Manulife Investment Management

Why is security selection so important to managing credit risk?

Corporate credit spreads are indeed relatively tight right now, trading inside their historical averages, so we think that warrants some caution when it comes to credit risk. From our perspective, the way we're embracing that within our portfolio doesn't mean there's no opportunities in credit, just means you want to probably be a little bit more selective.

For us, our allocation in high yield is towards the lower end of our historical range and within the high yield exposure that we have, it's predominantly focused on higher quality, mostly double exposure, with some select single B and no triple C corporate credit exposure.

Right now, I think given valuations where they are as well, one of the things you want to think about a security selection really becoming even more important at this stage, and that's looking for credit names where you can see some improvement, whether that are so-called rising stars that are high yield issuers that get upgraded to investment grade or could even still be names that remain within high yield, but that see an improving credit profile and that may see some credit upgrades as well. That's the type of security selection that you may want to look for.

Now, outside of just corporate credit, you can look for other ways to express yield and take some spread risk in the portfolio, whether that's through selective things like security sized assets. Now we're still avoiding Central business district commercial mortgages, but within single assets, single borrower or SASB, commercial mortgage banks, we do still find some interesting opportunities in focused commercial mortgages, things like cold storage facilities or biotech life sciences type facilities. We're even just looking at residential pastures. And there you can play. On the strength of the U.S. housing market.

Now, one of the other things that we can look at in a mandate as flexible as ours is looking at other sectors of fixed income for example, taxable municipals. Now that's a much smaller segment of the fixed income landscape, but it's one where you can find high quality investment grade rated issuers that can pay you spreads that are commensurate or in some cases even higher than what you would find from similarly credit quality rated corporates.

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