Media release

Nordic High Yield beckons with ten-percent returns

The sea on the Nordic High Yield market remains choppy on account of diminished oil prices. Much intuition and expertise is needed to select bonds. Rising oil prices will drive rates back up again in the medium and long term.

February 1, 2016. **The drop in oil prices has called a halt to the boom on the Nordic High Yield markets. Returns are now temptingly high at around ten percent, especially in the present low interest rate environment, but DNB experts predict payment defaults in the market as a whole. That said, the fund managers of DNB High Yield have been little affected by defaults. To keep things that way they have made efforts to shield the portfolio from future defaults. A tax-transparent fund under Luxembourg law has now been put onto the market for investors with a medium to long term horizon.**

Low oil prices have been badgering Scandinavian high yield energy bonds. Nobody in the High Yield market can say exactly when the bottom will be reached, but many individual issuers and bonds within the energy sector now seem attractive. The market as a whole also looks attractive with gross returns of around ten percent. “Investors with a long term horizon looking for returns on their portfolio in today’s low interest rate environment can begin to build up positions,” says Hagen-Holger Apel, Senior Portfolio Manager at DNB Asset Management in Luxembourg. On top of that, access to this market recently became easier for professional and small investors alike. The DNB High Yield has been on the market since 11 November 2015 as a fund under Luxembourg’s SICAV law. This product is a tax-transparent fund which mirrors the DNB High Yield fund available in Norway since 2012. Both funds are run by a team of portfolio managers based in Bergen, Norway.

Nordic High Yield is a 27 billion euro market involving primarily Norway and Sweden. More than half of the high yield bonds in the market come from issuers who receive their orders from the oil and gas industry.

Oil prices should recover

Whether an investment in the Nordic High Yield market pays off will depend very much on the development of oil prices. The oil price has already fallen to a level that has provoked massive cuts to investment plans from the oil companies and we do not believe that the oil price presents much of a downside risk from here. “The industry is in its comfort zone when oil costs between 65 and 80 dollars,” says Hagen-Holger Apel. A barrel of oil currently changes hands for around 30 dollars, but recovery looks likely medium term. Economists at DNB Markets predict an oil price level of between 70 and 80 dollars for the next one to two years. Whether these experts are right depends very much on Saudi Arabia, and to be precise on the amount of oil which the world’s biggest producer pumps out of the ground. The Saudis have been keeping output artificially high since last year, thereby quite intentionally squeezing prices. Their main aim by keeping prices low is to force American shale oil producers with their higher production costs out of the market, the fracking boom having made the USA the world’s biggest energy producer in 2014. The Saudis, however, cannot survive for ever on these kind of competitive prices. Because many projects no longer pay off at the current oil price level, output has dropped long term “A reduced oil price has led to a reduction in investment in the exploration and production sector,” says fund manager Svein Aage Aanes. “This will lead to rapid depletion in oil production in the years ahead. It isn’t a question of whether the oil price and with it the Norwegian kroner will recover, it’s about when.”

The supply of corporate bonds in the Nordic market has widened considerably in recent years. The Scandinavian High Yield market was itself a growth story from 2001 to 2014; in Norway alone the annual volume of high yield bonds issued rocketed from 45 to almost 110 billion NOK. Half of Norwegian industrial companies have already raised outside capital by issuing bonds. That means it is now possible to build up a highly diversified portfolio of high yield bonds in different sectors.

Higher risk of defaults

Tougher regulation of financial institutions in the wake of the financial crisis is perhaps the most important cause for the surge in new issuers to the market. New capital requirements have made banks more hesitant to grant loans, especially in the high yield area, and as a result many companies are meeting their need for outside capital by issuing corporate bonds. The oil price shock has called a halt to this growth story within the energy sector. This year's volume of high yield issues in Norway is only half what it was in 2014. The simple reason is that there is less to finance. Because of low oil prices, oil producers (such as Statoil) have cut investments are refraining from developing new fields. That means less orders and therefore less cash flow for service providers. Because less money is flowing into the tills there is more risk of payment defaults. "We will see restructuring and there will be defaults," says Hagen-Holger Apel. However, credit spreads in the market have widened considerably for bonds in the oil services sector, thereby compensating for the increased default risk in the sector.

Well diversified portfolios reduces default risk

The more challenging the environment, the more experience is needed. DNB High Yield was approved in Norway in 2012; Svein Aage Aanes, Head of Global Fixed Income, and Anders Buvik, its fund managers in Norway, have so far been little affected by defaults. To increase the likelihood that things stay that way they have built up a highly diversified portfolio. There are at present around 82 different issuers in the portfolio and the exposure to the energy sector is below 30%. The focus is on companies with solid, stable cash flows and strong balance sheets who use their liquidity efficiently and are likely to keep up with their payment obligations. In excess of 90 percent of the portfolio is invested in securities with a BB/B rating. Whenever there are defaults on the Nordic High Yield market, most of them affect the CCC+ segment and below.

And should there be a default, its influence on the fund will be limited. With around 120 different bonds, the fund is highly diversified. Only a few of its positions account for more than two percent.

One such security is the high yield bond issued by Petroleum Geo-Services, or PGS for short. What the fund managers like about this technologically cutting-edge service provider in the 3D seismics segment is that, compared to its rivals, its balance sheet is strong. Its buffer of liquid funds for the coming twelve months is higher than average and its risk-to-revenue profile is attractive.

Away from the oil industry there is AINMT Scandinavia Holdings, to mention another specific investment. This company benefits from the protection of the competition watchdog, since Tele2 Norway has been taken over by Telia Sonera, causing a concentration of the market. The Scandinavian mobile services provider's business is well protected by high entry barriers; its investment program is flexible, expenditure can be postponed if necessary, and a financially strong owner will most probably step in and guarantee repayments in the event of an emergency. These products are mentioned as examples; the Scandinavian High Yield market also contains bonds from other sectors such as Real Estate and Seafood, and of course many industrials.

It is however unadvisable to invest in single securities. The opportunity-to-risk ratio is much more attractive in highly diversified funds. Because there is always the chance of heavy fluctuations, patience and a medium to long term investment horizon are needed to ride out volatile phases.

About DNB and the High Yield Fund

DNB Asset Management is a leading Scandinavian asset manager offering investment products within the Nordic asset classes and in selected other themes. DNB Asset Management is owned 100% by DNB Holding ASA, which in turn is one of the oldest and most successful financial services providers in Scandinavia. In the Fixed Income segment DNB and DNB Asset Management are among the largest and most competitive suppliers in Scandinavia. The consistent high yield investment strategy, which is based on a bottom-up analysis, allows investors to participate in above-average interest rate premiums and simultaneously reduces the risk of individual single investments. The DNB High Yield Fund (LU1303786500) is managed by Svein Aage Aanes, Head of Fixed Income and Fund Manager Anders Buvik. The fund managers are based in Bergen, Norway. Currently, the fund combines around 120 individual securities with an average yield of about 10% and a duration of about 0,98.

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