Tortoise QuickTake Credit Podcast

Tortoise

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Welcome to the Tortoise QuickTake podcast. Thank you for joining us. Today, Tortoise provides a timely update on trending topics in the market.

Welcome to the Thanksgiving edition of the Tortoise credit podcast. I'm John Heitkemper, portfolio manager for high yield bonds and leveraged loans at Tortoise. As most Americans get ready to sit down to a big meal of turkey and all the trimmings, we thought it only appropriate to cover the gorging that the high yield market has partaken in recently. Last week, high yield investors devoured nearly $19 billion in new issue from 19 different companies. According to J.P. Morgan, this was the highest weekly new issue total in over two years, and combined with the prior week's nearly $11 billion in supply, the highest two-week total since May 2014. With one holiday-shortened trading week left in the month, November new issue volume already exceeds $35 billion, the largest single-month tally in over two years and the most active November on record.

Enough with all of the data, what are companies doing with all of the cash? The proceeds of nearly every deal done last week were to refinance existing bonds and term loans. The week's largest offering, Centene's $7 billion, three-tranche new issue to finance its pending acquisition of Wellcare, being the notable exception. In fact, November's high yield new issue trends are a continuation of a 2019 theme, namely that supply is coming from higher-quality issuers and used predominantly to refinance existing debt. Again, according to J.P. Morgan stats, 45% of 2019 deals are BB-rated and over two-thirds are refinancings; both figures are post-crisis highs. Strong demand for these high-quality issuers, as well as the low overall yield environment (the 10-year Treasury has traded in a recent range of 1.4-1.9%), has led many of the new high yield bonds to price inside of 5%, i.e. with a "4-handle". The internal joke in our office is now whether we should change the name if the high yield desk to the not-so-high-yield desk.

With starting yields so low, it only makes sense to ask how these 4-handle deals will perform. Our friends over on the Citigroup high yield trading desk, crunched some numbers at the end of last week and found that bonds issued in November with a 4-handle have actually widened 11 bps on average from their new issue spread. Note that this excludes the Centene deal, which given the company's investment grade rating from one agency, saw a strong bid from the IG community. As a recent comparison, back in September, there were also a lot of 4-handle bonds issued in the high yield market, but by contract, those are 38 bps tighter, on average. The September and November cohorts are similar in several respects: consistent durations, maturities, and ratings, as well as broadly comparable spreads for the BB high yield bucket. But the one difference is that November's 4-handle deals have priced, on average, roughly 30 bps tighter than September's deals.

Why are high yield investors stuffing themselves with highly-rated, but low-coupon bonds issued at aggressively tight spread levels? Our Citigroup friends speculate that the answer lies in the year's other dominate theme, the massive divergence between performance of BB bonds, which are up more than 13% year-to-date, and CCC bonds, which have gained just over 5%. In fact, the spreads on CCCs recently breached 1,000 bps for the first time in more than three years, while BBs remain historically tight compared to the IG market. Goldman Sachs noted recently that CCCs have delivered their worst risk-adjusted performance versus BBs since the early 1990s.

With credit markets broadly delivering double-digit returns this year and equity markets hitting new peaks, CCC underperformance is largely a result of idiosyncratic credits such as McDermott, Dean Foods, Mallinckrodt and Murray Energy, all of which are down more than 50 points, as well as a growing list of stressed energy companies. Many of these companies were crowded longs in the hedge fund world, according to Citigroup, and as those trades have gone wrong, there have been few willing buyers to step in as those bonds have plummeted. Having seen the punishment imposed on this year's credit blow-ups, very few high yield investors are willing to take on significant credit risk this close to year-end, fearful

that they might hit the next landmine. Recent macro data showing slowing growth both in the U.S. and abroad, doesn't help the case for owning riskier credit either. So with growing cash balances, high yield investors are gobbling up BB new issue despite tight pricing, hoping that today's feast doesn't bring indigestion tomorrow.

Happy Thanksgiving, enjoy your time with friends and family, and please tune in for future Tortoise credit podcasts.

Thank you for joining us. And stay tuned for our next cast. Have topics you want covered or other feedback to share? Write us at info@tortoiseadvisors.com.