COVID-19: CREDIT AND FIXED INCOME MARKET AND PORTFOLIO UPDATES

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Every market correction is unique

The recent turmoil in financial markets triggered by the COVID-19 global pandemic is another (albeit historically significant) episode of market volatility punctuating the history of financial markets.

Like those before it, there are many aspects of this current crisis that we haven't seen before, starting with the COVID-19 pandemic itself and the simultaneous global demand and supply shocks it induced. This was further compounded by Russia's recalcitrant attitude towards OPEC and the consequent decision by the Saudi's to increase oil supply, at time when oil demand was already waning as a result of the pandemic. The markets have struggled for precedent, to what is now shaping up to be the largest global economic shock since World War II.

Coming into this crisis the warning signs were there

Only seven months ago there was US$18 trillion of bonds globally trading with negative yields. Just last month credit spreads were at post GFC tights and equity markets were at record highs. In the context of a low interest rate world, investors have been faced with the choice of accepting lower returns or taking more risk in order to maintain returns (chasing yield). The chase for yield has resulted in risk premiums on lower quality investments being driven ever lower.

A stark example of this occurred in mid February when Greek 10 year sovereign bond yields (rated non-investment grade) went below 1%! This was lower than where both Australian and U.S 10 year sovereign bonds (with their AAA ratings) were trading! A world away from the 40% peak that these Mediterranean bonds were trading at during the Greek sovereign debt crisis.

What has followed could almost be described as a Greek tragedy, where the protagonist who strove for greatness (of returns) was brought undone by a combination of fate (the COVID-19 pandemic and the inability of central banks and governments to fully address a biological crisis with financial tools) and their own human flaws (chasing return at any cost).

Whilst no one had a crystal ball forewarning of the impact of COVID-19, our portfolios were strongly positioned. By early 2020, Perpetuals outlook for credit had remained in neutral or negative territory for almost 6 months (as measured by our credit score), prompting us to defensively position portfolios (with well diversified portfolios with a predominant weighting to domestic, senior investment grade debt with short dated maturities). Our defensive positioning has helped cushion the blow, as credit spreads widened to levels last seen during the Greek sovereign debt crisis in 2011 and in some cases since the GFC in 2009.

We are well equipped to navigate these stressed market conditions

Experience

The senior members of the team (consisting of nine) are industry veterans, with three of them having worked together for almost two decades and importantly having experience managing portfolios during the GFC and its aftermath.

Quality

Due to the asymmetric risk profile of credit investing, screening out of downside risk is an important contributor to returns. The team has a long history of conducting bottom up fundamental credit analysis to construct their investable universe. Our focus on quality supports liquidity and capital stability.

Active Management

Our active management style is well suited to taking advantage of opportunities and managing risks as they arise, with periods of volatility playing to the teams' strengths.

Find out more about Perpetual's range of Credit and Fixed Income Funds.

FURTHER READING - COVID-19

Visit our COVID-19 Insights Hub for economic and market updates to keep you informed as the situation evolves.