July 26, 2024

JUNE 2024

15 years of Fulcra

Intro

Before diving into our latest investment commentary and analysis we would like to acknowledge that Fulcra, as of July 2024 is celebrating 15 years of investing in credit markets.

Thank you to our investors who have trusted us to protect and grow their assets. Fulcra reflects both the honor and duty we feel towards our work to generate strong returns for our investors.

The firm was started with the fundamental principles of integrity, deep research and finding unique investments within corporate credit markets as pillars. Today, these principles continue to guide the firm as we sit at what seems, for capital markets, a point of change.

With the quick rise in government bond yields over the past two years it is probable, in our opinion, that the full impact of the increase in borrowing costs hasn't impacted the economy yet.

Firm Update

Some exciting firm developments:

- Crossed $500mm AUM in the Lysander-Fulcra Corporate Securities Fund managed by Fulcra in partnership with the exceptional team at Lysander Funds.
- Expanded our investment and trading capabilities with the hire of Adam Burns (ex.-NBF and BMO credit trader).
- Opened an office in Toronto to support the growth of the firm.

As always, we continue to work hard to identify the best risk-adjusted return opportunities within North American credit markets for our investors. We hope to continue providing industry leading returns for the next 15 years!

Market Commentary

The second quarter is behind us and as always, there were many interesting market events and themes to navigate.

Key events:

- The Bank of Canada cut their overnight lending rate
- US President Joe Biden's mental health questioned after presidential debate
- S&P500 ended at all-time highs
- US high yield credit spreads traded below +350 basis points for the entire quarter

Key themes:

- Commercial real estate risk
- Private credit liquidity
- AI and the "Magnificent 7"
- Energy infrastructure transition

As we pointed out in our last quarterly commentary, market conditions have been ripe for primary market activity. Indeed, we continued to see strong performance in new issuance and refinancing transactions throughout the quarter.

Fund flows into the iShares iBoxx High Yield Corporate Bond ETF (HYG – NYSE), the largest high yield ETF by assets, were -2.08bn, +2.52bn and -239mm in April, May and June respectively. Rolling 5-year US interest rates peaked in April at 4.72% and closed out the quarter on the low at 4.37%.[1]

Portfolio Activity

Q2 was very interesting from a portfolio perspective.

We have a good opportunity during the April market sell-off to add to some core positions in companies like Cineplex, Parkland and EG Global Finance.

We also added new positions in Cascades, Summit Midstream and Hertz.

In Cascades we found an attractively priced bond maturing in January 2025. The bond was purchased at a yield-to-maturity ("YTM") of 6.03% when the yield on 6-month government debt was 4.88%. This spread of 115bps over the risk-free rate looked attractive at the time and we increased the position later in the quarter after the company announced they had secured a line of credit to repay these bonds.

Summit Midstream is in the process of deleveraging its balance sheet. The company expects to complete a comprehensive refinancing in Q1 2025. The bond was purchased with a YTM of 8.76% but we anticipate that the company will repay these bonds at an earlier date. If these bonds are indeed called at the end of Q1 2025, its yield-to-call jumps to 9.22%.

Hertz is undergoing a strategic shift in fleet composition under new management. We saw attractive value in the bankruptcy exit term loan around 11% YTM and an interesting tactical investment in the near dated 2026 maturity bond around 15.6% YTM. During the quarter, Hertz raised debt capital in the form of a senior secured bond as well as a new convertible bond. The financing helped to improve the liquidity and financial flexibility to see the company through previous management's failed EV strategy.

Risk Philosophy

A key mantra that we repeat daily in both life and investing is "be patient."

In investing, patience really is a virtue and influences two very important portfolio management traits.

The first is the patience to avoid buying high or, paying too high a price for a security. With credit index spreads near the bottom of their historical ranges we are cognizant of the fact that credit market "beta" has become expensive.

We are not rushing to buy new issues nor are we trying to chase secondary trades higher. Credit spreads can always go tighter but history shows that the risk-reward for committing capital to higher duration credit risk is skewed negatively.

Source:

[1] Bloomberg L.P.