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**MICHAEL HALEY, REORG RADIO:**

Welcome back to another episode of the Reorg Primary View Podcast, where we bring you informed insights on critical issues in the leveraged finance and distressed markets. My name is Michael Haley, Senior Primary Market Reporter at Reorg and I'm pleased to have David Forgash of PIMCO with me today to discuss the future of the leveraged finance market. David leads PIMCO's leveraged finance business, overseeing all high yield bond, CLO, and loan portfolios. Welcome, David.

**DAVID FORGASH, PIMCO:**

Thanks very much for having me, Michael.

**HALEY:**

So David, as we're in October and approaching the next Federal Reserve meeting at the end of the month with a possible rate hike expected. And 10-year treasury yields at their highest since 2007. How are you thinking about these factors impacting the leveraged finance market as we soon head into 2024?

**FORGASH:**

Yeah, well, I mean, that is the question now, obviously, for a lot of people are asking investors as well. And the thing to keep in mind, Michael, a lot has changed over, you know, the past few years, but there's no really such thing as high yield anymore. It's all credit, really. It's just composed of leveraged loans and private credit. And yeah, high yield does make up a significant part of it, but it's a really, it's a 5 trillion market that each replaces each other, you know, at different times of stress to market. So there are opportunities in all of it. You're asking how we, how we're viewing as we headed to the end of the year, well, we're at some pretty attractive levels. I mean, when we look at high yield itself, we're at 9%, or just above 9%. And when I think about investing, just a short time as 2021, I think it was the middle of 2021, we were trying to get a yield of 3.8%, I mean, that was about the average of the high yield index at that time. And if you, if you wanted to really stretch it out, you would have bought some triple Cs, and with certainly more risk involved, at 6, 6 and a half percent, well, you know, that still had a chance of defaults, but now we're in a period where those defaults are potentially higher, still pretty low, but you're getting those same yields, you're getting double Bs at 8%. So the market right now is pretty, and is priced pretty attractively. And as we headed to the end of the year, you know, I see a lot of opportunities to take advantage of that.

**HALEY:**

Great, great, that's great to know, David. Next, I'd like to get your perspective on what the future looks like in terms of new issuance in the high yield bond market for the rest of the year and into next year. I guess what changes can the market expect from bond issuers and new deals that differ from this year's deals?

**FORGASH:**

Yeah, well, so this, this-, what you had in 2021 was a big series of deals coming out that were at unattractive levels and that always happens when there's a flooding of money that comes into the market. So you get some poorly priced deals with some very weak covenants. So as we look into next year, I think one of the things you'll see change a lot, and we've already seen this so far, is a much better covenant package, not perfect, but much better than we've seen in the past. So less concerns about money or assets escaping from the business. So that's a positive for our investors, a positive for ourselves. We always tend to fight for the tightest covenant package possible, but when there's a high level of demand, sometimes those packages still arise. So now we're in a period where rates are higher and borrowing needs are still there. They're not as great as they were, but they're still there. So what I think you'll see going into next year is you'll still see some volumes of new issuance. They'll likely be lower than this year, and they'll likely be mostly for refinance. There's some M&A that's coming down that we know about, and there's some that's been announced. But generally speaking, this year, we've seen mostly refinancing activity. And next year, we think you'll see the same. The difference is you'll decide for those packages if you see when there's a high yield deal coming, they'll be competing interest from either the leverage loan market or what we've seen this year is greater interest from private credit. So that private direct lending mechanism has really stood in at times of either stressing the market or even times like now, when there's just the same different piles of money competing for the same assets.

**HALEY:**

That's a great point you bring in on competing with syndicated leveraged loans and private credit, I guess. Then what does that mean for high yield bonds then when there's these other competing forces competing with the market?

**FORGASH:**

Well, so in some cases, it's quite positive for high yield. So if you think about it this way, yes, it does make competition for the same lending, but there are a lot of deals that would have trouble being refinanced. That now with private credit so available, the last numbers we were able to estimate was about 450 million of- billion, I'm sorry, 450 billion of private credit sitting on the sidelines, cash available to invest. So if you have a high yield deal that's having trouble refinancing, that can be taken out now by private credit and we've seen that happen as it is. And some of it is not just being taken out, some of it is even being used for general corporate purposes. So that I think is where you'll see it helpful for high yield. So in other words, if a company was potentially facing default, now instead of default and the high yield market doesn't want to refinance it, there are other ways for them to get refinanced. So that should help bring down what we would worry about, would be a higher default rate when it's a slowing economy.

**HALEY:**

Right, right, that's good to know. Then I guess what can you expect for high yield bond volumes in 2024 and how are issues looking to address- the looming 2025 maturity wall, issues that once borrowed at 4% to 5%, and they're not looking at higher yields, how are they going to address these?

**FORGASH:**

Yeah, so for some of them, it will be quite tough. We see issuance- and so issuance this year were down about 25% from the previous year and we see it falling still in 2024. So the market is shrinking in high yield, which is giving it a very strong technical backdrop. You're also seeing a lot of rising stars, in other words, companies that were in high yield previously, so call it double B, moving into investment grade. There's been about 70 billion that's fallen out of that market. So in cases like that, the supply that you'll see will be taken well by the market.

**HALEY:**

I guess as an investor, when you're looking at your firm's exposure to new primary bond deals, has there been an increase in pushback on more investor-friendly terms when you're working with syndicate bankers on marketing deals?

**FORGASH:**

So there's always this push and pull. Thankfully, at a place like PIMCO, where we have a lot of size and involvement in the market, we get to push a little bit more than we have to pull. In other words, we get a stronger hand in being able to negotiate some of these terms, as do other investors, and so the primary deals that are coming out, there always will be loose terms that want to be put in. We fight against that, and we'll walk away, and we often do. So if there's a hundred deals that come out, we might just invest in, call it, 20 of them. And in the other 80, we won't, if they don't have the proper terms. So it could just be the docks, it could also just be that there was a bad business model or bad pricing. But it all comes into the evaluation we make when we decide whether or not we're going to invest in any specific deal. So generally speaking, we're pretty conservative with our investors' money. So it doesn't mean we won't move out into very attractive opportunities in the Triple C, but mostly when you're in an environment now where you have nice high yields, so like I said above 9% for the average high yield, you can get Double B’s for 8%. And you can prep those with some really strong Single B’s and bring your full yield up to 8.5%. So you can stay in some very resilient credit, some resilient sectors and avoid, if not all, but at least most, the falls. And therefore, really capture that entirety of that yield.

**HALEY:**

As we’re wrapping up the year soon, how would you categorize this year so far in the high yield primary market? Is it safe to say this year saw tighter spreads with higher yields?

**FORGASH:**

Yeah, so we have seen tighter spreads. And yes, we've also seen higher yields. We ended last year around just under 9% in yield, but spreads were a good 50 basis points wider. So what you've seen is you've seen the base rate of yields moving up, so the underlying government or the SOFR spread moving higher. And while that was happening, you also saw spreads compress and why would that happen? Well, you're getting to more attractive levels where investors come in. So once you get to yields that are approaching 9%, you're really starting to get, those are like equity-like returns. Those are long-term equity-like returns with really historically less volatility than the equity market. So that brings in additional capital. So it kind of puts a top on those yields. So now as we're entering the end of the year and looking to the Fed, whether or not we'll have additional raises, you start to focus on the idea of what's your total yield you're getting and what part of that is spreads. And although spreads might be attractive historically, yields themselves are very attractive. I mean, we're getting yields here that we haven't seen. You know, except for briefly during the GFC, you haven't seen in 15, 20 years.

**HALEY:**

Great. Well, David, thank you so much for your time. It was a pleasure having you on Reorg’s Primary View Podcast and thanks so much for listening.

**FORGASH:**

Thanks for having me, Michael.