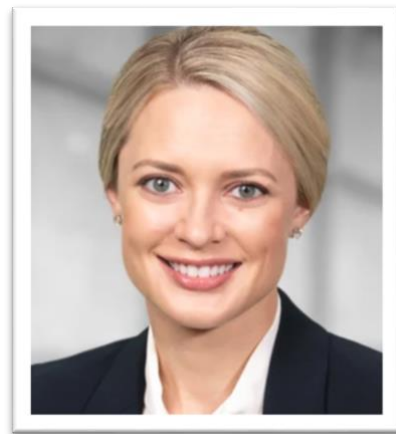




Oaktree's Poli: Amid Concerns Over Stocks And Bonds, Credit Is The Place To Be

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Chuck Jaffe, in this episode of The NAVigator podcast interviews Danielle Poli, Portfolio Manager at Oaktree Capital Management. Danielle says the credit market is delivering returns that are close to the historic gains for equities, noting that the current set-up is reminiscent of times in the early 2000s when credit "smoked" equities. With high-yield bonds earning around eight percent and private credit showing significant demand, Poli says that credit can be more than just "a great place to hide out"

amid rocky conditions and uncertainty surrounding the stock and bond markets. In talking with corporate executives, Poli says she has come to expect a slower economic environment, with the potential for higher inflation from tariffs, creating the kind of environment where "you're going to want to be in credit over equities."

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CHUCK JAFFE: We're talking all things credit markets with Danielle Poli, portfolio manager at Oaktree Capital Management, 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 representing the full spectrum of the closed-end fund business from investors and users 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 we're pointed in the direction of credit markets with Danielle Poli, a portfolio manager at Oaktree Capital Management, where she's on the team for Oaktree's Global Credit Strategy, that's the firm's flagship multi-asset credit offering. You can learn more about that strategy and the firm and Danielle at OaktreeCapital.com. And if you want 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. Danielle Poli, welcome to The NAVigator.

DANIELLE POLI: Thanks so much, Chuck. Great to be here.

CHUCK JAFFE: Let's start with a general take on the state of the credit markets, because the headlines and everybody's attention has been on stock markets given all the turmoil and policy shifting in recent weeks, and secondarily there's been a lot of attention paid to the bond market because that seems to be what's helped reshape and maybe mitigate some of those policies. Credit has been mainly ignored by the mainstream media, so give us an idea of what's happening in credit markets relative to the others.

DANIELLE POLI: Well, Chuck, thanks so much for having me on to talk credit. I agree with you, credit has not been in the limelight but I think it deserves to be, because it's been relatively resilient in light of the volatility that we're seeing. I consider equities in the eye of the storm, to me they represent where we are in the cycle, sentiment with the uncertainty related to global trade policy, and they've been the first to react to market moves. We did some volatility in credit, but mostly in longer duration assets like Treasuries. The area of credit that we focus on at Oaktree is the sub-investment grade credit markets, and that in particular has been very resilient, as I mentioned, in this period of volatility. So while the S&P 500 was

at one point flirting with a correction down 20% peak to trough, high-yield bonds, an area that I focus in, was down only about 3% for that same period. Equities are still down on the year and the sub-investment grade high-yield bond leveraged loan universes are up, so what that showed is that you're getting good downside protection in your portfolio, always good to have diversification away from equities, and I think credit really has a strong case to make for that today, and also some upside just given how attractive yields are. So I'm sure we'll spend some time on this, but the yield or income that you can get in sub-investment grade is above the historical average, and I think is going to rival equity returns in this market environment.

CHUCK JAFFE: Which means that you're seeing returns in what range?

DANIELLE POLI: The yield right now on high-yield bonds is right around 8%, and that's always the best kind of indication of what the return might be of that asset class. You can get some benefit as well from buying bonds at a discount and having them appreciate back to par, but usually the yield is where I guide investors to. Over the past couple years, some of these markets have delivered double-digit returns, which the S&P over the last 100 years has averaged about 10%, so that's rivaling a historical equity return. Really what I think is interesting is when you think about equities versus credit, one of the metrics I like to look at is the equity-risk premium, which is really the reciprocal of the PE ratio, and if you look at that over 25 years, what flashes is that ratio has gone negative today and it was negative in the early 2000s right around the Dot-com bubble. What's interesting in particular about today is, normally when interest rates are rising, and we saw the Fed take up rates pretty significantly starting in 2022, usually the equity-risk premium adjusts and moves higher, you should be compensated more for higher equity risk when you have higher yields, but we haven't seen that, and it's due to over-valued mega cap stocks, growth stocks, and uncertainty about the outlook. If you go back historically and you look at how equities versus credit has performed when this ratio has been so low, so looking at performance from 2001 for the following 10 years, credit smokes equities, equities are down for a couple years, maybe three years in total before they really start kind of giving you a boost. So I do think credit's a great place to hide out, but given how high the yield is, you probably also have the potential to earn some really good historically equity-like returns.

CHUCK JAFFE: I want to stay for a moment focused in the area that you say you focus on, that being high yield, because when times are good they get called high-yield securities, when times are not so good they get called junk bonds, and they haven't been junky, we have not seen a significant default problem in a long time. There were expectations when rates started going up that we would see a significant default wave, we didn't. Rates having held steady and potentially coming down later this year would seem to suggest that it's not going to be the rate picture that creates more junk, but given the economic picture that we are seeing, if we go into a recession and the rest, how does recession or potentially stagflation historically wind up hitting the high-yield market?

DANIELLE POLI: Sure. So it's going to hit equities more, but it's also going to have its impact on credit, especially when you're talking about sub-investment grade borrowers who have higher levels of leverage. We have seen a historically low default rate in the high-yield market, and the loan market too, though it's starting to tick up a little bit, as you would expect with interest rates having been so high for so long, but the market, as you pointed out, looks so much different today than it did 10 years ago. There's still over half of the market that's in BB-rated securities, so the highest rating level below investment grade, some of the worst companies defaulted out of the index during Covid, we had this kind of cleansing period of the market that you usually don't have in advance of a potential recession, so there's still companies out there that are generating good free cash flow, have manageable maturities, no upcoming maturity wall, have kept leverage in control, and CFOs have been planning for this. We've been talking about a recession at various points in time over the last three or so years, and so I do think that there's been some prudent management. Now there is bifurcation, and that lower quality CCC cohort within the bond market that's enjoyed really strong performance up till now, you're starting to see those names not have as much of a bid in the market because the concerns of a weakening consumer and continued consumer spending can really hit some of those companies, especially in areas like retail and the specialty consumer sectors.

CHUCK JAFFE: One of the things that you do at Oaktree is that you're not just looking at public securities, you're also looking at private credit. There's been a lot of talk about private credit, which in some respects scares me as a market observer, when I wind up seeing something that's a little less liquid become very popular I start to worry about what folks are doing. But

I know that that's not a worry that you have because you're in this every day, so why would you tell someone that they want to be putting together public and private in a portfolio?

DANIELLE POLI: I think it's so important to take a step back when thinking about private credit. At Oaktree we've been doing private credit for decades, it originated in more of our opportunistic distressed area and then really grew with our mezzanine strategy launched in the early 2000s. Private credit looks a lot different today, and it's really become more representative of the LBO financing, sponsor-backed kind of transaction market, but there's still so many different types of private credit that diversify the asset class, whether it's non-sponsor originated debt to a variety of different companies, it could be asset-backed finance, so the market is very large and evolved and you're also seeing a convergence of issues tapping into both the public market and the private market. And so to me it means you need to be in both markets, which we've been doing for a while, which we think gives us the biggest opportunity set, so we're happy to lend in either, I think it's important when you're lending in the private market that you are commanding a premium. There's a reason usually that companies are tapping into the private market, maybe their business is better understood there, they can receive financing that more mirrors their business complexity, but as an investor you should demand an illiquidity premium. We've seen that premium compress pretty significantly with the rapid growth of that market, and so being able to still go out and source opportunities that give you more yield is important. I don't get worried given the experience that we have and the built out team, I view it as an opportunity. One of the things that Oaktree is known for, in addition to our focus on risk control and bottom-up investing, is being opportunistic, so in times of dislocation or when capital becomes constrained like we saw over the last few weeks or during the period of Covid, that's a great time to step into those private markets and provide capital when the public markets are closed, and be really opportunistic. The Global Credit Strategy is meant to have a lot of tools in its toolkit and be able to flex into public or private when one opportunity set looks better than the other, and then also expand into a lot of different areas in both those markets.

CHUCK JAFFE: I just want to confirm one thing that you were saying there, which is that, as you were talking about, that illiquidity premium as being compressed, that's the result of so much competition being there. Does that force you to be more selective? And does that have a long lasting impact in terms of if private credit's going to keep getting more popular, the

profitability of private credit for investors is going to keep going down because we're not going to get as big an illiquidity premium, et cetera?

DANIELLE POLI: Yeah, I think you've got a couple things going on there. To your point, we have seen rapid growth of private credit and demand for it from investors who like the stable, consistent return profile with equity-like returns that we were talking about earlier in the context of the public market, you have that even more so in the private market. And individual investors by and large don't have a lot of their portfolios allocated to alternatives, and so there is that constant demand to diversify into private, add it to a portfolio, and so you're seeing a lot of money that's flooding into the space, and so it does, as a manager, make it more competitive when sourcing deals. It means you need to staff up, we have a sourcing and origination team that speaks on behalf of the entire firm no matter which one of our strategies may be pursuing an opportunity, that's very important to have those relationships with private equity sponsors but also CFOs of companies and be able to originate our own debt. And so I do think that manager selection matters in this market so that you're not getting the beta of the market, you're still getting really what private credit should provide, which is specialized, unique opportunities that can't be accessed in the public markets. The other thing that you've got going on is that private equity transaction volumes remain very limited despite all the predictions about how we would see a boom this year, some of that coming from loosened regulation from the new administration, and that has really significant ramifications for our market because there has been a lack of fresh new deals or new supply, and leveraged credit, whether it's public or private, usually provides the funding for M&A and IPOs, and at the same time, as I mentioned, you have these elevated yields that are making investors really want private credit, and so it's creating this very supportive supply-demand dynamic that helps constrain spread widening and helps provide some downside protection for investors, but it's challenging candidly out there to continue to deploy capital and maintain our high standards for underwriting.

CHUCK JAFFE: Everybody's looking at the stock market and the bond market and trying to question whether or not things are different now, but from the sounds of it, they're not different in the credit markets, are they?

DANIELLE POLI: There's so much uncertainty today, luckily our investment philosophy that was penned by Howard Marks when the firm was founded, eschews macro investing, and we

don't think anyone knows or can accurately predict exactly what is going to transpire with respect to global trade policy, all we can do is manage our portfolios based on the underlying fundamentals of the company and what we're seeing bottom-up. Regardless I think of what happens with tariffs, the genie's already out of the bottle and it's hard to put it back in, if I will, so speaking with CFOs of companies, they are already cutting CapEx on projects, they're slashing advertising budgets, they're putting hiring freezes in place, limiting wage growth, doing things that are going to translate into slower growth in the economy. It doesn't feel like it's going to happen rapidly, and it may take a while to show up in the data because there's a lot of noise given that these tariffs also caused quite a bit of imports to flow into the US over the last month in advance of the announcements, but I think overall we need to brace for a slower economic environment with the potential for higher inflation from tariffs, so the potential for stagflation, and in that type of an environment you're going to want to be in credit over equities and you're going to want to have picked a manager who understands and can underwrite credit to avoid defaults. That's what it's all about, is really minimizing defaults in the portfolio in that type of a scenario so that you can capture those higher average yields today.

CHUCK JAFFE: Danielle, great stuff, time has flown by but we're out of it now. Thanks for joining me on The NAVigator, let's do this again down the line.

DANIELLE POLI: Thanks so much. I would love that, Chuck.

CHUCK JAFFE: Danielle Poli is a portfolio manager at Oaktree Capital Management, on the team for Oaktree's Global Credit Strategy, the firm's flagship multi-asset credit offering. Learn more about that strategy, the firm, and Danielle at OaktreeCapital.com. Later on Money Life, Craig Johnson of Piper Sandler will be here talking technicals, how he's expecting the market to still finish this year strong, but up next, Charles Rotblut from *AIII* Journal, we'll be talking investor sentiment and more, this is Money Life.

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