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US junk bond rout entices asset managers

Robin Wigglesworth in New York and Ralph Atkins in London

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The US junk bond rout — culminating last week in the biggest investor outflow since 2014 — has begun to entice asset managers who are betting the market will recover despite the prospect of US rate increases this year.

The yield of the Bank of America Merrill Lynch junk bond index has climbed from below 6 per cent at the end of May to a five-month high of 6.4 per cent, as the turmoil in government debt markets finally began to rattle corporate bonds.

As a result, retail investors yanked $2.6bn out of US junk bond investment vehicles in the seven days to June 10, according to EPFR Global, the biggest weekly outflow since mid-December. Several high-profile exchange traded funds were among the biggest victims, tumbling sharply as money flowed out.

Asset managers are wary that retail investors could continue to withdraw money from the asset class but view the recent sell-off as a buying opportunity for bonds that boast some of the highest yields on offer.

Gershon Distenfeld, head of high yield at AllianceBernstein, said the US asset manager had "begun to have a nibble" again after the turbulence. "We're all nervous that retail investors will panic, but we view this as a buying opportunity, as it was after the taper tantrum."

Some European-based investors also think US high-yield debt now offers some attractive bargains. Nicholas Gartside, the London-based chief investment officer for international fixed income at JPMorgan Asset Management, said that the group was planning to buy US junk bonds.

“What we have seen so far is a consolidation, not a reversal,” he said. “The market is much better prepared [for a US interest rate rise this year] than it was before the taper tantrum — both from a positioning and valuation perspective.”

Andrew Milligan, head of global strategy at Standard Life Investments, remains concerned over the possible impact of Fed interest rate increases but pointed out that “there is incredible investor demand for yield from a large cadre of investors, including insurance companies and pension funds, so market threshold levels are almost triggers for people to look to get back in”.

“The rise in yields will be constrained by that willingness to pursue income — so long as the underlying economic fundamentals do not deteriorate materially,” he said.

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- Gershon Distenfeld at AllianceBernstein

When the Federal Reserve first hinted in 2013 that it planned to “taper” its quantitative easing programme, the yield of the BAML junk bond index shot up to a peak of 6.9 per cent, before settling down as money returned to the asset class.

Junk bonds suffered another blow late last year, when crashing oil prices clobbered debt issued by energy companies and dented appetite more widely, sending the average yield back up to a peak of 7.3 per cent. But investors returned again to junk bonds this year, given the paucity of yields elsewhere in bond markets and the extra insulation their coupons offer to movements in benchmark interest rates.