Examining Stressed and Distressed Credit: Risk and Reward

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Moderator: Ann Glazier Rothwell | *Principal, Co-Head of Client Portfolio Management*
Panelist: Derrick Jumper | *Principal, Head of Credit Research*

Ann Glazier Rothwell moderated a thought-provoking panel on "Examining Stress and Distressed Credit: Risk and Reward" at the Canadian Alternative Investment Forum 2024, hosted by Introduction Capital in April. The panel featured industry experts Derrick Jumper (RPIA), Parul Garg (PenderFund Capital Management), and Ryan Dunfield (SAF Group), who shared their perspectives on stressed and distressed credits (debt from companies struggling with serious financial difficulties). Below, we have summarized the key themes and takeaways from the panel as it relates to RPIA and our strategies.

Are we seeing signs of stress in the credit market today?

With credit spreads at the tighter end of historical ranges, both investment grade and high yield markets are not reflecting substantial stress. The main driver of potential distress in our view will be persistently higher rates. We have begun to see cracks in certain segments of the high yield and leveraged loan market with an expectation of more stress to come if rates remain in the higher for longer scenario amid a complex economic picture.

The private leveraged loan market could be a potential source of defaults, particularly in the 2021 vintage of loans that were issued during a completely different rates environment. Companies that were borrowing at 7–8% are now borrowing at 12–13% and some of these capital structures will not be sustainable at today's elevated rate levels. We are also keenly focused on the health of the consumer as recent data highlights a declining savings rate, elevated credit card balances, and a rise in auto delinquencies.

Example: Altice France

Altice France, the second largest telecom provider in France, is a recent distressed situation that has had reverberating impacts across certain markets and asset classes. Altice France is the largest issuer in the European High Yield market. The company has an overleveraged capital structure, with plans to modestly de-lever over time, but last month, management completely changed their tone.

Citing persistently elevated rates, significant competition, and cost inflation, management decided to meaningfully reduce their leverage target and indicated that creditors would have to incur haircuts (impairments) to meet the new targets. This led to a "substantial" selloff across their secured and unsecured bonds and term loans. The Altice France selloff also led to contagion across other leveraged telecom companies throughout the U.S. and Europe as investors reassessed potential downside scenarios.

What should investors be focused on when investing in the distressed market?

Investors need to be keenly focused on downside protection and investing in securities with covenant protections, which were often weaker when yields were lower. There is increasing prevalence of stressed companies moving assets away from creditors or inviting in new, priming capital that can severely diminish the expected recovery of the securities, especially for smaller players in the distressed credit market.

How does RPIA target the stressed/distressed market?

In the current tight spread environment, we are conservatively positioned in anticipation of potential disruptions in a higher for longer rate environment. When distressed opportunities do present themselves, we gravitate toward high-quality issuers within industries that are under duress or collateralized securities offering strong downside protection. Our active and dynamic approach to security selection allows us to identify the best priced security within an investment theme we find compelling enough to pursue.