For the 3 months ending September 2024, the Global Credit Opportunities Fund returned 4.2% and paid a 1.73 cents per unit distribution (1.875% distribution yield). The fund has returned 7.9% net of fees for the 12 months ended 30 September. The portfolio currently has a yield to maturity of 10.3%, with a weighted average life of 3.2 years, and comprises investments across fourteen industries. We are targeting a distribution yield of 7-8% for the 2024/2025 financial year.

Earlier-than-anticipated repayments and exits from several investments drove performance in the quarter. In particular, we exited our investment in Frontier Telecommunications at a premium, after the announcement of the acquisition of the business by Verizon Telecommunications.

The current environment remains attractive for credit investors. There is enough growth to drive improving corporate cash flows. Meanwhile, asset valuations remain robust, and interest rates are high. We are fortunate that the size of our investible universe and the current market environment allow us to selectively redeploy capital in attractive opportunities at yields to maturity of 8-12%.

There is well-warranted optimism about the resilience of the global economy, but a considerable amount of that optimism is already priced into the valuation of high-quality assets across both equities and credit. The 50 basis point rate cut by the US Federal Reserve in September was largely priced in by credit markets, but the dovish forward guidance was not, and the market moved higher as a result. It remains counter-intuitive that a resilient US economy, with moderating inflation, requires 150bps in rate cuts. Nevertheless, the projected rate cuts are now fully priced into long-dated interest rates. We are not inclined to chase. We suspect that longer-term interest rates will continue to be volatile as markets, and an increasingly “data-dependent” Federal Reserve, react to growth and inflation data.

Many unsecured fixed-rate bonds are now “priced for perfection” and will likely underperform if current rate expectations are proven too optimistic. In many cases, first lien, senior secured loans now offer higher yields than the more junior unsecured bonds from the same issuer (company). This is highly unusual and presents an attractive opportunity.

Our industry positioning remains defensive with a large weighting towards food, telecommunications, asset-backed securities, and technology. We are consistently looking for opportunities where we can underwrite through the cycle and minimise downside risk. Our sector preference is driven by valuation, our bottom-up industry work, and our views on the broader economic environment. Our view is that forward returns in credit will be driven by underwriting and credit selection rather than interest rate and macro “calls” - we think this plays to our strengths.

The outcome of the US election remains too close to call and the policies of Harris and Trump have very specific, and divergent, sector implications. Rather than take a strong view on the likelihood of either candidate winning the election, we are focused on sectors and individual opportunities where valuations are independently attractive, and the outlook is not overly reliant on an uncertain political outcome.

Our investors are increasingly asking about private credit, with many concerned that the rapid growth in the asset class, and the associated intense competition for transactions, has lowered the quality of underwriting. We think the asset class is here to stay but share concerns about underwriting quality, fund leverage, and increasing asset/liability mismatches. In our opinion, the “free-lunch” of returns, low volatility, and limited credit losses in private credit will be severely tested in a downturn. The asset class has been rife with “volatility washing’” over the last few years, and most investors have been happy to turn a blind eye. Private credit is much more opaque than public credit – there is limited regulatory oversight, a lack of transparent pricing, and investor disclosure varies considerably. Investors in private credit will need to rely on the valuation methodologies of their chosen private credit managers when things go bad and hope that both valuations and provisioning are robust.

One of the most interesting side effects of the private credit boom has been the derisking of the traditional High Yield and Leveraged Loan markets. A large number of the most aggressive financings now sit outside the public credit markets, with a very high portion of lower-rated and smaller deals being done in Private Credit markets. In previous cycles, these deals disproportionally affected the loss rates (defaults and recoveries) in public markets, we suspect the same will be true for private credit.

Closer to home, in September APRA proposed that banks phase out AT1 bonds by 1 January 2027. While well-loved by Australian retail investors we have long held the view that Australian bank AT1s offer poor risk-reward relative to corporate credit and offshore AT1s, as well as offering little-to-no diversification benefits for investors. Australian banks have been fortunate to have a supportive retail investor base who have been willing to provide cheap capital, and we think APRA is right to look for better solutions. Whilst still early days, the banks have plenty of time to implement APRAs proposals, and retail investors and their advisors have time to search for more attractive options for the defensive portion of their portfolios.

As always, we are grateful for your support and welcome any questions.

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