Man

Views From the Floor

Oddly Distressing

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Oddly Distressing

It's fair to say that there is quite a lot going on in international distressed credit: commodity price volatility, the emergence of inflation, regime change in central banks' market intervention, rising interest rates, supply chain disruptions, a collapsing Chinese real estate market, the default of numerous EM sovereigns, and the Russian invasion of Ukraine have caused tectonic shifts in bond prices.

By our calculation, more than USD500 billion of the USD1.8 trillion of emerging-market high yield ('EM HY') bonds are currently trading below 70 cents. In contrast, the equally sized US high yield market only has USD18 billion of bonds trading below the threshold (or about 1% of the total US HY market), which is even less than the USD75 billion that traded as distressed before the pandemic in February 2020.[1]

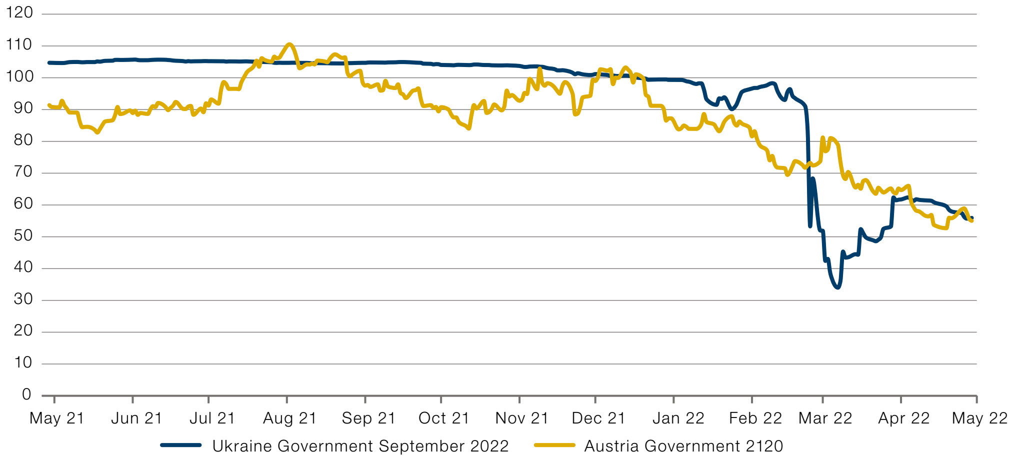
Although some of the price moves that have resulted from the first and second-order effects are significant but not surprising, others seem odd, to say the least.

For example, if we asked you to name a sovereign credit that returned -38% in the last 12 months, you would be right to answer Ukraine given the Russian invasion (Figure 1). But how many people realise that that has been the same return for AA+ rated Austrian century bonds due 2120, currently trading at 55 cents (but yielding only 1.9%)? Although Austria is clearly not a distressed credit, how many distressed owners of Austrian debt are now nursing significant losses? Indeed, the pain may not be confined to Austria alone, with the Bloomberg Global Aggregate Total Return index – a major investment grade benchmark – down almost 11% year-to-date at the time of writing.

Many of the large first- and second-order price effects from some of the significant economic events of the post-pandemic era have quickly reflected a new reality for many assets, some of which have become uninvestable. The second- and third-order effects are still playing out and are exceptionally hard to predict. In our experience, these tectonic shifts often create forced selling – and in turn, an irrational market where good credits are sold for far less than their value. From sovereign debt priced at levels that imply a total collapse in government to corporates getting sold indiscriminately, often market prices do not reflect fundamentals. Odd – but interesting – times to be an international distressed debt investor.

1. Figures given are from Man GLG calculations.

Figure 1. Ukraine Government September 2022 Versus Austrian Government 2120



Source: Bloomberg; as of 28 April 2022.

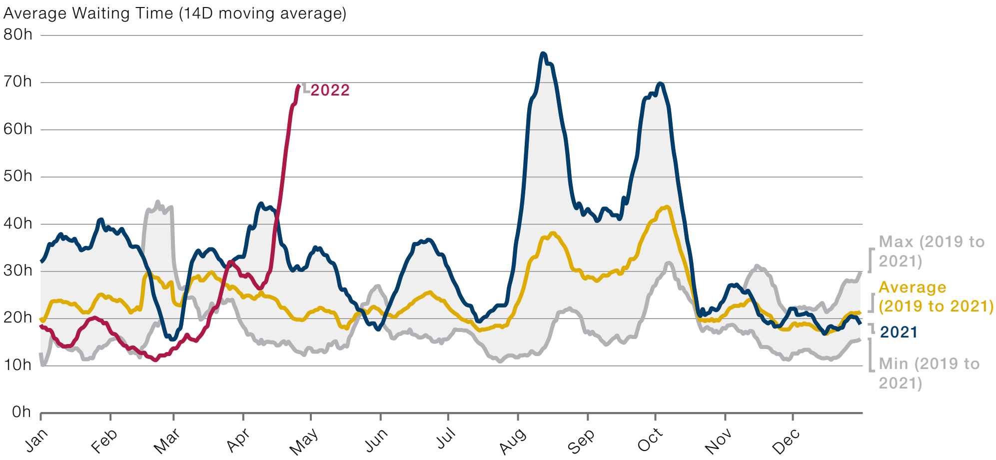
Ships, Dips and Consumer Confidence

More than 300 ships sit outside of the port of Shanghai, unable to load or unload, as the city enters its sixth week of lockdown.[2] This is a staggering level of congestion, more than 50% higher than during the height of the 2021 supply chain breakdown. As a result, the 14-day moving average waiting time has increased to 70 hours, a figure slightly lower than the 2021 peak of 76 hours (Figure 2).

However, the gridlock is not being reflected in the cost of shipping. Container rates from Los Angeles to Shanghai are falling, despite the supply bottlenecks (Figure 3).

In our view, this reflects a weakening of consumer demand. Consumer confidence is falling in major export destinations such as the US and the Europe (Figure 4). While bottlenecks will persist until lockdowns end, the impact on shipping costs (and by extension inflation) may differ versus 2021 in the event that consumer demand fails to recover.

Figure 2. Average Waiting Time for Container Ships at Shanghai



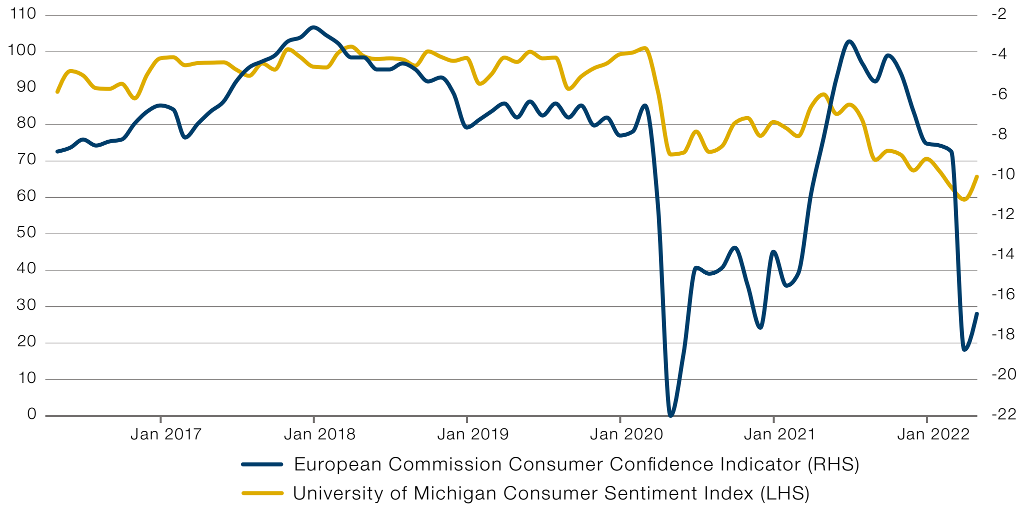
Source: Vessels Value; as of 25 April 2022.

2. www.bbc.co.uk/news/world-asia-china-61023811

Figure 3. Container Rates – LA to Shanghai

Source: Bloomberg; as of 27 April 2022.

Figure 4. US and EU Consumer Confidence



Source: Bloomberg; as of 27 April 2022.
Note: European Commission Consumer Confidence Indicator is a balance/ diffusion index.

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