

Credit – canary in the coal mine?

As an infrastructure debt fund manager (and former infrastructure equity fund manager) we like to think, on average, that credit investors are smarter than equity investors. While some of this is pure self-interest, credit markets do have a track record of moving before broader equity market downturns. Perhaps this is due to the focus on downside risk of credit investors.

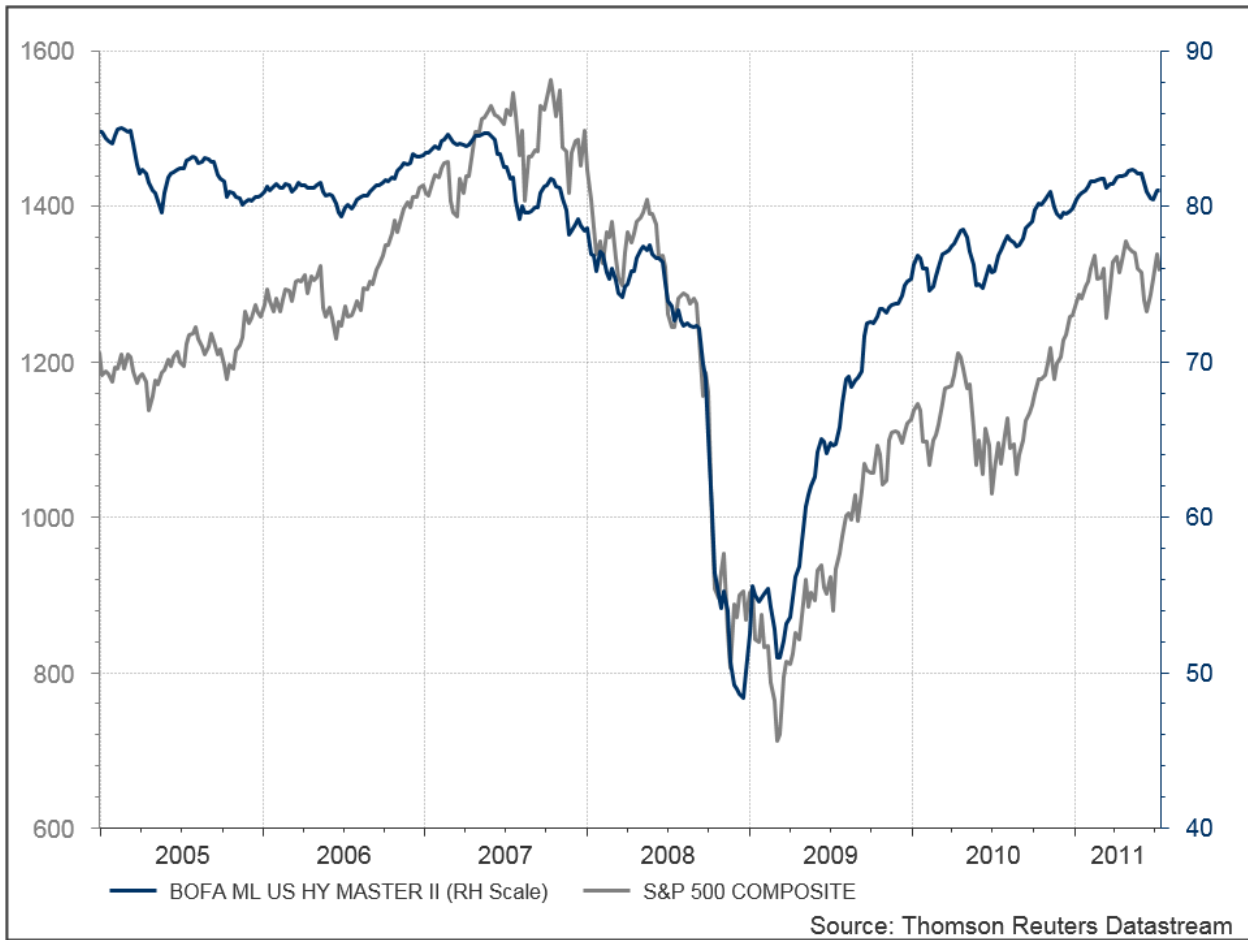
For example, the high yield market peaked in the second half of 1998 and deteriorated steadily through 1999, well ahead of the dot com market peak in March 2000.

Technology bubble (2000)



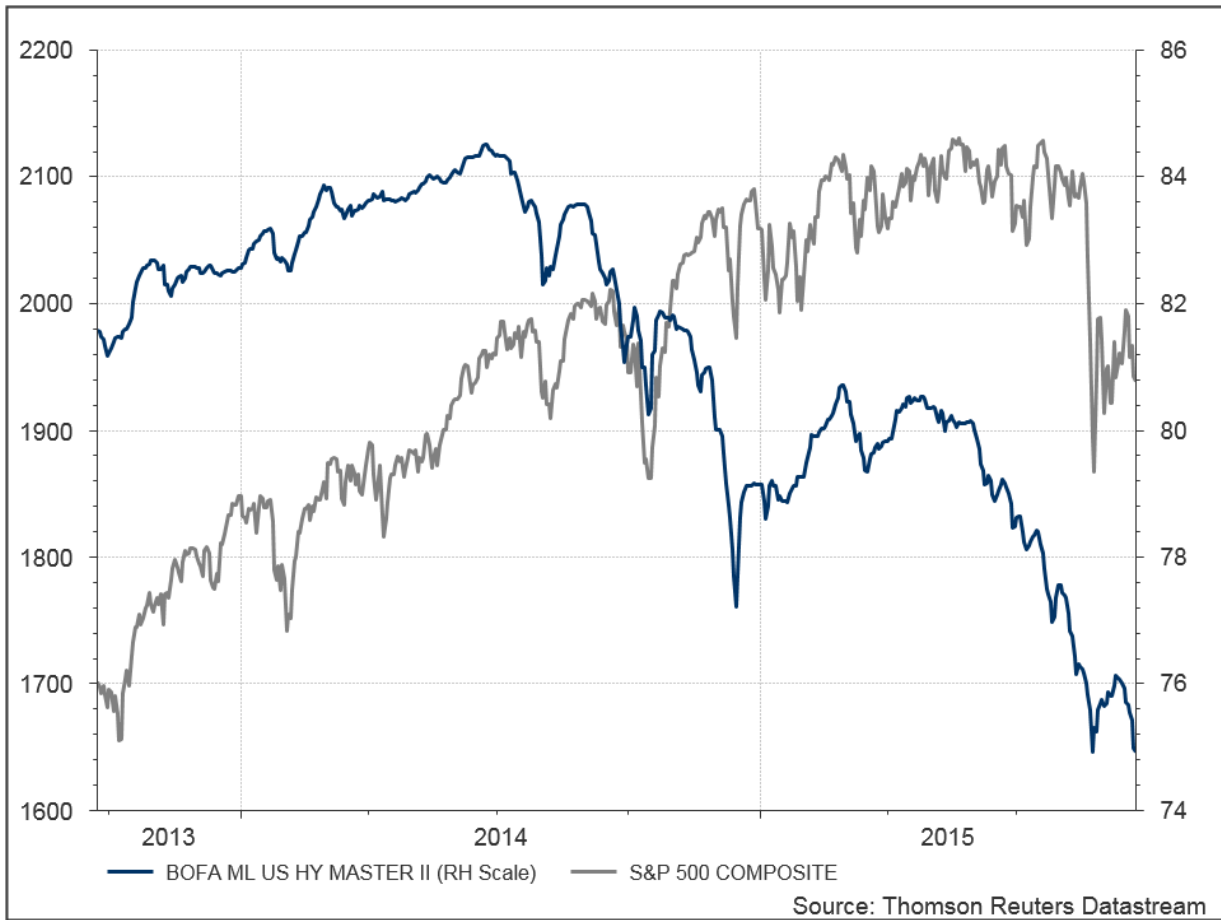
Ahead of the GFC, credit markets suffered significant deterioration in the second quarter of 2007 (starting with ABS and then spreading to broader credit markets). This was ahead of the peak in equities in October 2007, and certainly well ahead of the worst of the equity market falls in 2008.

GFC (2009)



More recently – high yield bond markets clearly peaked at the end of 2014 – coincident with the collapse in oil prices and its implications for the energy sector (which accounted for 20% of the market at the time). Credit markets have continued to deteriorate over the course of 2015 – with both high yield and investment grade spreads moving steadily wider.

2015 Black Monday



Are credit markets trying to tell us something about the current cycle? Asset prices have benefitted from unprecedented central bank stimulus with valuations at the high end compared to history. The underlying economic growth that has been generated post the 2009 financial has been relatively weak. In this context, the devaluation of the RMB by China is a potentially critical development, as a signal that its capacity to drive global growth has reached an inflection point.

We believe investors should be keeping a close eye on credit market indicators along with the traditional equity metrics. Time will tell whether the most recent equity market ructions are a short-term correction or something more serious, but Infradebt has been, and continues to be, defensively positioned.