



Where are we in the credit cycle?

Gene Tannuzzo, Senior Portfolio Manager

I think there really are a lot of opportunities in the bond market right now, but we have to understand where we are fundamentally in the credit cycle.

As we think about credit cycles, we want to understand how levered are the issuers, how much debt do the companies have, how much debt do the consumers have, how much debt do the sovereign countries have, and is it at a point where that debt service is becoming hard or untenable for them. Because in the bond market, as we get to a point where they're unable to service that debt, we can see large drawdowns in bond prices.

So the credit cycle has a number of layers. It's not as simple as saying we are early or late in the credit cycle. I think the corporate credit cycle is perhaps very late-stage right now, and we can see that in a variety of ways. We see that in high corporate leverage. We also see that in various metrics in terms of how companies are rewarding shareholders rather than bondholders, paying out more dividends and doing more share buybacks, for example.

The household credit cycle is in a very different position. Largely due to the scars of the financial crisis, the household sector is not nearly as levered as it was before 2007. So actually, with an improving labor market, the household credit cycle is in much better shape. That allows us to find opportunities that are exposed to the household, for example, in the mortgage-backed securities area.

We tend to think about credit cycles in terms of innings of a baseball game. And as we think about the divergence across the layers of the credit cycle, I don't think they're all in the same inning. I think if we look at the corporate credit cycle, perhaps that is in the 8th or 9th inning, but perhaps the household credit cycle, because of improvements in the labor market and household balance sheets, may only be in the 5th inning. And as we look at the emerging market credit cycle, as many of these countries are still just emerging from deep recessions, they may only be in the 2nd or 3rd inning of their credit cycle.

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