Investors should be prepared

Investment Team Weekly Focus

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Investors should be prepared (1/3)

High Yield Bonds look highly vulnerable

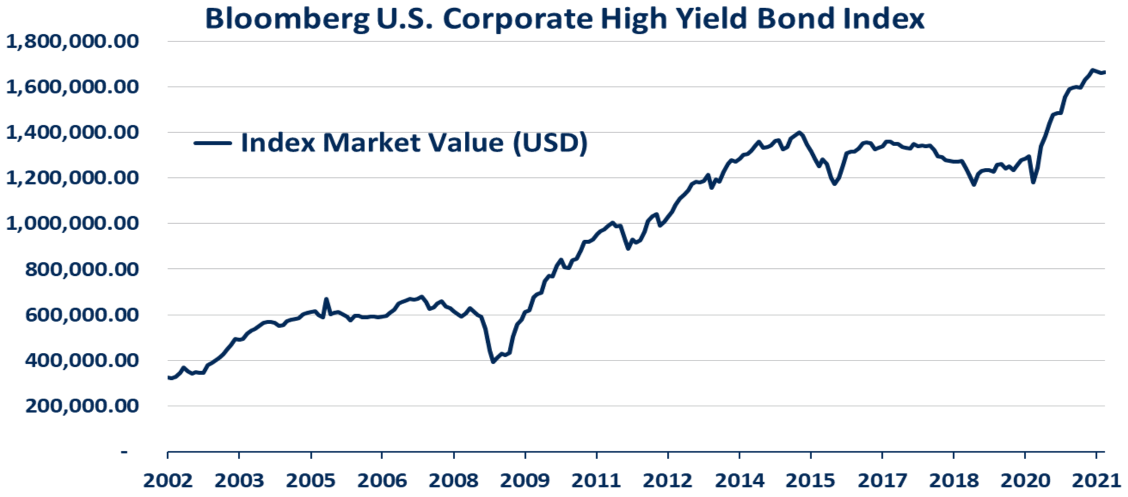
- As the Bloomberg U.S. Corporate High Yield Index indicates (top chart), the notional amount of junk bonds has never been so high amongst U.S. Corporates.

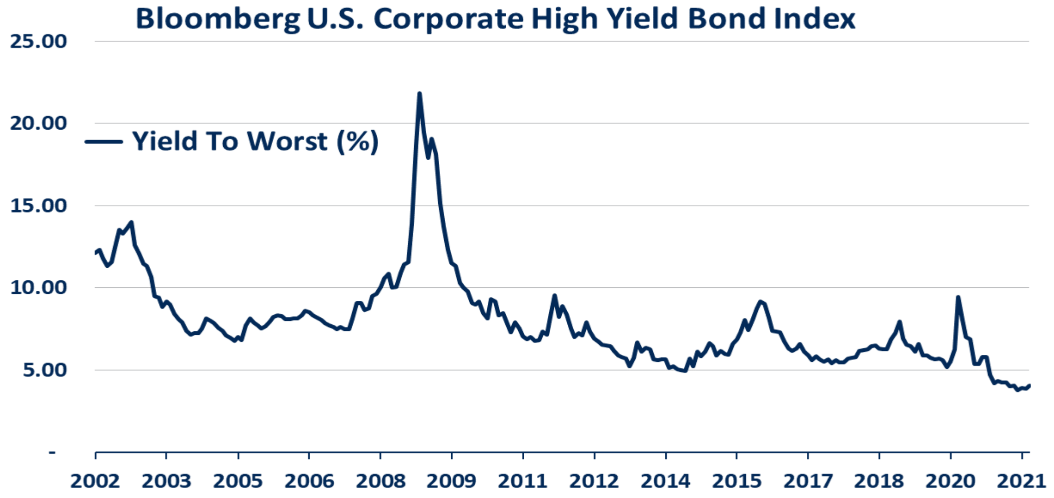
- It now accounts for USD 1.6 trillion, a 30% increase compared to December 2019, which is all the more regrettable seeing as the amount of junk issuance had previously receded from $1.4tn in Q2 2015 to $1.2tn in Q1 2020.

- What concerns us is that with credit spreads at record low levels (bottom chart), a lot of companies look vulnerable to any tapering or interest rates hike, which are now likely to happen in the coming quarters due to inflationary pressure.

- To be fair the same pattern (more debt but lower yields) is true across most developed economies.

Source: Bloomberg, October 2021



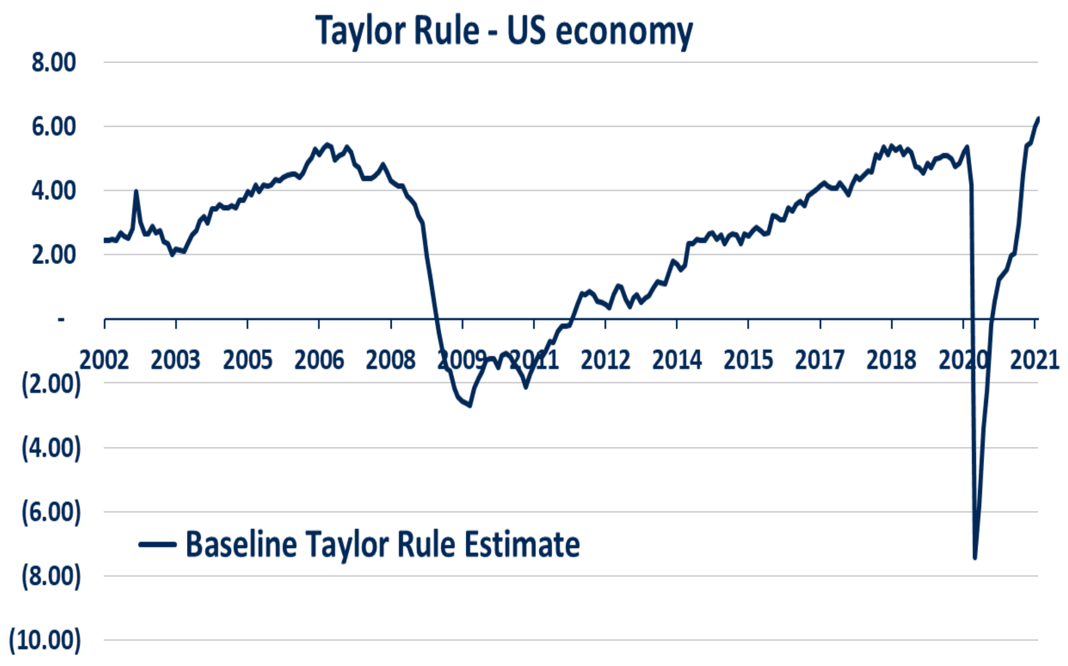


Investors should be prepared (2/3)

The Taylor Rule points to 6% rates in the U.S.

- The Taylor Rule is an econometric model that describes the relationship between Federal Reserve operating targets and the rates of inflation and gross domestic product growth. Whereas the Taylor Rule is purely a theoretical level, it is nevertheless a useful gauge for economists to anticipate the direction of interest rates.

- The bad news is that the Taylor Rule applied to the U.S. economy is currently indicating a theoretical level of no less than 6% for interest rates. To be fair to Federal Reserve Chair Jerome Powell, since inflationary pressures are caused by a Supply shock (as opposed to raising demand), hiking rates would probably be a costly mistake and explain why the Fed is unwilling to start hiking rates before 2023. That said, reducing the amount of money in circulation is urgent and overdue to prevent excessive leverage and consequently corporate defaults.



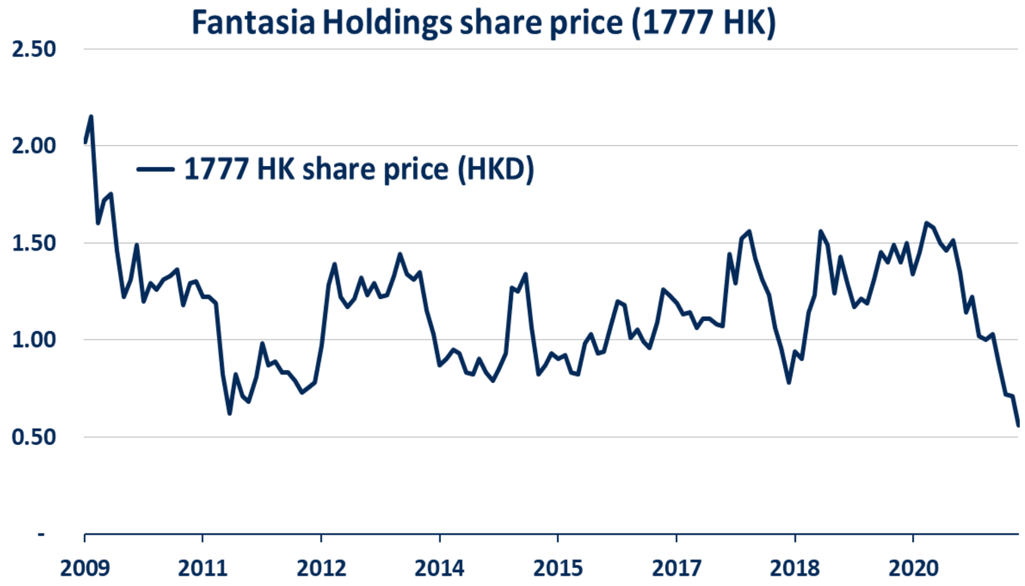
Source: Investopedia, Bloomberg, October 2021

Investors should be prepared (3/3)

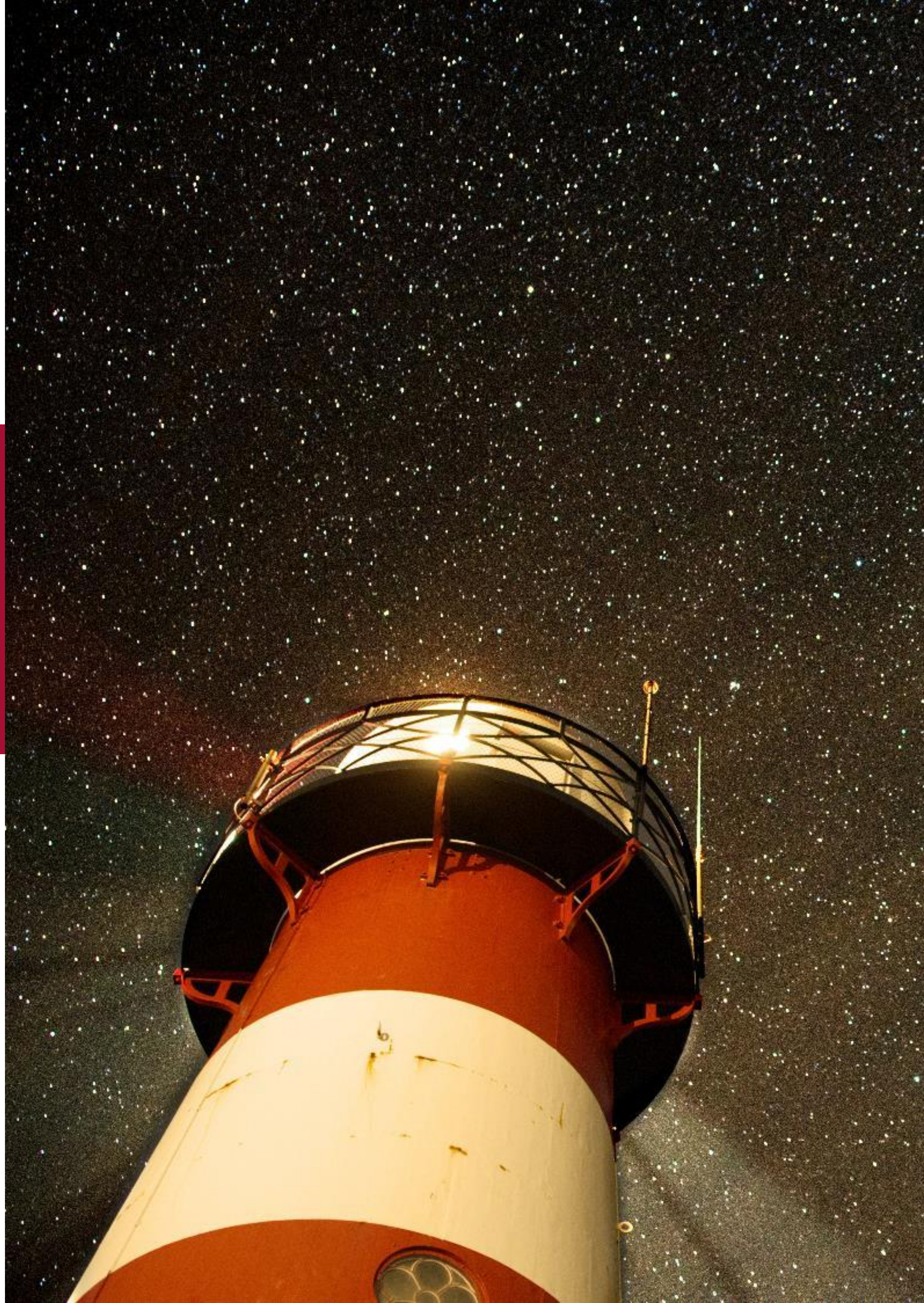
Like Evergrande? You'll love Fantasia

- As announced two weeks ago in our weekly "Evergrande's (de)fault", more bankruptcies were to be expected in the Chinese real estate sector. The second one happened last week with Fantasia Holdings missing a $206 million USD bond payment and its shares suspended in Hong Kong on September 29th (graph).

- While Fantasia's size is much smaller than Evergrande, ranking only 64th in China's real estate industry (Source Bloomberg), it indicates that Evergrande was not an isolated case and that the whole sector is at risk of restructuration, not just its largest player.



Source: Bloomberg, October 2021



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