is doing within a company; an event in a company can be a liquidity problem, a crisis and more. So the question is, can you help my audience get a clear picture of event-driven credit? And are we seeing more of those company level problematic events that also for you are opportunities given all of the global events that are going on right now?

DUNCAN FARLEY: Yes, yes. Well, the short answer to your last question is, yes, we are. The events that are happening, whether they're directly war related, inflationary, rate pressures, and these are global, are creating volatility in the markets. And volatility creates the types of events, and I'll go on to give a few examples through the call, as the sort of things that we can look to invest in. As someone said to me this morning, the bull market mentality is ending. We're no longer seeing people buying the dips, instead they're selling the rallies, and this is sort of adding to the volatility. So I would say to people to simply explain what we do in the fund, we're looking to buy bonds and loans that are priced anywhere between five cents and 80 cents, then hopefully through proper analysis and proper management, sell them at a higher price than that. Whereas for the last few years perhaps there haven't been quite as many of those bonds and loans for us to buy, today there simply are. But it's still buyer beware though. There's still a lot of asymmetric risk in buying bonds around 80 cents or loans at 80 cents, so you have to have the right approach to investing and the right team to invest in it.

CHUCK JAFFE: Are there common issues or some themes that are driving corporate bonds down to 80 cents on the dollar or what have you? I mean, are there certain stories that you keep seeing played out again and again, especially given war or rising inflation or all those other issues?

DUNCAN FARLEY: Yeah look, they're all feeding into the issue. Neither of us have mentioned the word "Covid" yet, but we're coming off the back of over two years of Covid-impacted market. A lot of companies have come out of Covid with more debt, with more leverage, with less liquidity, and therefore just not positioned to withstand any other kind of shock. And when that shock is, say inflationary driven, where the cost base is increasing, unless they're able to pass that price rise on very quickly, then their profits reduce, their cash and liquidity subside. And they're either breaching covenants, and therefore the debt structure is under pressure, or even worse, they're facing liquidity pressure and they need cash. So we are seeing examples of that happening certainly in Europe, and I'm aware of it happening in the States as well, this is creating opportunity set for us. The things that we would always look for on this is obviously, in those instances, good companies, the classic bad balance sheet.

CHUCK JAFFE: Good companies, the classic bad balance sheet, the standard size of the companies that you're working on? And help us understand maybe how this process works, like walk us full cycle through an opportunity you've had and maybe where it goes or has gone from when you got in to now.

DUNCAN FARLEY: Look, from a thematic point of view, obviously we can't sit around waiting for volatility to occur across the board, we've got to be searching for ideas every day. I guess the feeding grounds, the main feeding grounds for our fund is in the SME market, and this could be public or it can be private. So it can be public or private loans, cut it either way. Look, a good example of where we've been busy up until now, over the last 18 months we've recognized that within the energy space and the shipping space, that is a pretty unloved sector. And for good reason. I mean, to be honest, it has performed from the credit perspective very poorly over the last four or five years. I mean, arguably for eight or nine of the last nine or 10 years it's not been a happy hunting ground for a lot of investors, so as a consequence you are seeing some very stressed and distressed prices of assets and the debts in support of the assets. As an example, here is a company called North Shore, which owns dive support vessels, which does what it suggests it does, it supports off-shore activity with

divers and diving [inaudible]. And they are [inaudible]. Those bonds were trading at a dollar price of around 10-15 cents, which created that asset at about $20 million. Now bear in mind, that asset costs well over $150 million to build in 2010-2011. Even the brokers were suggesting that that asset should be worth around $45-50 million. But the market didn't want to believe it, because the market couldn't really see when the recovery was coming. Now for all of the problems that the world is having at this point, some of us believe the commodity space, and oil in particular has been one of the beneficiaries, well, even before the war, the recognition, but the supply wasn't there. So suddenly assets like [inaudible] suddenly become in short supply, and as a consequence, the day rate that you can achieve on an asset like that starts to increase and the valuation starts to increase. Luckily for us though, in playing out to our investment thesis, that asset was sold within 12 months of us putting on the position for just under $47 million, so over two times what we paid for it. Now what we liked about that investment was two things. One is we thought the value could go up and we felt there was good appreciation, but the other thing we liked is that on the downside we thought the scrap value was probably worth maybe $10-15 million. So upside/downside on the trade was very attractive to us. So a mispriced asset, it's a mispriced risk, and a good example of the kinds of things that we've been doing for the last 12 to 18 months. We've got many other similar trades on and there are more of these opportunities presenting themselves now across different sectors.

CHUCK JAFFE: It's also paid off in performance. I mean, the fund has been around for about three years. I should point out, it is what's known as a continuously-offered interval fund, which means you can buy-in anytime but you have limited availability to get out. But this fund has done well over its three-year history, how much more challenging are these market conditions? How much are you finding that the opportunities you're looking at right now are maybe a little bit longer term in terms of how long it's going to take to pay off?

DUNCAN FARLEY: Not worried at all actually. If anything, the market is presenting more opportunity, so hopefully our ability to keep up a good performance is there. And to underlie or underpin that, year to date the fund's up over 12%, which is good in any year. But if you look across pretty much every other asset class year to date, you realize that that is very pleasing for us. And that goes against nearly 15% on a three-year basis and just under 12% since inception. And by the way, in the first two years of the fund it was actually split so that

only half of the fund was actually event-driven credit generating more of the return. So yes, we're really pleased that we've been able to do well in a difficult market where the opportunities didn't present themselves in quite the volume that they're starting to present today. So it should definitely be busier, but it maybe gets easier for us because we've got more to choose from.

CHUCK JAFFE: It's not necessarily designed to be a contrarian play, although you are diving in obviously when folks have trouble, but it certainly has proven to be contrarian in these markets. Going into troubling spots that seem more troubling, I have to imagine most folks would consider you to be swimming upstream.

DUNCAN FARLEY: Yeah, we prefer to say that we're not correlated to markets as opposed to contrarian, that to me is a better way to describe it. And I think our performance over the course of this run highlights that. We've got a team of six people, three of us sit on the investment committee has sadly for us over 100 years of experience in looking at credit. So we've seen all the cycles, and I think that helps us identify what's to be focused on in an up cycle and what to be focused on in a down cycle. There's always things to be investing in and looking at and to be looking at, and we bolster the team with some European expertise that enable us to have a bigger universe from which to pick our investments.

CHUCK JAFFE: Duncan, thanks so much for joining me to talk about it.

DUNCAN FARLEY: An absolute pleasure, thanks.

CHUCK JAFFE: The NAVigator is a joint production of the Active Investment Company Alliance and Money Life with Chuck Jaffe. And yes, that's me, you can check out my show on your favorite podcast app or at MoneyLifeShow.com. To learn more about interval funds, closed-end 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 Duncan Farley, portfolio manager for BlueBay Asset Management, who oversees the Destra International Event-Driven Credit Fund, that's CEDAX for the A shares, which you can learn all about at DestraCapital.com. On Twitter @BlueBayAM and @DestraCapital. The NAVigator podcast is new every Friday, don't miss a thing by following on your favorite podcast app. And until we do this again next week, happy investing everybody.

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