

SAHYCF Commentary: Never a dull moment

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Australian credit markets are navigating a path through persistent inflation, a renewed bout of interest rate volatility and record issuance. While spreads widened slightly in the last quarter, credit fundamentals remain strong which is providing a backdrop for selective opportunities. Meanwhile, growing strains in private credit reinforce the importance of defensive income strategies, liquidity and disciplined risk management.

Authors

Theres a lot to feel uneasy about in Australia at the moment. The budget was unpleasant and confusing for most, private credit's chickens are coming home to roost (more on that later), the RBA Governor, Michelle Bullock, warned us that a 4.5% unemployment rate was still a bit tight and that somewhere between there and 5% would probably take enough heat out of the labour market, signalling she cares somewhat more about stubbornly high inflation than jobs numbers right now. Then, she slam-dunked the end of the month with a 25 basis point increase to the cash rate getting us to the highest rate in 15 years, and it doesn't appear that she's done. The market is now pricing a terminal rate closer to 5%.

With macro events keeping rates markets on a perpetual rollercoaster, for credit investors we are naturally thinking about the impact on the consumer and the flow through to consumption and company earnings margins. Fortunately, very few of the available corporate bonds in Australia have earnings predicated on discretionary spending. Our only exposure to this space is limited to two names - The Lottery Corporation and Tabcorp.

Market Review

Spreads underperformed again this month. whilst this move was only marginal at an index level (3bps), the move was more pronounced for higher beta securities. This eroded some performance this month, but it has given the team the opportunity to get set at higher spreads in more of the names where we have high levels of conviction.

Supply was again the key culprit when it came to performance with another glut of issuance in the market for both corporates and financials. Following on from heavy supply in August, which was headlined by NextEra and Alphabet's A\$5.5bn transaction, corporates priced ~A\$4bn in September predominately in senior format. Issuance came mainly from utilities names well known to the market including ElectraNet, Aurizon Network and E.ON. We also had debut issuance from UK water utility Anglian Water and from The Lottery Corporation. These deals gave us an opportunity to selectively allocate to corporates with robust credit profiles, whilst focusing on capital protection being up in the capital stack with senior unsecured formats. At the end of the month the market gave a clear sign of deal fatigue amidst an uncertain macro backdrop. Port of Brisbane, which we regard as a very high quality corporate, printed a small A\$300m deal which did not receive the same weight of market demand which we have come to expect from this issuer and the ports sector. This signals to us that the market requires more time to digest our record-setting year of issuance, and further supply will require meaningful concessions to garner stronger investor demand.

The highlight of September's issuance was Transgrid's return to markets with both a 10-year senior and non-call 5-year subordinated note. The \$450m subordinated note was particularly well supported ending 4x over-subscribed, offering roughly 10bps of concession to the existing curve. Given elevated rates volatility and strong price progression, secondary performance did not reflect the impressive book-build which stood out amongst a month of more muted demand. The pipeline for further corporate subordinated issuance in the market looks limited from here, which gives us confidence that this deal and the broader subordinated universe can perform once macro moves are digested.

Private credit – There she blows! A disaster waiting to happen, yes indeed. Further to my commentary last month (and in the past), the private credit landscape looks somewhat dire in Australia. 20 years of low regulation and lack of scrutiny has introduced a plethora of bad practices. I want to reiterate that this is an entirely different market to Public Credit and why I have argued for some time that Private Debt is not, and will never be, defensive fixed income.

Portfolio Commentary

We have rotated a number of our positions across the Fund this month, most notably the reduction in Tier 2 bank paper, using the spread widening as an opportunity to get set at better levels in the sectors which we maintain high levels of confidence, regulated utilities and infrastructure.

Tier 2 paper continues to underperform broader markets although there is a very odd kink in the Tier 2 curve, as long-dated bullet major bank Tier 2 outperforms the mid-curve, where spreads remain relatively elevated. We have therefore reduced long-end exposure, recycling capital into higher spread opportunities.

Learn more about investing in the Schroder Australian High Yielding Credit Fund or the Schroder Australian High Yielding Credit Fund - Active ETF.

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