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Kempen (Lux) Euro High Yield Fund

Fallen and rising

'We focus on risk control'

The behaviour of traditional investors and rating agencies creates an imbalance in the market for debt securities, especially in the highest segment: of the high-yield market Specialists Rik den Hartog and Luuk Cummins tell us about the new Kempen investment fund that focuses on this segment of the credit market.

The expected return on credits is more or less determined by two factors, Den Hartog explains: the interest rate and a spread as a reflection of the creditworthiness of a company. This is known as the credit spread. Rating agencies such as Standard & Poor's occupy an important position in the credit market as they rate the creditworthiness of companies. To do so, they apply a rating that is split into investment grade (IG), i.e. the most creditworthy companies, and high yield (HY).

'The new investment fund focuses on credits with a BB rating and subordinated bonds,' Den Hartog says. 'This is the highest class within high yield and is close to investment grade. What makes these bonds interesting is the fact that the risk/return ratio is currently very attractive. Companies in this segment enjoy a robust corporate profile combined with high

angels
stars

Rik den Hartog, Senior Portfolio Manager

Luuk Cummins, Portfolio Manager

yield spreads. This results in a relatively high Sharpe ratio (extra return for the additional risk) with a low downside risk.'

Fallen angels, rising stars

Part of the attractiveness of the BB segment lies in the fact that many investors distinguish rigidly between investment grade and high yield. If a company is downgraded by the rating agencies from BBB (IG) to BB (HY), they sell these bonds. 'You can then often buy these so-called fallen angels at a good price,' Cummins explains.

'In addition there are the bonds of companies that are working hard to earn a higher rating, the rising stars. We buy these bonds at a favourable time and when the company performs better the bonds rise in value. It is the BB segment that profits most from this. We believe that this segment is inefficiently priced and that the value is not always an accurate reflection of the credit risk.'

Kempen has a highly-experienced credit team that has operated in this market since 2008. 'We believe that our process is especially suited to this segment,' Den Hartog confirms. In his opinion, this is due to the team's *alpha-by-control* approach: 'We focus on risk control. We diversify our investments, make many smaller bets. This limits downside risk. In addition, we put a huge amount of energy into forming our own opinion on companies, into identifying discrepancies between creditworthiness and credit spreads.'

There are also companies with a structural BB rating. As an example, Den Hartog takes packaging company Ball, a global market leader in the production of cans for the beverages sector. 'At its core it is a sound company that enjoys stable revenue and cashflows. It operates with a slightly higher amount of debt on its balance sheet as a result of acquisitions, but in our eyes it is a creditworthy company.'

An eye for sustainability

ESG (Environment, Social and Governance) criteria are taken into account when selecting the bonds. 'On the one hand this is because we always take these criteria in principle into account, but also because a poor performance in ESG terms can have an impact on the company's creditworthiness,' Cummins continues. 'If we think something ought to be done differently, we seek contact with the company. If we observe little progress, this has consequences for our decision to invest in the company.'

The Kempen (Lux) Euro High Yield Fund may appeal to investors who seek a sound return at a relatively low level of risk. 'Investors who already invest in high yield can shift to a lower risk profile without relinquishing much return in the process,' Den Hartog asserts. 'Investors who currently favour investment grade can earn a higher return via our fund without investing in the riskiest companies. Focus on quality is essential, especially at this stage of the credit cycle.' ■