TheStreet
March 2016

# "High Yield Attractive Again But Beware Metals & Mining Bonds"

*Investment Reporter: Gregg Greenberg*

## Video Replay

***The lower possibility of a recession in the U.S. is making high yield bonds attractive again, but that does not mean every sector is out of the woods, said Ray Kennedy, Portfolio Manager for the Hotchkis & Wiley High Yield Fund***


## Transcript

**Gregg Greenberg**: Ray Kennedy. High yield or junk bonds have made somewhat of a comeback since mid-February along with the equity market so where are valuations now and was that the bottom, you think?

**Ray Kennedy**: I don't know if it was the bottom, but we definitely are approaching a valuation point that I think will have a sustainable value attractiveness for investors. We clearly were approaching this thousand mark, which is the number we kind of use as the golden number that says you're at recession type levels. We were within 10 percent of it. What's going to continue to weigh on this market is this tension. Are we in a recession or are we in a massive air pocket. None of us really know at this point. What I will say is for the long term investor, I think it's getting pretty attractive and I've encouraged investors if you have a hundred dollars, maybe you're supposed to put 25 in now because you're never going to find the bottom, but we're clearly a lot more attractive than we were a few years ago. We know that.

**Gregg Greenberg**: Well, the big worry right now is whether or not the problems in the energy sector are going to infiltrate the rest of the high yield world. What's your view? Is energy cordoned off enough to protect the rest of high yield?

**Ray Kennedy**: First of all, it already has. If you look at the earnings that we've been watching for about the last 12 months once this all started, we've watched company after company have exposure that I think quite surprised a lot of us. Sometimes it was 5 percent of their earnings, sometimes it was 8 percent of their earnings so we've kind of weathered that. In fact, I would say we've kind of gone through worst part of that. Now, we will continue to see some defaults. We have 50 percent of the names of energy are trading below 50 dollar price so in essence, the market has already expected this to occur. What I've been telling investors is that, look, you can find pockets in this space.

There are going to be headline defaults. There could be a Chesapeake default, we don't know, but if you're focused on the default statistic, that's the wrong thing. You need to focus on the valuation and now we've got high yield energy bonds yielding 15 hundred basis points, which is a pretty astronomical level. You can find value. At Hotchkis and Wiley, we've tended to focus on balance sheets that tend to have low borrowing basis ahead of us so we're more senior in the capital structure. We tend to focus on companies that have concentrated areas so they're not spread out. That's one of the mistakes you'll find with a lot of the big issuers in high yield so there are pockets of valuation that you can basically look at. There are certain names that are attractive. Investors should not get wrapped into the actual default stats.

**Gregg Greenberg**: All right. What about the metals and mining sector? We've seen a comeback in gold. I'm not sure why, perhaps for geopolitical fear reasons. That said, will that spur the high yield bonds to come along?

**Ray Kennedy**: No. That's the one area I do tell investors don't get excited about. Coal, there's nothing good that's happening in the coal space. Let's face it, even with a new administration, it's going to be a challenging regulatory environment. The steel sector, which is another part of the metals and mining space in high yield, that's under a lot of pressure. You can't see that changing any time soon. The demand profile's bad. There are 250 steel plants in China. You can't compete against that. There are certain areas where there seems to be some growing demand like aluminum. There are certain areas like at the processors. The core miners that we have in high yield, something like a Molycorp, etcetera, they will continue to struggle on their cost curves in a competitive world so I don't see much attractiveness there. There are some investment grade names to keep an eye out for. For example, Teck Resources would be one that we tell investors we're keeping an eye on that could be attractive. Obviously, we have Freeport. That's the big guy out there that we're all watching.

**Gregg Greenberg**: What about liquidity? We know that Third Avenue had problems with its fund, that was more of a distress fund than a high yield fund, but that said, we've seen a lot of investment banks, Wall Street brokerage houses lay off a lot of their bond desks so what's going on with regard to liquidity. Can you sell paper when you want to sell paper?

**Ray Kennedy**: We can because of our size. We're lucky. I would look at some of these big funds and I realize they're probably liquidity challenged, trying to move 25 or 50 million in one clip is very difficult. The way I look at liquidity is that investors just have to get paid for it and that, I think, we can all agree is starting to happen. In the old days, we used to say that the liquidity premium was somewhere between and a hundred and 2 hundred basis points. That's probably widened out to 2 hundred to 4 hundred basis points so in some sense, I would say it's actually becoming a little bit more attractive. Now, can you transact in this world? You can. We're back to a little bit of the old agency model that we had in the mid 1990s. When I joined this business our largest counter party was actually an agency firm. It was a never a big Wall Street firm so we're kind of going back to that model as the street shrinks their business model, which was largely driven by new issues. Doesn't mean it's going to disappear. It just means it's going to shift a bit and it'll take some time.

**Gregg Greenberg**: All right, Ray.

**Ray Kennedy**: Great thank you. All right.

**Gregg Greenberg**: Thank you for watching The Street.

**You should consider the Fund's investment objectives, risks, and charges and expenses carefully before you invest. This and other important information is contained in the Fund's summary prospectus and prospectus, which can be obtained by calling 1-800-796-5606 or visiting our website at www.hwcm.com. Read carefully before you invest.**

*Mutual fund investing involves risk. Principal loss is possible. Investments in debt securities typically decrease in value when interest rates rise. This risk is usually greater for longer-term debt securities. Investment by the fund in lower-rated and non-rated securities presents a greater risk of loss to principal and interest than higher-rated securities. The Fund may invest in derivative securities, which derive their performance from the performance of an underlying asset, index, interest rate or currency exchange rate. Derivatives can be volatile and involve various types and degrees of risks. Depending on the characteristics of the particular derivative, it could become illiquid. Investment in Asset Backed and Mortgage Backed Securities include additional risks that investors should be aware of such as credit risk, prepayment risk, possible illiquidity and default, as well as increased susceptibility to adverse economic developments. The Fund may invest in foreign* *as well as emerging markets which involve greater volatility and political, economic and currency risks and differences in accounting methods. Investing in smaller and/or newer companies involves greater risks than those associated with investing in larger companies, such as business risk, significant stock price fluctuations and illiquidity.*

Bond quality ratings are grades given to bonds that indicate their credit quality as determined by private independent rating services such as Standard & Poor's, Moody's or Fitch. These firms evaluate a bond issuer's financial strength, or its ability to pay a bond's principal and interest in a timely fashion. Ratings are expressed as letters ranging from 'AAA', which is the highest grade, to 'D', which is the lowest grade. In limited situations when none of the three rating agencies have issued a formal rating, the Advisor will classify the security as nonrated.

Top 10 holdings as of 9/30/17 as a % of the Fund's net assets: Momentive Performance Mat'ls 1.0%, Rain CII Carbon LLC 0.9%, Weekley Homes LP 0.9%, CCO Holdings LLC 0.9%, Kosmos Energy Ltd. 0.9%, McDermott Int'l Inc. 0.9%, AMAG Pharmaceuticals 0.9%, Harland Clarke Hldgs Corp. 0.9%, Halyard Health Inc. 0.9%, and Rayonier A.M. Products Inc. 0.9%. Portfolio weightings, sector allocations, and/or fund holdings are subject to change and should not be considered a recommendation to buy or sell any security. Basis point is a unit equal to 1/100th of 1% and is used to denote the change in a financial instrument. Investment grade indicates that a municipal or corporate bond has a relatively low risk of default. Opinions expressed are those of the author and are subject to change, are not intended to be a forecast of future events, a guarantee of future results, nor investment advice. References to other products should not be interpreted as an offer of these securities. **Diversification does not assure a profit or protect against loss in a declining market.**

**NOT FDIC INSURED ■ NO BANK GUARANTEE ■ MAY LOSE VALUE**

The Hotchkis & Wiley Funds are distributed by Quasar Distributors, LLC. No other products mentioned are distributed by Quasar Distributors, LLC.

725 S. Figueroa St., 39th Flr • Los Angeles, CA 90017
1-800-796-5606 • www.hwcm.com
HWHY-TheStreet-3/16