Monthly Fund Commentary

Muzinich & Co

Institutional: MZFIX April 2019

Fund

Muzinich High Income Floating Rate Fund

Portfolio Commentary

US corporate credit continued its positive run with another strong month in April. Risk-on sentiment dominated, as evidenced by strong equity, high yield and loan returns. Investment grade corporates also generated positive performance while Treasuries declined. Risk-on sentiment was bolstered by solid US economic data (Gross Domestic Product beat expectations), good earnings, progress on US/China trade negotiations, and an accommodative Federal Reserve. Technicals were positive for both investment grade and high yield given limited new issuance (many companies were in their mandated blackout periods given earnings releases and therefore not able to come to market) and solid inflows. Defaults remain at historic lows. We believe going forward, credit is largely a carry trade. In a world of low government yields, investors will generally take the spread[1] where they can get it.

After a weak March, where the syndicated loan market underperformed comparable asset classes on redemption fears, April saw a significant bounce back in syndicated loan performance. As March's underperformance in the loan market was driven by fears of redemptions due to the Federal Reserve's pivot, so April's outperformance was driven by the realization that these redemption fears are not as significant as had been imagined. The Collaterlized Loan Obligations (CLO)[2] market is now slightly ahead of the amount it had created at the same point in 2018, which ended up being a record year of volume. Coupled with the continued strong CLO market is the lack of new issue supply[3]. Given weak markets at the end of 2018 and uncertainty in the early part of 2019, the new issue market has failed to produce similar levels of supply to those of 2018. Refinancings away from the loan market into the high yield market, where spreads have rallied harder, have also contributed to the strong technical picture.

Strategy and Outlook

In this environment, the fund generated positive returns. On a ratings basis, the fund benefitted most from BB and B rated loans. On an absolute sector basis, notable contributions came from industrials, technology, and cable/satellite TV, while select healthcare loans detracted from returns. Looking forward, we expect strong technicals in the loan market to continue. Relative value considerations are also likely to continue to be supportive to the loan market, given the pick-up available in the loan market versus comparable high yield valuations.

Developed market inflation remains low despite unprecedented global central bank stimulus and, in the US, a strong jobs picture and solid economic growth. One explanation for low US inflation is that while the US economy is at full employment, this has not been accompanied by a rise in wages. Some argue that globalization and technology have put a damper on inflation and that we may never see inflation again. Several factors, however, could lead to an increase in inflation: increasing budget deficits (US and select European countries), rising commodity prices, continued loose monetary policy, and an increase in the US minimum wage (higher wages without an increase in productivity). What does it mean for fixed income? A little inflation is good because it could signify a solid economy and that companies have pricing power. If inflation is too high, however, this can be problematic – particularly for rates. Central banks would be forced to raise interest rates, a headwind for fixed income investors. In an inflationary environment, spread product would likely outperform more rate-sensitive investment grade.

All references to market performance are sourced from Bloomberg. [1]Spread is the difference in yield between a U.S. Treasury bond and a debt security with the same maturity but of lesser quality. [2]A Collateralized Loan Obligation (CLO) is a security backed by a pool of debt, often low-rated corporate loans. [3] S&P, Leveraged Commentary & Data, April 30 2019.

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