July 7th, 2020

High Yield Quarterly Commentary

Environment

The high yield market continued to recovery in June and the second quarter, although the pace of recovery slowed. Investors continue to weigh the Fed backstop support and economic recovery with any increased virus threats. So far, the recent increase in virus infection rates in the U.S. has not had much of an impact on high yield and financial markets. The high yield market has continued to strengthen with strong secondary market trading, record new bond issuance and record new retail investor fund flows into high yield. The recovery in the high yield market has now become broad-based with all industry sectors and weaker cyclical and lower credit rated names moving higher.

Performance

The Steinberg High Yield Series-O Fund had a +6.5% return in the second quarter, resulting in a -9.3% year-to-date total return. As a result of the economic shut down, we had a couple of defaults in the portfolio, particularly in the retail and energy sectors. Given that these defaulted issuers are currently in the midst of balance sheet restructurings, it remains unclear what their ultimate return impact will be to the high yield portfolio. Improving financial markets and a U.S. economy restarting, should help to limit the impact of the defaults. Performance has been helped by a number of new investments, which were made at price discounts. We continued to maintain a fairly conservative high yield investment strategy of balancing credit risk, duration and returns.

Portfolio Highlights

We were again very active in the second quarter. We added to existing positions in Russell Metals (industrials), Superior Plus (energy), Avis Budget (services), iStar (financials), Nova Chemicals (chemicals) and Solera (technology). We had the bonds of Kinetic Concepts (healthcare) and Infor (technology) called during the quarter.

With the additional investments our cash position has dropped to 2% of the high yield portfolio and our U.S. dollar exposure is at 82% of the portfolio. To reduce currency risk we continue to hedge almost all the U.S. dollar exposure. We are currently invested in a total of 22 different industry sub-sectors, enjoying significant industry-sector diversification.

Outlook

We are encouraged that financial and the high yield markets have bounced back fairly quickly. Government support and back-stops should continue to support the high yield market. In addition, with the high yield new issue market almost completely open, reflected in a record June month in new high yield issuance, companies are able to finance themselves to meet debt maturities and provide some financial insurance. This should reduce the number of distress companies and potential defaults. The March market sell-off had provided a very good high yield buying opportunity and even with the yield coming in to now closer to 7.5% the high yield market continues to look attractive versus other fixed income alternatives in this near zero interest rate environment. As always, we are committed to the disciplined investment approach and long-term perspective that defines Lorne Steinberg Wealth Management.

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