



**PGIM**  
India Mutual Fund

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# The Future In Focus

Pivoting from uncertainty to opportunity.

**2021 BEST IDEAS - PART 1**

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## The Golden Age Of Credit, Continued



**PGIM** FIXED INCOME

# THE GOLDEN AGE OF CREDIT, CONTINUED

Few people will have a difficult time watching the calendar flip past 2020. The reality, however, is that 2021 will no doubt bring its fair share of uncertainty as well, whether it be ongoing pandemic worries, geopolitics or an economic backdrop that remains unpredictable.

The recent “phase one” trade agreement between the U.S. and China eases some (but not all) of the uncertainty that was hanging over global markets. Factor in the residual effects from 2019’s broad easing in monetary policies, along with investors’ ongoing search for yield amid generally limited supply, and the outlook for EMD appears broadly positive.

Those near-term concerns are likely to keep corporations conservative and focused on improving their balance sheets. And over the long term, the continued support of fiscal policy and

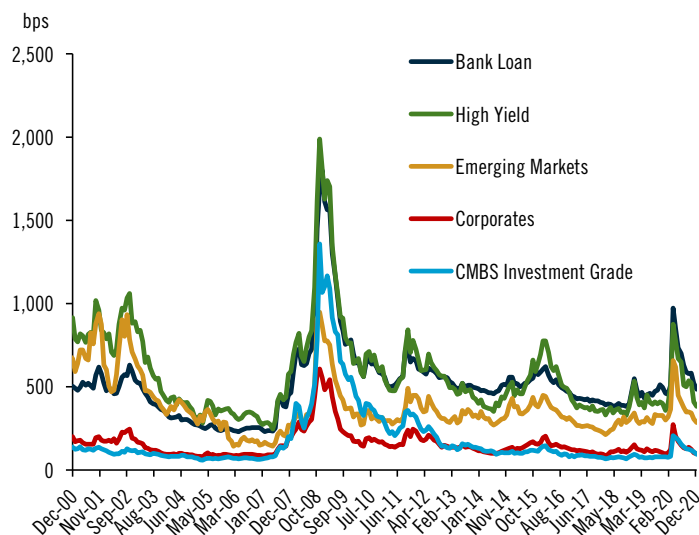
central banks around the world, in a moderately low economic growth backdrop, tends to bode well for credit investors.

We call it the Golden Age of Credit, and it has a handful of powerful drivers:

- 1. Attractive valuations:** While spreads have recovered from their recent wide levels, they still offer long-term value. The first leg of the credit spread rally in 2020 featured assets that were directly targeted by various support programs, namely high-quality assets. For example, AAA-rated securitized

## CREDIT SPREADS

As of December 31, 2020



	Spreads (bps) <sup>1</sup>		
	12/31/2019	3/31/2020	12/31/2020
US IG Corporates	93	272	96
US IG Intermediate Corporates	70	271	68
US IG Long Corporates	136	274	141
European IG Corporates	93	239	92
Municipal Bonds	116	238	127
US High Yield	336	880	360
European High Yield	292	778	347
CMBS	80	207	94
Non-Agency CMBS	85	238	109
Agency CMBS (added 6/2014)	53	116	44
Non-Agency CMBS “AAA” Tranche	82	180	75
Agency MBS	39	60	39
AAA CLO	133	268	123
Emerging Markets	301	657	284
Emerging Market Sovereigns	277	577	323
Emerging Market Corporates	311	599	328

Source: Corporates and CMBS from Barclays. Emerging Markets from JP Morgan. High Yield from BofA Merrill. Bank Loans from CSFB. <sup>1</sup>Source of data: Bloomberg. Loan data on a week lag. Provided for discussion purposes only. Does not constitute a recommendation regarding the merits of any investments. Past performance is not a guarantee or a reliable indicator of future results.

products and high-quality, shorter-duration investment-grade corporate bonds rallied strongly and largely recovered. However, the second leg of the spread recovery still has room to play out in some portions of the market. In particular, the credit crossover corridor of BBB and BB appears attractive. Historically, in the repair part of the credit cycle, fallen angels in the crossover corridor represent a “gift from above,” and segmentation in the fixed income markets is particularly acute in the crossover corridor, which subsequently creates a meaningful source of potential alpha for multi-sector investors. Default and downgrade activity could pick up materially should the economic environment deteriorate, and credit selection remains paramount, but we believe that spreads still provide investors with more than adequate compensation for that risk.

- 2. Balance sheet repair:** Credit investing is a rare world in which not-so-favorable news can improve the investment outlook. Essentially, credit investors benefit the most when companies are in free cash flow conservation mode and they pull back on balance sheet destructive activities, such as share repurchases, dividends, and capital expenditures. We expect corporations to embark on multi-faceted balance sheet repair over the coming quarters and years. Provided that a company doesn't default, of course, the direction of a credit's travel may actually be a better determinant of its performance, rather than simply assessing the current state of its credit profile.
- 3. Slow growth is good growth:** The sudden stop in the global economy in the early part of 2020 will likely have lasting effects on growth and the future economic trajectory. The extent of the scarring is not completely known at this

stage, and while we believe ultimately that a U-shaped recovery is the most probable, alternate scenarios cannot be dismissed. Nonetheless, we see a long road back to trendline growth, which should keep corporations in free cash flow conservation mode for some time to come. In fact, the longer and harder the economic road to recovery, the more likely that companies will remain friendly to bondholders (or at least less hostile).

- 4. Ongoing support:** The global fiscal and monetary responses to the pandemic have been nothing short of astounding. These often-coordinated, swift and decisive actions arguably staved off the worst-case scenario for the global economy and, thus, the markets. Crucially, the economic state of the COVID-19 crisis is unlike the Global Financial Crisis, where fiscal and monetary authorities were worried about “bailing out” bad behavior and actors. The current lack of villains strongly suggests that both governments and central banks will continue to do whatever it takes to support their citizens and the global economy.

We see the post-virus world carrying forward many of the demographically related themes that have characterized the past decade — restrained global growth, low inflation (which will require central banks to remain stimulative), and low long-term interest rates. This, in turn, should translate into a low volatility macro-financial environment. Taken cumulatively, we believe that the sun is far from setting on the Golden Age of Credit.

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