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Gulf Widens in Credit Markets Fraught With Danger for Investors

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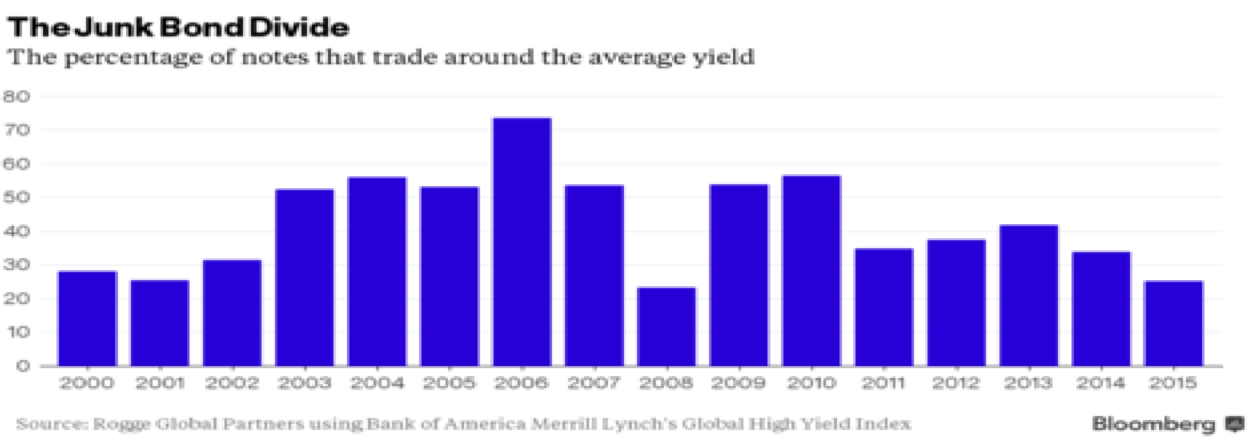
Not since the financial crisis has there been such a divide between winners and losers in global credit markets.

It was on full display Wednesday as Anheuser-Busch InBev NV attracted a record $110 billion of investor orders and sold $46 billion of bonds on the same day that a fear gauge for the credit market jumped to a three-year high. In high-yield debt, just a quarter of the bonds in a widely followed index are trading near the benchmark's average yield -- the least since 2008, according to Rogge Global Partners.

After years of central bank stimulus that drove demand for just about any and all corporate debt, investors who gobbled up $12.5 trillion of bonds globally in the past seven years are becoming increasingly discerning. Amid an economic slowdown in China and carnage in commodities prices, the gap between the safest and riskiest borrowers is making it more expensive for companies to raise debt, while shutting the lowliest out of the market altogether.

"The market has been split into winners and losers, the haves and have nots," said Mikkel Velin, a high-yield portfolio manager at London-based Rogge, which manages about $40 billion. "This will be a year of security and sector selection as investors try to dodge landmines."



That's in stark contrast to just a year and a half ago, when investors sent yields on even the riskiest junk bonds to all-time lows. The average yield on bonds rated CCC or lower reached 9 percent in July 2014 and has since soared to a six-year-plus high of 20 percent.

Now, corporate defaults are the highest since 2009 and Standard & Poor's said this week that the outlook for corporate borrowers worldwide is the worst since the global financial crisis. Investors including DoubleLine Capital's Jeffrey Gundlach are warningof recession in the U.S.

Too Risky

"Some companies will not be able to sell bonds in this market because they look too risky," said Olivier Monnoyeur, a London-based high-yield portfolio manager at BNP Paribas Investment Partners, which oversees about 509 billion euros. "That doesn't help a whole chunk of the U.S. market, namely the oil sector, where defaults are likely to increase."

The firm reduced holdings in consumer and auto sectors because they've become expensive to hold, while buying riskier securities of ArcelorMittal and Anglo American that sold off too much, Monnoyeur said.

Money managers are worried about buying assets that may be hard to sell in stressed markets after the failure of a high-yield bond fund overseen by Third Avenue Management LLC. The $788.5 million fund blocked clients from pulling their money because it couldn't meet redemptions without selling holdings at steep discounts.

Awful Damage

"You pick the wrong name in this market and it can do an awful lot of damage to your performance," said Henry Craik-White, a senior investment analyst at Wells Fargo Asset Management, which oversees about $488 billion. "There's a liquidity gap between the level people want to sell at and the level where others are willing to buy."

For investors reluctant to take on more risk, the cash is piling up, and when they see a high-quality borrower come along with attractive yields, they're hardly holding back -- as seen in the AB InBev deal. The world's biggest brewer, which has already arranged the largest-ever debt package backing its purchase of SABMiller Plc, was inundated with investor demand for its U.S.-dollar bond sale Wednesday.

The strong response, partly fueled by investors' desire to hold liquid assets, allowed the company to increase its bond offering, initially slated at about $25 billion. The beer-maker was also able to reduce yields enough to shave off about $100 million in potential annual interest costs, according to data compiled by Bloomberg and a person with knowledge of the transaction.

Growing Dispersion

Even among junk-rated borrowers, those in the highest tier are still being welcomed to the market, with Pinnacle Foods Inc. improving the terms of its debt offering for itself earlier this week.

The dispersion of risk in the junk bond market has been growing since 2013, when yields on more than 40 percent of notes in Bank of America Merrill Lynch's Global High-Yield Index were clustered at the mean, according to Rogge's analysis. Three quarters of the securities now fall outside of bounds Rogge set near the average.

That makes it harder to determine where new deals should price and provides opportunities for credit pickers, said Eric Gross, a credit strategist at Barclays Plc in New York.

"When there is a lot of appetite for risk, people don't spend as much time differentiating between credits," Gross said. "When liquidity dries up and the world doesn't look as good, investors become a lot more discerning."