Withdrawals hit US corporate bond funds

Credit market shows cracks as investors pull record $5.1bn from high-grade funds

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by: **Eric Platt** *in New York*

Investment grade bond funds in the US have been hit with a record wave of redemptions, a week after two high-yield funds announced they would shutter and another barred withdrawals as the credit market showed further cracks.

Investors withdrew $5.1bn from US mutual funds and exchange traded funds purchasing investment grade bonds — those rated triple B minus or higher by one of the major rating agencies — in the latest week, according to fund flows tracked by Lipper.

The figures, the largest since Lipper began tracking flows in 1992, accompanied another week of $3bn-plus withdrawals from junk bond funds.

Lipper put the total investor withdrawals from taxable bond funds in the week to December 16 at $15.4bn.

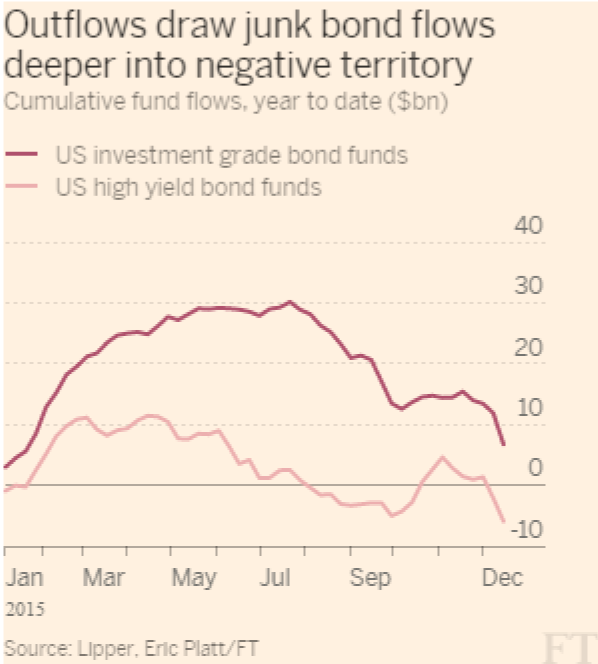
The ructions in credit markets have been exacerbated by the closure of funds managed by Third Avenue and Lucidus, as well as the decision to bar redemptions from a Stone Lion credit fund.

The figures underscore the skittishness in the US corporate bond market headed into the final days of the year. Analysts and portfolio managers have warned that defaults are likely to climb in 2016, as the slide in oil and other commodity prices weighs on the energy and materials industries.

Yields on both investment grade and junk bonds hit their highest level since 2012 this week, Bank of America Merrill Lynch data shows. Yields, which move inversely to price, eclipsed 9 per cent on the bank's high yield index.

"There have been funds closing and people in the credit space [are] having a difficult time," Tom Stolberg, a portfolio manager with Loomis Sayles, said. Third Avenue "was part of the trigger for last Friday's absolute debacle in high yield. Is it a sign of more to come? I don't think necessarily."

Leverage has risen rapidly over the past five years as US companies issued debt to fund acquisitions, raise dividends and buy back stock. While banks have largely repaired their balance sheets since the financial crisis, the corporate debt burden in the US has climbed to $5.6tn, up 59 per cent from December 2010, according to Barclays Indices.



Investors have started to push back at deals from lower-rated US companies, requiring stronger protections as well as steep discounts to buy into new offerings.

In some cases, banks have failed to drum up enough interest despite sweetening terms, with underwriters facing the prospect of hung bridge loans.

Banks cut the price of a credit offering from Kraton Polymers in the market this week while underwriters to NGL Energy Partners' $300m offering were forced to improve the terms, according to a person familiar with the transactions. Neither deal has been completed.

Several portfolio managers said that they are loath to test the waters as liquidity dries up heading into year's end, particularly as fund flows and markets whipsaw.

Corporate bond prices have been increasingly volatile, with investors warning of the difficulty to trade in and out of large positions without significantly impacting prices.

BlackRock's popular junk bond ETF — known by its stock market ticker HYG — has moved more than 1 per cent between its intraday high and low for the past five consecutive trading days. State Street's high-yield bond ETF — JNK — has done so on four of the past five days.

"The number one thing on our mind is liquidity," Christine Todd, head of tax sensitive and insurance strategies at Standish, the fixed income arm of Bank of New York Mellon, says. "There are a lot of tides that are conflicting and moving and it's very hard to predict how that will impact markets, prices and investor behaviour."

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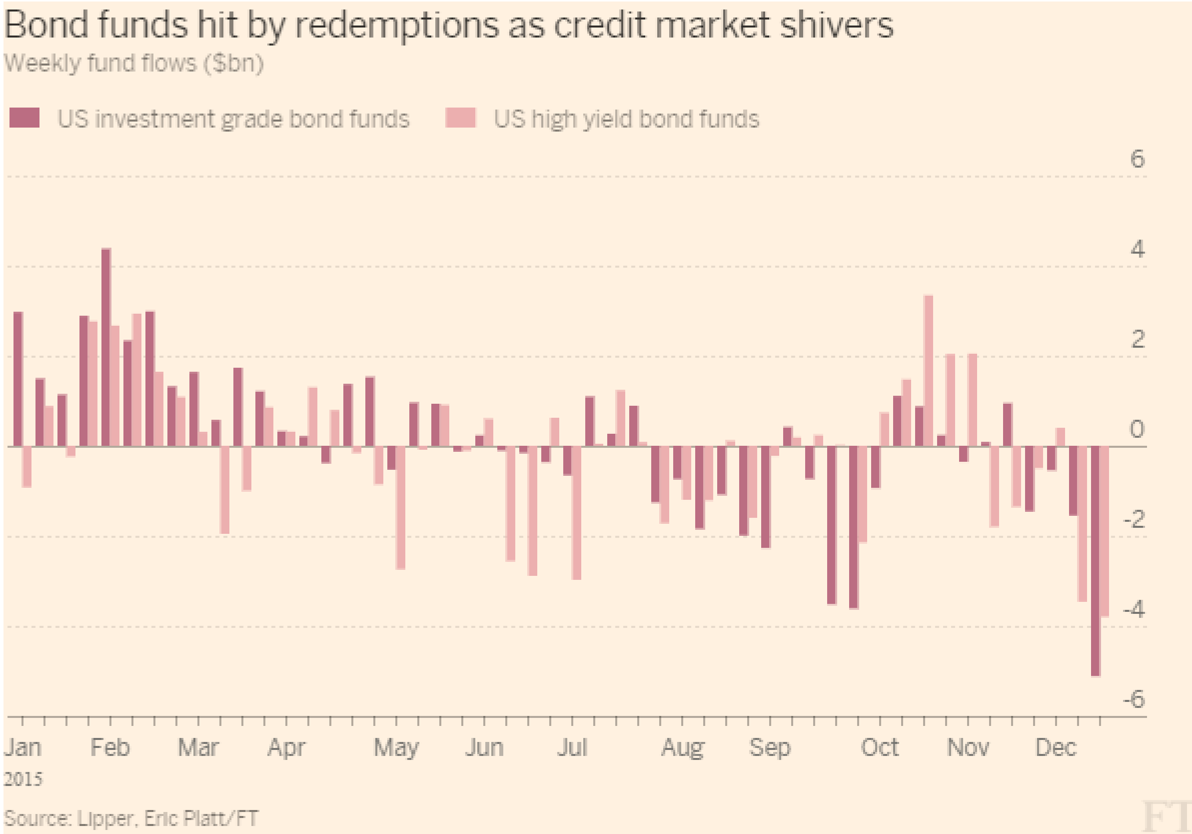
Bond funds hit by redemptions as credit market shivers
Weekly fund flows ($bn)
US investment grade bond funds
US high yield bond funds
6
4
2
0
-2
-4
-6
Jan
Feb
Mar
Apr
May
Jun
Jul
Aug
Sep
Oct
Nov
Dec
2015
Source: Lipper, Eric Platt/FT
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