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DoubleLine Is Overweight Blue-Chip Debt for First Time in Decade

- Credit chief Robert Cohen likes bonds from big banks, pharma
- High yields seen offsetting credit risk from economic slowdown

by Caleb Mutua
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DoubleLine Capital is making its most aggressive bet on high-quality corporate bonds in years, wagering that the highest yields since the global financial crisis will offset risks posed by an economic slowdown.

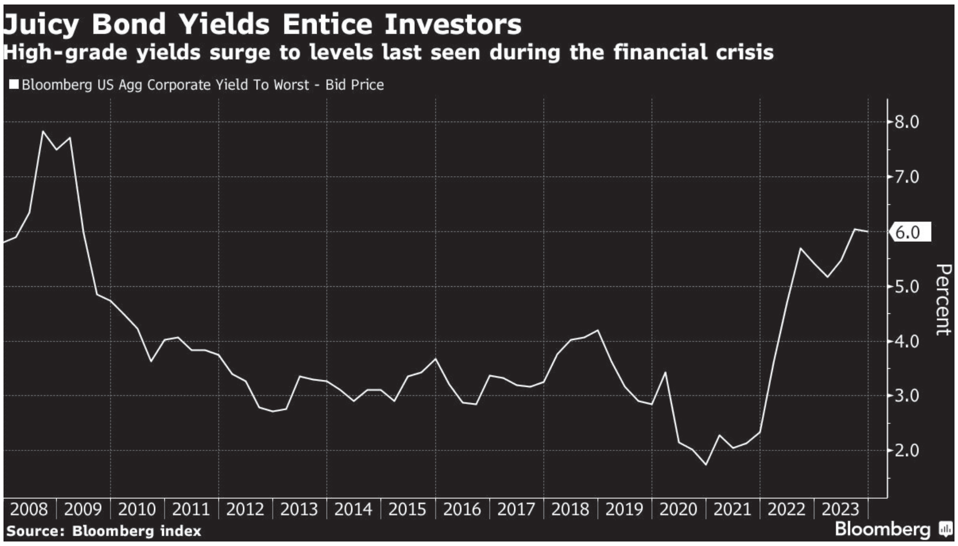
"We find this to be one of the most attractive periods for fixed income overall, but specifically for corporate credit," said Robert Cohen, head of global developed credit at DoubleLine, which oversees more than $90 billion. "We think it's one of the most interesting times over basically the last 10 years."

After staying broadly underweight investment-grade corporate bonds over the past decade as the Federal Reserve kept rates low, DoubleLine shifted into an overweight stance during the past two months, Cohen said in an interview.

While the volatility that has whipsawed fixed-income markets likely isn't over, the steep jump in yields, an improvement in credit quality and a shift that's reduced the interest-rate risk of many corporate bonds have made them "highly attractive," he added.

A broad measure of investment-grade corporate bond yields surged last month to nearly 6.5%, a more than 14-year high, while the average duration has shrunk to a little under 7 years from a peak of close to nine. Meanwhile, risk premiums are below their 20-year averages and well under levels seen during historical times of economic stress.

Los Angeles, California-based DoubleLine has been focused on debt from globally systemic banks that are increasing market share and have the ability to weather regulatory changes; pharmaceutical companies with solid cash flows; and tech companies with disciplined capital allocation policies. The firm is neutral on duration risk given the volatility in rates and finds the most value in the four- to 10-years maturity range.



"The odds of a positive return are very high and the odds of a negative return are relatively low," said Cohen. "Even if we have economic weakness and spreads widen, they're largely offset by yield and potentially the duration rally that you would have if economic conditions continue to deteriorate."

Corporate debt rallied along with the broader bond market last week as the Fed kept interest-rates unchanged and a slowdown in job growth strengthened conviction that it will shift to cutting rates next year. That reversed what had been an escalating rout, leaving corporate bonds now with a small gain for the year.

"The best opportunities in markets are when you have the greatest uncertainty and the highest volatility," said Cohen. "You're going to have periods where the trade is not going your way, but that doesn't mean over a longer period of time it's not going to work."

He's also banking on improving credit quality, noting that blue-chip firms have been paying down debt instead of borrowing. Credit quality improved notably over the third quarter, with most upgrades concentrated in the lower-rated investment grade categories, S&P Global Ratings analysts including Patrick Drury Byrne and Nicole Serino wrote in their investment-grade credit check note last week.

There are still pockets of risk. Cohen is staying away from regional banks, which led S&P's high-grade downgrades in the third quarter and are more exposed to the troubled commercial real estate industry.

He says investors need to be "sober" about the outlook for below-investment-grade bonds and says credit selection is important. He expects default rates to rise in 2024 on both junk bonds and bank loans. Still, he sees the speculative-grade market outperforming equities and recommends investors move some of their stock exposure into junk bonds.

"There are some companies that are over-levered and cannot handle the current rate environment," he said. "But I don't think you need to stretch into those credits. We like the strong single-B and BB segment of the market."

Robert Cohen, CFA
Director, Global Developed Credit
DoubleLine Capital

Mr. Cohen joined DoubleLine in 2012. He is a Portfolio Manager and Director of the Global Developed Credit team. Mr. Cohen oversees the team's investment activities in investment grade, high yield (HY) and bank loan corporate credit markets. He also leads the collateralized loan obligation (CLO) issuance effort at the firm. Mr. Cohen is a Portfolio Manager for the Opportunistic Income, Income Solutions, Low Duration, CLO and Floating Rate strategies. He is a permanent member of the Fixed Income Asset Allocation Committee. Prior to DoubleLine, Mr. Cohen was a Senior Credit Analyst at West Gate Horizons Advisors (and its predecessor, ING Capital Advisors), where he worked as an Analyst covering bank loans and HY bonds. Prior to ING, he was an Assistant Vice President in the Asset Management Group of Union Bank, where he managed CLO and bank loan portfolios. Prior to Union Bank, Mr. Cohen was an Associate Director of Corporate and Investment Banking at the Bank of Montreal in its Natural Resources Group. He holds a B.A. in Economics from the University of Arizona and an MBA from the University of Southern California. Mr. Cohen is a CFA® charterholder.

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