Interview with Lori Pomerantz, Lead Portfolio Manager – High Yield, Bank Loans and Opportunistic Credit

Goldman Sachs' Lori Pomerantz discusses developments and investment opportunities in US credit markets

*Lori Pomerantz is **Lead Portfolio Manager on the High Yield, Bank Loan and Opportunistic credit teams within Goldman Sachs Asset Management Fixed Income**. Prior to joining GSAM Fixed Income in 2020, Lori was a Vice President in GSAM's Alternative Investments and Manager Selection (AIMS) business. Lori's expertise spans a variety of sub-asset classes, **including High Yield, Leveraged Loans, Investment Grade, Multi-Sector Fixed Income, Structured Credit, and Municipals,** as well as **ESG incorporation** into those strategies. Prior to Goldman, she spent 12 years as a High Yield and Leveraged Loan Credit Analyst at BNP Paribas, Macquarie Capital, Citigroup, and Lehman Brothers. Lori earned a **BBA with concentrations in Finance and Accounting** from the Ross School of Business at the University of Michigan and currently serves on the Advisory Board of Governors for the Ross School.*

1) US credit markets experienced sharp swings in both directions last year. What is your outlook for credit markets in 2021?

We are **constructive** on the credit markets. We believe a combination of macro and corporate forces should **keep credit spreads within a relatively tight range**, therefore making **coupon income** the dominant component of excess returns.

We believe that **friendly macro policies** alongside **vaccine-driven growth improvements** will bolster corporate fundamentals and will support credit markets in 2021. From a technical standpoint, credit markets also benefit from **robust investor demand given the low yield environment.** This is evidenced by limited new issue concessions.

More specifically, with central banks remaining dovish and growth optimism building, **we see value in cyclical segments of credit markets**, such as US high yield, which we expect to deliver total returns of 4-5% this year. We also see value in **broadly syndicated bank loans** given coupons will reset higher alongside any growth-driven rises in rates. Our bank loan return forecast ranges from 4.5-5.5% driven by coupon income as well as modest price appreciation.

2) What macro trends will impact credit markets as we head into the summer?

We are entering a period of **positive macro data momentum** as encouraging vaccine rollout allows for a normalization in corporate operating environments. This will allow companies to **improve balance sheet positions**, and brightens the outlook for **earnings and revenue growth**, which will result in **natural deleveraging**. In our view, sequential progress in balance sheet positions will be particularly notable in virus-sensitive sectors such as Airlines and Leisure that will benefit to a greater degree from normalization of high-contact service activities.

Inflation is another macro trend that is top of mind for credit investors. We believe **growth improvements** will be accompanied by **tamer increases in underlying inflation**. That said, we acknowledge that **near-term**

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inflation data will be volatile and may trend higher in response to transient factors, such as statistical base effects, higher oil prices, an unwind of policies such as VAT rate cuts, and a pick-up in certain services prices.

While we do not expect inflation to trend meaningfully higher on a sustained basis at the macro level, our corporate credit research analysts are **mindful of inflation dynamics at the sector level**. For example, **consumer goods companies** face higher input costs ranging from food, chemicals and packaging. These will **weigh on profit margins in the near term**, though we expect the impact to be partially offset by technology-driven productivity gains and cost controls. Broadly speaking, the extent to which corporate profit margins will be impacted by higher input costs will depend on their **ability to pass through higher costs to end consumers**, as well as the **buoyancy of the economic recovery**. Overall, our analysis suggests raw material prices are an important determinant of input cost measures relative to labor costs.

3) What Macro developments should credit investors be mindful of?

The main macro market event in 2021 to date has been a **rise in rates**. For credit markets and risk assets more generally, the driver of a rise in rates is important. Typically, **growth-driven increases in rates are not cause for concern for credit spreads,** while a rise in rates in response to pulled forward prospects for easy policy withdrawal can be a headwind.

Our base case expectation is for **spreads to remain relatively well-behaved** given the **supportive policy and growth backdrop.** In fact, bouts of spread widening, perhaps around rate increases driven by solid incoming economic data, may present an **opening to add idiosyncratic exposure to certain high yield rated corporate bonds and bank loans.** Nonetheless, we recognize that a tight starting point for spreads does create room for widening, underscoring the **importance of astute security selection.**

Beyond developments in rates, we are closely following the **evolution of the pandemic**, **consumer behavior** as normal spending opportunities return, **measures of underlying inflation pressures** and **US tax policy** announcements.

4) What credit developments are you keeping an eye out for in 2021?

As the economic recovery gains traction, we will be monitoring **corporate management behaviors.** Paradoxically, successful vaccine rollout and raised growth expectations **increase the risk that management teams abandon conservative mindsets** and opt for **behaviors that can weaken balance sheet positions.** This includes **re-leveraging and equity-friendly behaviors**, such as share buybacks and dividend payments. For example, an increase in leverage may arise from debt-funded mergers and acquisitions (M&A) as fiscal support lifts risk sentiment and leads companies to deploy cash buffers accumulated over the past year towards M&A. Lastly, we continue to carefully watch the industries which have been most impacted by the virus, particularly those exposed to the consumer and the reopening theme.

Our dynamic process that is driven by fundamental bottom-up analysis and complemented by our top-down macro theses allows us to add/trim positions depending on the changing economic conditions.

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