JAG CAPITAL MANAGEMENT LLC

JAG Team Insights

JAG Fixed Income Thematic Insights: Q4 2024

Total reading time = 2 minutes

Don't Miss the Trees for the Forest

Clients often ask us which corporate sectors, credit tiers, or tenors of the yield curve our team finds attractive. These are reasonable questions routinely addressed by fixed income managers. We tend to reframe the premise when asked ourselves. Rather than assigning outlooks to categorized segments, we prefer to identify those segments where we see investment opportunity and to highlight overlapping traits among recent purchases. To some, this may appear to be a question of semantics, or it may seem that these answers should be equivalent; however, the original question assumes a certain level of nuance, and, to us, the distinction is important.

These traits – sector, credit quality, and position on the curve (including duration) – do greatly influence prices. We certainly assess our own holdings within this framework. However, many of our competitors allocate tactically around these risk factors, over- or underweighting specific segments based on short-term trends or top-down analyses. By contrast, our portfolio exposures seldom translate into categorical "likes" or "dislikes." Differentiation at the security level is paramount to our process.

To understand why, one must first recognize the unique concentration of JAG's fixed income strategies. Our portfolios typically comprise 40 to 50 individual positions while the universe of intermediate bonds contains more than 5,000 corporate issues and 1,000 or so Treasury and agency bonds. The benchmark indices are also heavily skewed toward the largest issuers, with thousands of individual securities essentially amounting to rounding error. For us, this means each of our roughly equal-weighted positions represents a significant deviation from the benchmark. These high active weights magnify the differences between our holdings and any aggregated segments they belong to.

Additionally, bonds have significant differentiation within conventional segments. Wide price dispersion (i.e., differences in yield) exists between bonds even after controlling for many risk factors. This is likely common knowledge, but its extent is perhaps not well known. We contend that, excepting some investment professionals and regular market participants, most mainstream investors have not experienced this phenomenon first-hand. Admittedly, the variance in expected returns in fixed income is less captivating to many audiences than that in equities, but with focused position weights and prudent selection we can compound these excess return opportunities over time.

The exhibits below depict outstanding bond issues in the intermediate corporate bond universe as of November 29th. Each dot represents a single bond issue, and we narrow the focus to highlight certain segments. Extreme outliers have been excluded to improve visibility. Through this lens, it becomes apparent how one's opinion of an individual bond can easily differ from one's overall opinion of the various groups and categories it falls under.

Exhibit 1: Intermediate investment-grade corporates (excludes extreme outliers)

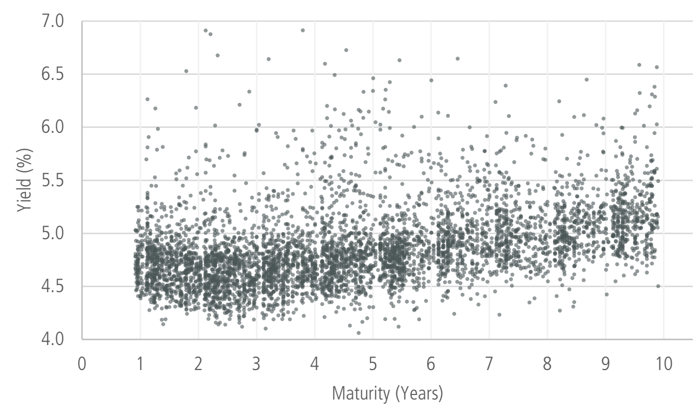


Exhibit 2: Financial sector issues in green

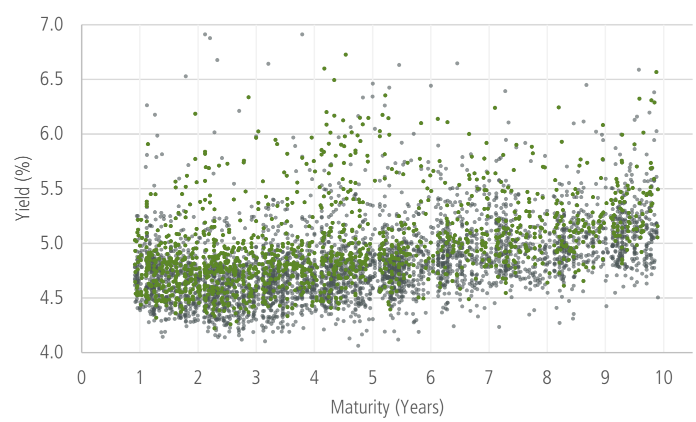


Exhibit 3: Single-A rated issues in blue

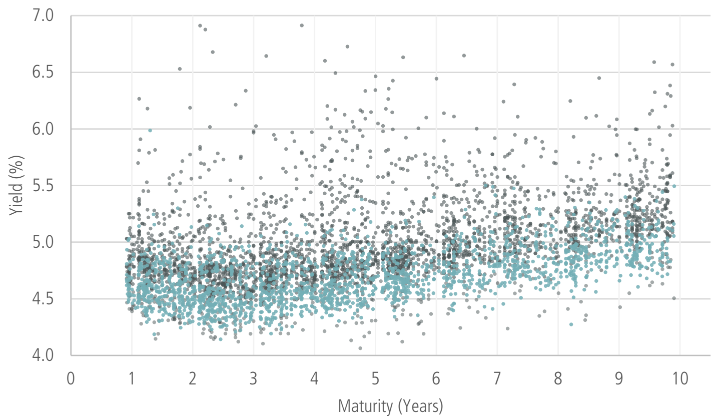


Exhibit 4: Single-A rated, financial sector issues in yellow

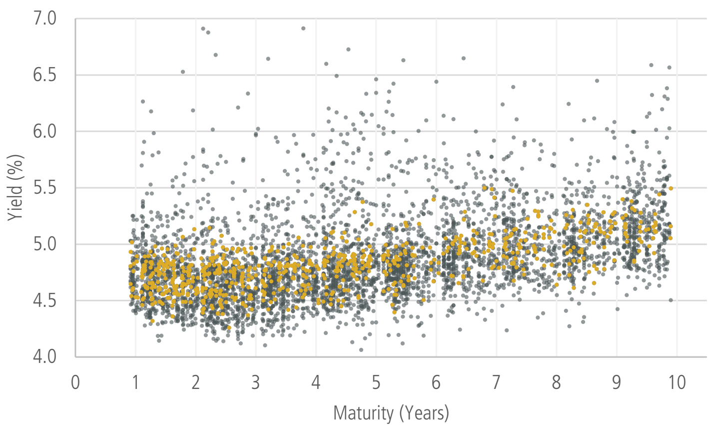
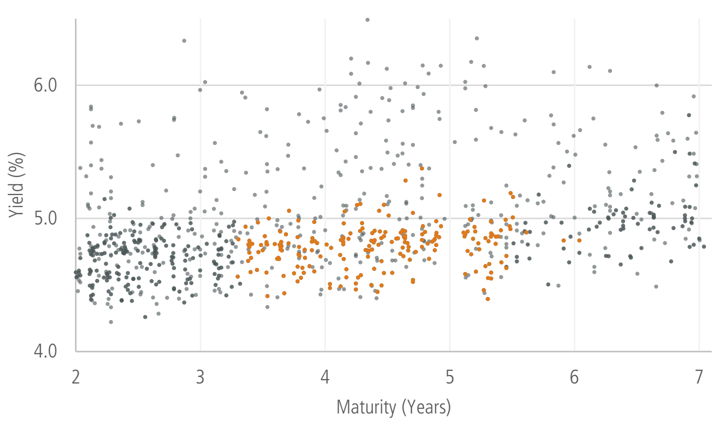


Exhibit 5: Single-A financials only; those with 3 to 5 years of duration in orange



Source: Bloomberg Finance LP, JAG Capital Management

In the final exhibit, we apply a rather narrow combination of parameters: single-A rated issues in the financial sector having 3 to 5 years of duration. As illustrated, an investor still has myriad issues to choose from – 202 to be exact – with a roughly 1% gap between the highest- and lowest-yielding issues in the group.

Importantly, higher-yielding issues should not be presumed to be attractive on a risk-adjusted basis. Many factors, including issuer fundamentals, specific bond features, and liquidity, can explain the market's discounting of these bonds. One may also determine that none of these bonds are appropriately priced, either based on each bond's own merit or because better opportunities exist elsewhere.

Returning to our original premise, we believe the question of which segments are attractive belies an approach that may be common but is not our own. JAG's philosophy is to surveil the full opportunity set, continuously searching for high-conviction ideas worthy of meaningfully sized positions. We find this approach to be well-suited to our philosophy of focusing on credit selection and fundamental research.

– JAG's Fixed Income Research Team

Disclosures

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A Veteran Owned Business (VOB) is a business owned, (51% ownership or greater) by a Veteran who has met the definition of a veteran. The following represents the criteria that the National Veteran Business Development Council (NVBDC) uses in determining ownership:

Ownership: Fifty-one percent ownership by a Veteran or Veterans. The applicant must share in all risk and profits commensurate with their ownership interest.

Control and Management: Proof of active management of the business. Veteran must possess the power to direct or cause to direct the management and policies of the business.

Contribution of Expertise and Capital: Contribution of capital and/or expertise by Veteran owner(s) to acquire their ownership interest shall be real and substantial and be in proportion of the interest acquired.

Independence: The Veteran owner(s) shall have the ability to perform in their area of specialty/expertise without substantial reliance on non-Veteran-owned businesses.

About JAG

JAG Capital Management (JAG) actively invests for institutions and individuals in highly selective, customizable, and nimble equity and fixed income strategies. JAG is a boutique, independent, employee-owned investment management firm in St. Louis.

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