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Michael Korber: Lessons learned from 40 years of fixed-income investing

By Perpetual Asset Management

7 August 2024

Financial innovation brings opportunity and risk – but time-tested investing tactics still trump chasing the newest thing. Perpetual's Michael Korber explains.

- Innovation is opening opportunities for investors
- Cash flow, pricing power and leverage still matter
- Find out more about the Perpetual Credit Income Trust

RAPID growth and innovation in Australia's credit markets over the past four decades have created myriad opportunities for investors seeking income and downside protection, says Perpetual's Michael Korber.

But alongside these opportunities comes the challenge of assessing new, untested products that have yet to demonstrate resilience in times of economic stress, he cautions.

Korber, who leads Perpetual's credit and fixed-income team – and manages Perpetual Credit Income Trust (ASX:PCI) – was reflecting on a 40-year career at Perpetual's Opportunities in credit markets: a 40-year perspective webinar.

"When I first got involved in the 90s, there were no credit markets, just government bonds. Today, from investment grade corporates through to securitised structures, private borrowers and high yield borrowers, there's a lot of texture – and that texture does really reward active investment," he says.

Market cycles

The latest financial innovation is private debt – a fast-growing but less liquid market that is tempting investors with promises of higher returns.

"Markets go through cycles," says Korber.

"We all remember the days pre-GFC when all sorts of financial innovation came along and we saw a whole alphabet soup of structures coming out of the US that didn't survive the stress during the GFC.

"That's part of the normal cycle of innovation in markets – until you have a bit of a cleansing period of stress, you can't really sort the wheat from the chaff."

He says that's the reason the team managing the PCI portfolio prefers to blend a range of assets together.

"We don't have a pure portfolio of only private loans, we blend private loans with investment-grade securities, asset-backed securities, and a mixture of other things.

“This approach does two things: it gives us a better risk profile, but it also means that there are some areas you want to avoid, and others which might be more attractive. Having a broad mandate means you can manage that risk more actively and generate more consistent returns for investors.”

What to look for in credit

Korber says the best opportunities in credit are found by keeping a tight focus on characteristics like cash flow, pricing power, and sensible leverage.

“Consequently, some smaller sectors should be avoided. For instance, real estate is an asset-heavy sector with poor cash flow. It is particularly challenged in the current interest rate environment. If a business cycle downturn occurs, these areas are likely to face difficulties.”

Positive outlook

“We try to avoid being too predictive,” says Korber. “We try to manage risks; we look at the environment and what can happen. And if the worst happens, how does that impact?”

Right now, the portfolio is comfortably, fully invested.

“We think the current environment is supportive. The impact of deglobalisation, the inflationary impact, the higher interest rates, and the geopolitical risk are all headwinds that could derail the orderly market we’re seeing. But on balance, we’re happy with the market. We think it’s well priced, it’s performing well, and we’re happy to be invested. We expect performance to continue to be quite positive.

Volatility drives opportunity

Still, Korber says there are growing long tail risks on the horizon and a down cycle over the next year or two would not be a surprise.

“Ultimately, business cycles still exist. We haven’t had a major downside for quite a while so that is always a risk.

“All credits can do well for a long period of time – but in the end, it is really about how different credits perform if you do have stress.

“It is one of the beauties of credit too – if you invest well, and you’ve got a good portfolio, then volatility drives opportunity. We often see the best opportunities when the less cautious are forced to bail out. That often drives good returns in this space.”

Unlike equities, fixed income investors do not get to participate in unexpected upside and instead rely on steady returns and a lower chance of loss.

“It’s a coupon world we operate in, you’re getting a fixed rate of return, and therefore you don’t want to be taking excessive risk.

“If things go badly, you could lose all your money. You are really getting rewarded for avoiding losers more so than you are picking winners. Our value add is sometimes found in the deal we don’t do

“We think strong investment into high quality issuers just delivers such consistent returns, such good compounding returns, that to take a lot more risk in marginal areas just isn’t worth it.”

About the Perpetual Credit Income Trust (PCI)

About Pure Credit Alpha Fund (PCA)

Learn more about Perpetual’s Credit and Fixed Income capabilities

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