Talking investments with Jonh Addeo – Manulife U.S. Unconstrained Bond Fund

The flexibility of the product is pretty attractive for this market environment; we have the ability to manage exposure to floating rate and high yield bonds, up and down depending on where we see value.

This is a tool that we utilize to manage the overall duration or rate sensitivity of the portfolio. Uh, we also think about credit risk in terms of quality.

So we can manage all the way down to triple C junk bonds, uh, up to investment grade corporate credit, uh, depending on where we see good opportunities in market.

The primary investment goal of the fund is to deliver a high level of current income. We do that with a combination of floating rate and high yield bonds.

Everything we do is fundamentally oriented, so what we're looking for are companies with uh, an attractive cash flow generation profile, a reasonable amount of debt and a roadmap for debt reduction over time.

We think of ourselves as, uh, fundamental investors driven by a catalyst for improvement over time. What we really wanna find, are good companies that are migrating toward great companies.

We wanna see over-levered balance sheets, with a road map to de-levering over time, which leads to upgrade from high yield, potentially to investment grade over a period of time, and during that time we're more than fairly compensated with a high level of current income.

The ideas in the portfolio come primarily from the credit analysts that we utilize to, uh, do security analysis. We have a team of twelve credit analysts in the Boston office, who're configured in sector teams, so we have four different teams.

Uh, Telecom, Media and Technology, Financials, Consumer Products, uh, and uh, Basic Industrials. Within the Basic Industrial space, for example, we invest in chemical companies, paper and packaging and steel companies.

Risk management is a very important part of our process. As bond investors, the primary focus is on protection from downside risk.

In the case of high yield bonds and floating rate loans, the upside is quantifiable. We generally expect to receive our coupon over time and par back at maturity.

The downside risk therefore is the critical compliment that we have to manage. Downside risk in less than investment grade credit is effectively default risk.

Over historic periods, we have seen defaults average about three and a half percent in the high yield market and recovery in the event of a default is another critical component in assessing downside risk.

In a case of floating rate loans, we typically see recoveries approximating seventy cents on the dollar in a default scenario. High yield bonds tend to be unsecured claims within those structures and therefore the recovery is going to be less – typically forty cents on the dollar on average.

Through fundamental analysis, we identify those companies where we feel the protection afforded to us as lenders are greatest and that really is driven by cash flow generation and the ability of that management team to reduce the debt burden over time.

We do admit that we make mistakes on occasion and therefore as part of our downside analysis we think about recovery values in the case of a default.

There we look at the underlying asset value of the businesses that we invest in and we also think about the multiples that which these businesses would trade in a public market setting.