



GRANT GUYURON, CFA, SENIOR MANAGING DIRECTOR

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### INTRODUCTION

In March, we spoke with many of our clients about buying back into equity and credit markets given the dramatic sell-off of risk assets. For many, we implemented portfolio changes that have added value. Many of our clients are non-profit organizations or retirement plans that have important missions and beneficiaries, so good investment decisions can help a lot of people.

Today, while public markets have experienced a meaningful recovery in value, we know there are businesses struggling to stay afloat because of the COVID-19 initiated recession – many may not survive or will need to declare bankruptcy. Therein lies the opportunity today: distressed businesses. We think this is the time to deploy capital to funds that can take advantage of these investment opportunities.

### THE OPPORTUNITY SET

All is not well in the global economy, though we are beginning to see positive signs (e.g. improving employment figures and positive trends in PMIs). There are many businesses that have been disrupted by the lockdowns and social distancing mandated by governments to help prevent the spread of COVID-19. Companies connected to retail, travel and leisure, real estate, and energy sectors have generally been hit the hardest, but the pain is more widespread.

## CLEARSTEAD CONTINUES TO BOLSTER TEAM WITH NEW TALENT

We are pleased to announce that we have added talent to the Research & Investment Management, Private Client, and Reporting & Operations teams with Svetlana Loshakov, Kayleigh Cowser, and Abby Hausman, respectively.

Svetlana Loshakov has joined Clearstead as a Senior Managing Director, Alternatives. Svetlana has spent the past 19 years at Agate Fund Management (previously Moreland Management Co.) as an Investment Analyst, Investment Officer, Managing Director, and most recently, President of the firm. Svetlana received a Bachelor of Science from The Academy of Oil and Gas in Moscow, Russia and a MBA from Southern Methodist University. She is a CFA charter holder.

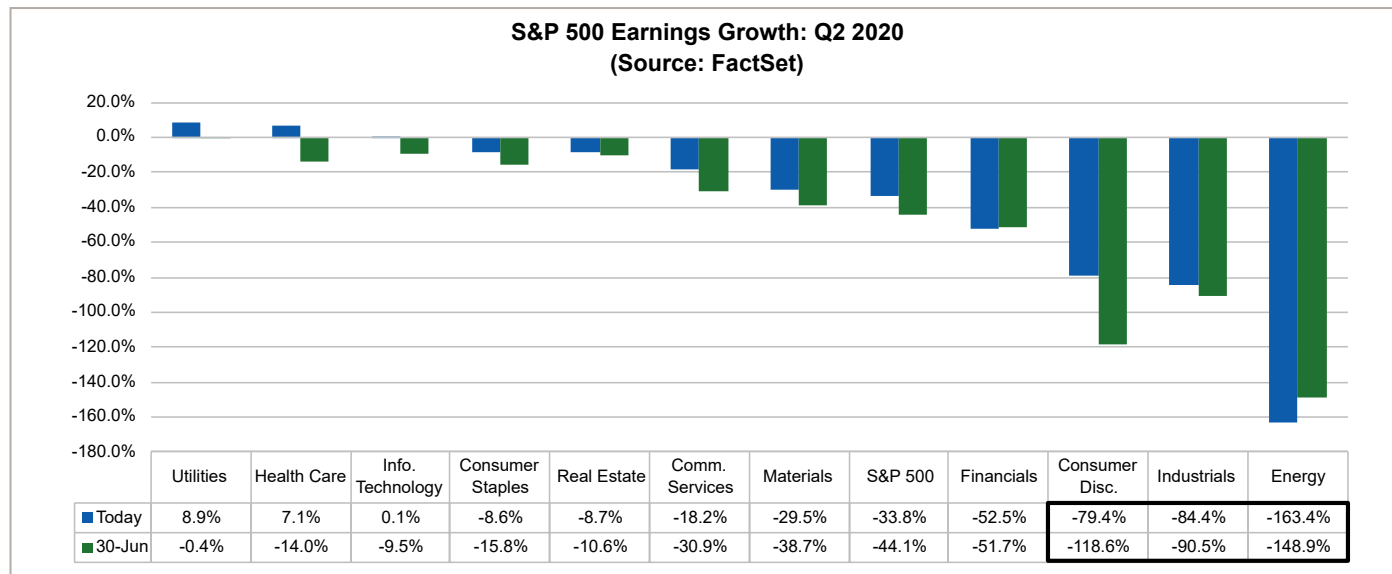
Kayleigh Cowser has joined Clearstead as Trust and Estate Planning Counsel. Kayleigh has a BA from Ohio Dominican College and a JD from the University of Akron. Most recently, Kayleigh has been employed at the Lynch Law Group as Estates and Trusts Attorney, handling estate planning and administration, tax preparation, guardianships, and family law planning.

Abby Hausman has joined Clearstead as a Performance Analyst. Abby recently graduated from Baldwin Wallace with a bachelor's degree in Business Administration and Finance.

These changes underscore the firm's commitment to building its investment consulting and financial planning practices, promoting the next generation of leadership, and maintaining a rigorous investment process.

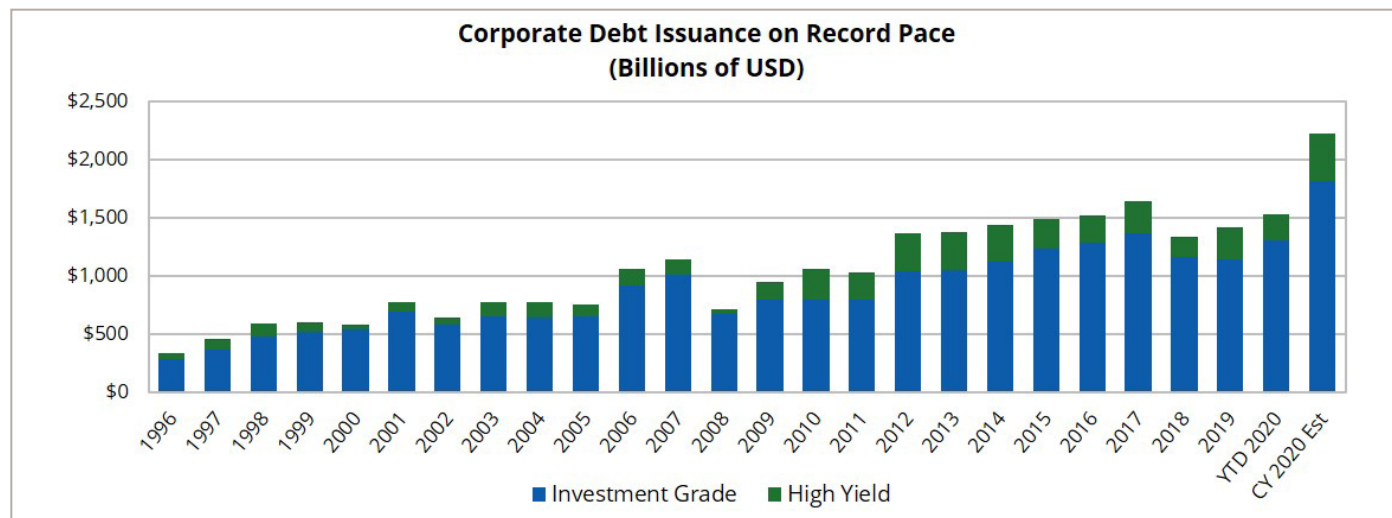
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We have begun to see a wave of bankruptcies in 2020, including some name brands such as Hertz, J.C. Penney, Brooks Brothers, and Neiman Marcus. Bankruptcy does not mean these companies are shutting their doors forever, but it does mean that they are unable to fund their obligations and may require restructuring. This can mean equity values are erased, jobs are lost, factories are closed, or assets are liquidated. Chapter 7 bankruptcy sets up a trust to liquidate assets and pay creditors, while Chapter 11 bankruptcy allows companies to reorganize, restructure and emerge in a stronger position. While we have seen some notable companies file for bankruptcy in 2020, the number of companies filing has also picked up considerably. In Q2 2020, 75 companies with at least \$50 million of liabilities declared for bankruptcy protection, which is the highest number of bankruptcies in a quarter since 2009 and the second worst quarter ever<sup>1</sup>. Year-to-date, that number is 160. Though it is impossible to predict how many companies ultimately will file, we are expecting the surge to continue. This will create opportunities for investors who buy the debt, particularly those higher in the capital structure, as they can participate in the restructuring of the company. Distressed debt investors can ultimately take equity positions in the company, focus on improving the business and financials and then exit to generate attractive returns.

Outside of bankruptcy, there is also opportunity to invest in corporate bond issues that are trading at stressed or distressed levels that may experience price appreciation. The sale of a company or refinancing of the debt could create such a situation for investors. As you can see in the chart below, we have seen a tremendous amount of corporate debt issuance so far in 2020 and are on pace for a record year; much of this is related to refinancing.



Source: Historical and YTD 2020 from SIFMA & Refinitiv, as of 4-Aug. CY 2020 Est. from Moody's Weekly Market Outlook, 4-Jun.

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Meanwhile, spreads of high yield bonds relative to government and investment grade bonds remain near historical averages, and remain attractive. Given the environment, we believe that active management is best situated to assess credit risk and identify undervalued securities.

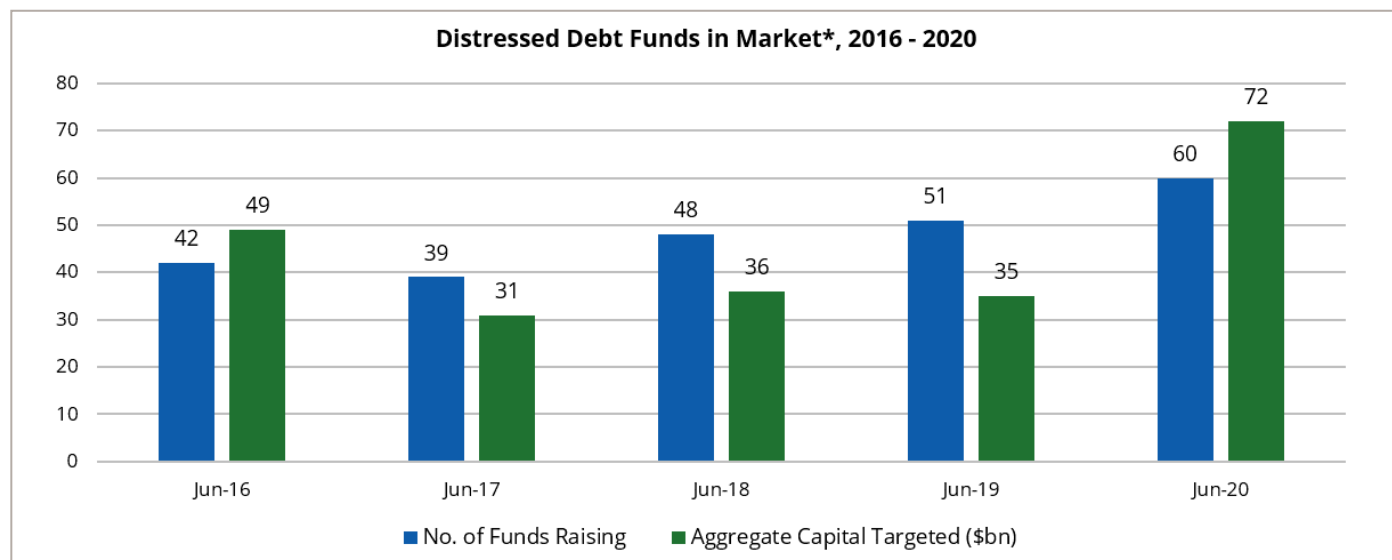
## INVESTMENT VEHICLES

Current opportunities in credit markets can be exploited through limited partnership structures such as private equity and hedge funds or through mutual fund vehicles or separately managed accounts for more liquid opportunities. To invest in stressed and distressed companies, we recommend private strategies, which better align the liquidity of the investment vehicle with that of the underlying securities. Depending on the client, we have been implementing one or more of these strategies to take advantage of market opportunities:

VEHICLE	PRIVATE EQUITY	HEDGE FUND	MUTUAL FUND / SMA
<b>Liquidity</b>	Illiquid (7 years+)	Monthly/Quarterly	Daily
<b>Strategy Focus</b>	Distressed credit	Stressed and distressed credit, trade claims, shorts	Below investment grade bonds
<b>Use of Leverage / Derivatives</b>	Yes	Yes	No
<b>Return Potential</b>	>15%	10-20%	4-8%
<b>Volatility / Principal Risk</b>	High	Moderate to High	Moderate to High

Return Potential performance is hypothetical based on the historical performance of investment vehicles in the listed strategy. Clearstead makes no representations that the Return Potential can or will be achieved. Past performance is no guarantee of future results.

We are finding opportunities among private equity and hedge fund managers to deploy capital in the credit markets. Managers too have recognized the opportunity and are raising funds in an asset class that has seen a decrease in fund raising in recent years:



Source: Prequin Pro. As of 6/30/2020.

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51 distressed debt funds raised approximately \$35 billion in 2019 versus 42 funds that raised \$49 billion in 2016: in 2020, firms are collectively targeting \$72 billion in capital<sup>2</sup>. Fund raising has begun to accelerate in recent months, with many notable firms holding large or final closings. Clearstead has been evaluating these strategies for many years and began allocating to these opportunities more aggressively in the last year.

## CONCLUSION

There are and likely will continue to be opportunities to invest in distressed credit. The unknown is the timing about making these investments. Some investors believe the economy will experience a v-shaped recovery, which may lead to a smaller investment window. Others are of the opinion that we will experience more of a gradual, u-shaped recovery, and there will be more corporate casualties. We believe we have investment solutions that can capitalize on both of those scenarios, and we are making them available to our clients.

### Sources:

- (1) Bloomberg. US Bankruptcy Tracker: Retail, Energy Set Grim Milestones.
- (2) <https://www.preqin.com/insights/research/blogs/record-number-of-distressed-debt-funds-in-market-amid-downturn>.

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*Performance data shown represents past performance. Past performance is not indicative of future results. Current performance data may be lower or higher than the performance data presented.*

### MARKET BENCHMARK RETURNS

August 31, 2020		1M	3M	12M	YTD
US Large Cap	S&P 500	7.2%	15.5%	21.9%	9.7%
US Small Cap	Russell 2000	5.6%	12.4%	6.0%	-5.5%
Developed Intl	MSCI EAFE	5.1%	11.3%	6.1%	-4.6%
Emerging Intl	MSCI Em Mkt	2.2%	19.5%	14.5%	0.4%
Real Estate	NAREIT	0.3%	7.0%	-9.2%	-11.5%
Core Fixed	BarCap Agg	-0.8%	1.3%	6.5%	6.9%
Short Fixed	BarCap 1-3Yr	0.0%	0.4%	3.7%	3.1%
Long Fixed	BarCap LT G/C	-3.7%	2.9%	10.9%	14.4%
Corp Debt	BarCap Corp	-1.3%	3.6%	7.1%	6.7%

Source: Bloomberg

Past performance is not indicative of future results.