

**Jennison**

**Curve Your Enthusiasm**

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## **Audio Starts**

**Alex:** [00:00:00] Welcome back everyone. We're doing clipping coupons here with Jennison Fixed Income. Today I'm here with Griffin Sullivan, who's a Portfolio Manager on the credit desks here at Jennison.

**Griffin:** Hi Alex. Thanks so much for having me.

**Alex:** Yeah, I'm pumped to have you on. Alright, so we'll jump right into it then. On the credit desks, you cover a lot of consumer-based sectors. What are a couple of the high-level themes that you're seeing these days?

**Griffin:** Sure thing. Well, one high level thing I'm seeing is I find it really interesting, this contrast between the animal spirits in much of the market and the cautious commentary we are hearing from so many consumer-oriented companies. And these signs of caution seem to relate to both structural and cyclical headwinds.

So first, in terms of cyclical stress, I'm sure all of us have seen many headlines about the current K shape of our economy, where the top part of the K, meaning your higher income demographics are responsible for a larger share of overall consumer spending. And thus far, this wealthiest demographic has been spending enough to support strong economic growth.

However, many consumer-oriented companies are also exposed to the bottom part of the K. The lowest income shoppers have been gradually getting more stretched since inflation started ticking up several years ago, and some companies are starting to see the stress leak into middle income consumers as well.

And to state the obvious, cautious consumers create sales headwinds for consumer-facing companies. These customers are more likely to exhibit value seeking behaviors, such as seeking out promotions or simply buying fewer products. In addition to these signs of cyclical stress, there's also worry about the potential for structural shifts as well, or changes that could permanently affect customers buying habits.

One example of a structural issue is private label penetration. So for many decades, consumers [00:02:00] have been buying store label brands to try to save some money. But more recently, a growing range of customers are buying these types of products, not just to save money, but because of their perceived quality as well.

Other structural issues are the continued growth of GLP-1s, which clearly is impacting people's snacking habits and lower levels of alcohol consumption, which we're seeing more of from younger

demographics. Structural issues not only threaten near term earnings, but if companies feels threatened enough, it can have impacts on management teams' capital allocation priorities, and we have seen an uptick in transformational acquisitions as well as asset divestitures.

And while these types of transactions are somewhat opposite in nature, both of them can have negative implications for bond holders. Large acquisitions typically involved taking on more leverage. Divestitures leave bond holders with a less diversified company.

**Alex:** So then with all of those trends, understandably, you're giving us a lot of the risks to start off with. Do you see any attractive opportunities within those consumer sectors?

**Griffin:** Sure we are concerned about the challenges in the sector. In credit investors receive spread over the risk-free rate to compensate for taking on risk and uncertainty. Right now, risks seem elevated and the landscape seems uncertain while spread compensation remains pretty low. And this compressed spread environment leads us to find more value in the strongest credits.

So overall, we're looking for companies that have world class brands with proven track records for innovation. As well as revenue diversity across both geographies and segments. And in terms of valuation, it's also worth noting the existence of extremely flat, or in some cases inverted consumer credit curves.

And this is due to a mismatch of supply and demand technicals. Issuers have been reluctant to issue long dated paper ever since interest rates started ticking up while there has been a [00:04:00] consistently strong investor demand for long duration bonds, so this mismatch of supply and demand has the long end trading pretty tight.

We seek to avoid paying through our perceived fair value due to short term technicals. So we do see a wider opportunity set in the short to intermediate part of the curve versus the long end due to the curve's shape.

**Alex:** Fantastic. Okay, thank you. So then with your trading background, you have a good record of spotting attractive swaps for the team. What do you look for when you're analyzing those swap opportunities?

**Griffin:** I love this question because to me, relative value swaps are one of the more unique and rewarding parts of working in credit.

Most investment grade issuers have several bonds each with its own unique characteristics, such as coupon, maturity, amount outstanding, and in many cases, structural seniority or subordination. In addition to ensuring we're investing in the best companies through our fundamental credit research, we also seek to optimize our client's portfolios within each issuer's maturity stack.

This means constantly analyzing curves and repositioning into the most attractive bonds in the stack. Ultimately, this is going to be driven by finding opportunities with the best potential for spread compression versus a risk-free rate. We also seek out opportunities to move into items with better downturn

characteristics, such as lower dollar price or stronger liquidity. One thing I really like about swap opportunities is that they're what I call "all weather trades", meaning we can pursue these ideas regardless of the overall spread valuation landscape.

The bond universe is vast and at any given time there are going to be technical factors that make certain similar bonds stand out as rich or cheap versus one another, and it's really exciting trying to take advantage of these mispricing opportunities.

**Alex:** Okay. Thank you. So then last question I have for you on here, the team has been doing a lot of extension trades in corporates. What do you think about these? How do you think about these kinds of trades in respect to the, the ones that you normally do?

**Griffin:** [00:06:00] Sure. Well, as I mentioned when describing the supply demand mismatch earlier, we do still consider 10s 30s curves to be flat from a historical perspective. But recently we have seen some strong performance from certain rolled down 10-to-15 year credits. Not that long ago, this 10-to-15 year bucket had been part of the curve we found very cheap.

But recently it's outperformed, which has us pursuing modest extensions out of these issues.

I think the value we see is best explained In an example, imagine an issue with an established 20 basis point 10s to 30s curve. In other words, if the curve was a straight line, on average, an investor would receive one additional basis point of spread per year.

They extended after all the curve is 20 basis points and they're 20 years in between 10 to 30 years out, 20 years, 20 bips, one BIP per year. However, credit OAS curves, particularly in the long end, are far from a straight line, and we're seeing opportunities where we could, for example, extend from a rolled down 12-year bond into a 17-year bond on the same issuer stack – at, call it pick 10 basis points. So in this example, we're picking two basis points per year. We're extending five years and picking 10 basis points.

We find these opportunities attractive because if curves remain flat, we will have moved into a bond with more attractive annualized roll. And if curves steepened, we'd have now locked in a nice pick for five years while maintaining the opportunity to extend this new 17 year holding into a 30-year later in the future. Even in this compressed spread environment, there are sensible switches we can use as a lever for increased potential spread compression. And this doesn't necessarily need to involve reaching for yield or going down in quality.

**Alex:** Great. Thank you so much, Griffin.

**Griffin:** Thanks so much for having me. This was a lot of fun.

## **Audio Ends**

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