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HEADLINE: High Yield Funds Bouncing Back

BYLINE: MS

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Junk bonds are back in favor.

Investors took flight from high yield bond funds in June, withdrawing more money than they had added to these vehicles in the first five months of the year.

They have since returned.

Money is flowing back into the sector as concerns about rising interest rates abate and investors renew their search for yield. High yield bond funds took in an estimated $2.75 billion in the first half of the week and were expected to exceed the previous weekly record of $4.25 billion set the week ended Oct. 26, 2011, according to a JPMorgan North American Credit Research report.

This is coming on top of the $2.67 billion that high yield mutual funds including exchange-traded funds took in for the week ended July 17, according toLipper FMI. That week was the third consecutive week of positive inflows but the first time this year that weekly purchases passed the $1 billion mark.

By comparison, junk bond funds saw more than $12 billion walk out the door in the weeks after Federal Reserve Chairman Ben Bernanke hinted that the Fed would "taper" its bond buying program, potentially raising interest rates.

Going with the Flows

As of July 19, year-to-date outflows for high yield funds totaled $6.7 billion with a weekly average outflow of $229 million, according to theRoyal Bank of Scotland.

"I'm not surprised money is coming back into high yield," Elaine Stokes, a portfolio manager with Loomis Sayles & Co., said in a phone interview. "People left high yield bonds and then realized they had nowhere else to go. ... Money was sitting on the sidelines asking, 'Now what?'"

Stokes said that money left bonds quickly after the fear of rising interest rates took hold but then was hit with the fact that risk in other markets was on the increase and there were not readily available asset classes offering significant yield.

Stokes also noted that world events such as the credit crunch in China, military coup in Egypt and rioting in Brazil brought the need for stable, U.S.-based **investment** into focus. "When the dust settled, the story is the same. The U.S. is still the best of developed economies and has a rising growth trajectory. It might be subpar, but it's rising."

Market participants see the same story in the bond market that there was before the correction in May and June. "People are desperate for yield right now," said John Riley, founder and chief **investment** strategist of Cornerstone **Investment** Services. "Desperation is not exactly an **investment** strategy, but that's what happening. They're throwing money into high yield and disregarding the risk they're taking. ... I bet everything that flowed out will flow back in and then some so long as Bernanke stays relatively calm."

As of July 17, year-to-date outflows for high yield funds total $6.7 billion with a weekly average outflow of $229 million, according to theRoyal Bank of Scotland.

Stokes said that the money that fled in the aftermath of the May Bernanke comments will come back in and that these very inflows would likely taper off soon.

Money is returning to exchange-traded funds faster than it is to mutual funds. ETFs have already reversed 70% of the outflows they saw in May and June, according to JPMorgan. By comparison, junk bond mutual funds have reversed just 40% of outflows.

ETFs accounted for $1.08 billion or about 40% of the money added to junk bond funds for the week ended July 17. High yield mutual funds not including ETFs accounted for $1.58 billion that week.

ETFs proved to be less volatile than might have been expected during the weeks of heavy outflows; for example, they accounting for less than 30% of the record $4.6 billion redeemed from all junk bond funds in the week ended June 5.

Riley pointed out that ETFs are now often used by professional investors and are not simply a retail vehicle and thus not as volatile as in years past.

But it's been leveraged loan funds' show this year as far as a year of record inflows. Loan funds already topped last year's total before this year was half over, and market observers think that loan funds will continue to see positive flows throughout the year, though probably at a subdued pace later on. Leveraged loan funds including ETFs took in $1.7 billion for the week ended July 17, an increase from the previous week's $777 million and the largest weekly inflow of the year. The four-week trailing average increased to $1.13 billion from $1.06 billion. Leveraged loan ETFs accounted for $142 million in flows for the week. Leveraged loan funds have taken in record $30.2 billion year-to-date as of July 17 with a weekly average inflow of $1 billion, according to RBS.

"Loans are a great place in the cap structure, and generally hold up well in bad economies. I suspect we will see this trend continue," Mathew Van Alstyne, co-founder and managing member of the Odeon Capital Group, said in an email.

Riley warns investors, however that current **investment** trends could be creating another bubble ready to burst. He notes that no one expected the commercial paper market to seize up several years ago, but it did, leaving companies and investors in the lurch.

"Memories are short... these markets can lock up on you," he said. "Right now there's a lot of liquidity but ... you just don't know. These types of things can happen."

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