BUSINESS INSIDER

GUNDLACH: When the Fed starts hiking rates, 'GET OUT' of this asset class

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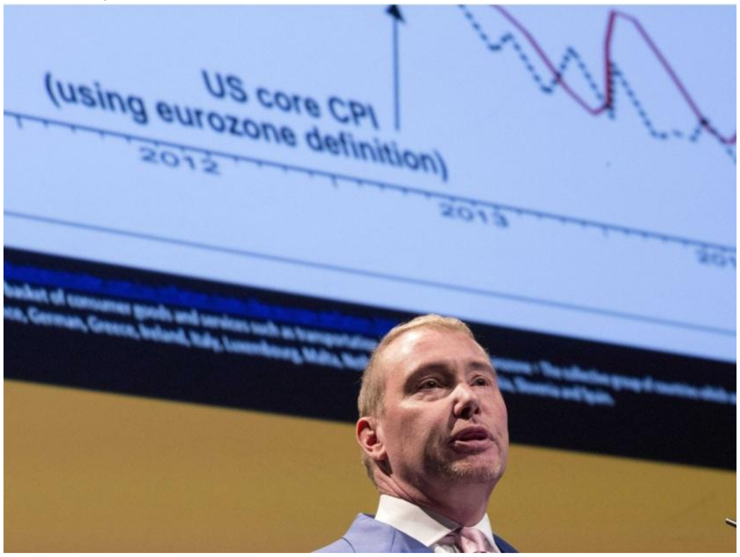

(Photo: REUTERS/Brendan McDermid)

Jeffrey Gundlach

"The entire existence of the high-yield bond market is during secularly declining rates," DoubleLine's Jeff Gundlach said.

This was a key theme in Gundlach's [presentation titled "Summer Insects,"] which he gave late Tuesday to a room of investors at the New York Yacht Club.

Gundlach argued this market was exposed to a unique set of risks that will intensify in the coming years.

High-yield bonds, or "junk" bonds, are bonds issued by companies of relatively low credit quality. Because of the higher risks that come with lending to such companies, they have to offer higher yields than those of their investment-grade peers.

In this post-financial-crisis environment of low interest rates, more and more investors have moved increasing amounts of their investment capital into junk bonds in their desperate reach for more yield.

But with the prospects of higher rates not too far off, the big risk is that investors start dumping these bonds as higher quality bonds become more attractive and the risk profile of these companies increases.

'Get out'

Some bond-market experts will say you have time to sit on these junk bonds, even after the Federal Reserve begins raising interest rates, which it does by hiking its fed funds rate.

Gundlach told the room full of investors Tuesday night to think about selling "the day of the first hike."

He presented the below chart, which he said was [the most important chart of his entire presentation](). The white line is of the fed funds rate, and the vertical blue bars indicate the first rate hike during each cycle. The yellow line represents the spread between high-yield bonds and Treasury bonds.

When the yellow line moves up, high-yield bonds are losing value relative to Treasury bonds.

"Every single time," Gundlach said, the spread soon moved up after the first hike. He reiterated it was a "100% perfect record of history."

He walked the audience through each instance including the 2004 rate-hike cycle. In that instance, you had to wait a little bit, but when the pattern manifested, the spread exploded from about 300 basis points to over 1,900 basis points. If you were short high-yield bonds while long Treasurys, you would be rich.

"Get out," he reiterated very firmly and very close to the podium mic.

DoubleLine

Read more: http://www.businessinsider.com/high-yield-credit-spread-and-fed-funds-rate-2015-5#ixzz3ZMxdHgcX