# Lead Left Interview – Andrew Brady (Part 2)

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**This week we continue our conversation with Andrew Brady, Managing Director and Leveraged Loan Portfolio Manager of Marathon Asset Management, L.P. Marathon is a global credit manager with approximately $13 billion of capital under management investing in the global credit markets.** ***Second of two parts – View part one***

***The Lead Left: You mentioned health care. What happens if ACA is repealed?***

**Andrew Brady:** We've long been skeptical about investing in U.S. healthcare companies given the globally unique structure and levels for U.S. pricing. Pharma, for example, is much more expensive than elsewhere. That's also true of training, services, hospitals and devices, for a variety of reasons, but not including universally healthier people or better outcomes. One key factor is that the largest payors, especially most government bodies, do not or cannot negotiate for group discounts. Despite stable and growing healthcare needs, fixed income investors have seen plenty of defaulted borrowers across the healthcare industry, often from mandated changes in pricing of services or products. If the prevailing pricing structure changes, there is real downside for many companies, especially those with high profits margins and high debt loads. Hospitals, pharma, lab testing, dialysis, PBMs, and ambulatory surgery centers could all see more pressure. It is difficult for debt investors, with no upside participation, to be properly compensated for such risks. Changes in insurance programs such as higher deductibles have contributed to more attention on abusive pricing such as Mylan's Epipen and others where marketing seems to triumph over efficacy.

***TLL: What are Marathon's strategies given all this?***

**AB:** We continue to seek opportunities in performing and distressed credit situations in U.S. and European corporates, emerging markets, and asset-backed securities through long, paired, and short positions. We do not assign high probability to a recession anytime soon, or another wave of defaults in sectors beyond the existing problems in commodity sectors. However, we see a growing supply of corporate credits with little room for error, questionable earnings, less equity subordination, and more downside for lenders given weak documentation.

The asymmetry of risk versus return is not properly priced into various parts of the market. When too many credits are priced the same, one can conclude that many are mispriced. For example, after the U.S. high-yield bond market dropped 3% to 4% intra-month for five of six months through February 2016, we found many compelling values when higher quality credits were dragged down by weaker compatriots. Many high-yield bonds have rallied over 20% since then, compressing spreads to tight bands for very different credit risks…and the cycle repeats.

Investors still face significant risks and uncertainty including changes in government policy, opacity from China, and eventual normalization of unprecedented central bank policies that have dominated many markets and contributed to certain asset bubbles. For example, the recent recovery in Treasury yields from the lows in June after the Brexit referendum, when investors succumbed to the dangerous mentality that is was impossible to overpay for government debt, has seen some prices down over 20% for long-maturity sovereign bonds. While global equities have recently appreciated over $1 trillion, rising sovereign yields have led to $1.7 trillion of losses for the Barclays Aggregate Bond Index. That was a retracement of bond gains earlier in 2016, when sovereign debt outperformed nearly everything. But that was far from normal or sustainable.

***TLL: So where is the value to be found?***

**AB:** We think fundamentally selected high-yield corporate credits remain among the most attractive fixed income assets. Another value-priced asset class is junior debt tranches of certain CLOs, which are floating rate and have significant collateral. The keys are to diversify and understand what you're buying, avoiding credits subject to evaporation risk, potentially evident in certain technology sectors, and tranches with weak downside protection. We remain focused on each company's competitive position, asset values, insulation from obsolescence, management credibility, junior capital with skin in the game, and real free cash flows. Such situations, particularly with appealing return prospects, are not abundant given present market pricing and documentation.

***TLL: How do you find good opportunities?***

**AB:** Across our strategies and offices, we follow hundreds of companies around the globe and constantly learn about others. We remain agnostic toward most sectors and assets, and patient in deploying capital. We tend to find the best opportunities in specific situations that other investors choose to avoid, whether due to complexity, credit ratings, industry troubles, or necessary debt restructurings. We remain an active participant in syndicated markets and frequently create our own opportunities in more stressed credit situations, such as debt-for-equity exchanges or debt-for-debt swaps.

***TLL: So Andrew, what is your role in all of this?***

**AB:** For over 12 years, I have served as portfolio manager for performing corporate credit, including various high-yield loan and bond funds, managed accounts, and CLOs with roughly $3.5 billion of assets. Marathon's role differs from many asset managers by not excessively focusing on AUM growth. We rejected issuing CLOs in 2006 and 2007, for example, and have not rushed to issue one this year despite being the first to raise risk-retention capital. In fact, we created a CLO warehouse in late 2015 but chose to liquidate recently rather than issue the CLO to realize the strong investment results. This risk retention capital will allow us to continue our historical equity investments in vehicles we manage for issuance over several years.

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