FIXED INCOME OUTLOOK AND GENERAL PORTFOLIO STRATEGY

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Our “Behind the Markets” podcast is taped live every Friday at 1:00 p.m. ET, and the week before the inauguration we had the privilege of hosting James McGrath in our Wharton studio. James is Director of Research of LGL Partners, a family office and investment firm from the Philadelphia area with only 50–60 client relationships. We had a great discussion with McGrath on LGL’s approach to life planning, investments, including alternative investments, as well as his take on the current environment across the major markets.

We were joined by Peter Tchir of Brean Capital to hear his view on the fixed income markets under Trump. We covered a lot of great topics in this one.

Peter discussed the great rotation that is occurring with money coming out of cash and Treasuries and into high-yield bonds and leveraged loans. These are two reflation trades he is favorable on, whereas he’s more worried about duration in the investment-grade credit market.

High Yield Market Less Dangerous Than Historically?

Those could turn out to be famous last words. But we discussed whether high-yield bond spreads over Treasuries were too low—and there was a good discussion of how the changing composition of the category could be supportive.

One phrase from Peter I especially liked: There are fewer “drive-bys” in high-yield bond issuance market today—meaning fewer companies are flying by that no one ever heard of and trying to raise capital via a high-yield bond issuance. This makes the market more stable and requires less yield spread pickup.

We also discussed the U.S. Treasury’s recent issuance of floating rate debt with Trump potentially also reversing course and extending duration and issuing bonds with maturities up to 50 years. This could be another interesting potential development.

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DEFINITIONS

Treasury : Debt obligation issued by the U.S. government with payments of principal and interest backed by the full faith and credit of the U.S. government.

High Yield : Sometimes referred to as “junk bonds,” these securities have a higher risk of default than investment-grade securitie.

Leveraged loan market : Loans extended to companies or individuals that already have undertaken considerable amounts of debt, thereby increasing their risk of potential default.

Reflation : The term is used to describe the first phase of economic recovery after a period of contraction. This period is typically characterized by the act of stimulating the economy through accommodative central bank policies and reducing taxes, to bring growth and inflation back up to the long-term trend.

Duration : A measure of a bond’s sensitivity to changes in interest rates. The weighted average accounts for the various durations of the bonds purchased as well as the proportion of the total government bond portfolio that they make up.

Investment grade : An investment grade is a rating that signifies a municipal or corporate bond presents a relatively low risk of default.

Credit : A contractual agreement in which a borrower receives something of value now and agrees to repay the lender at some date in the future.

High-yield bond spread : The amount of incremental income a bondholder receives for assuming credit risk, specifically that of companies rated below investment grade credit.

Spread : Typically refers to a difference between a measure of yield for one asset class and a measure of yield for either a different subset of that asset class or a different asset class entirely.

Floating Rate Treasury Note : a debt instrument issued by the U.S. government whose coupon payments are linked to the 13-week Treasury bill auction rate.

Maturity : The amount of time until a loan is repai.