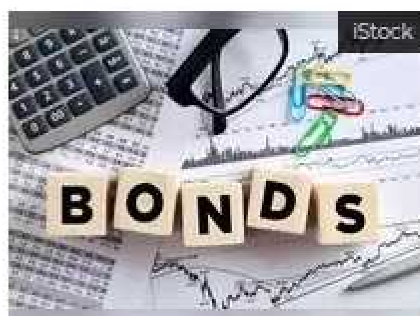
THE ECONOMIC TIMES | Markets
English Edition | Today's ePaper

High yield credit investing due for exponential growth in India

By Sameer Chhabra, ET CONTRIBUTORS • Last Updated: Jun 18, 2024, 11:44:00 AM IST

Synopsis
High Yield Credit funds, also called 'Performing Credit' funds, primarily invest in bonds issued by SMEs or structured corporate issuances. These bonds are typically bilateral agreements between issuers and investors, characterized by low liquidity, which translates into higher yields for investors.



The most common solution to a balanced and risk controlled portfolio has been to diversify across various asset classes, thereby providing a combination of growth and stability through risk reduction. The assets include equity, which provides growth, debt, which provides stability and diversification, and various alternative assets to reduce correlation in the portfolio.

Debt investments, which deliver moderate yields to the portfolio, also enjoyed a tax advantage through the mutual funds route till recent times. Insurance as well as Market Linked Debentures were other debt investing vehicles enjoying tax advantages.

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Debt mutual funds continue to be popular and form a significant part of most HNI portfolios. They take exposure to listed and well rated bonds with low to medium yields in the range from 6%-9%. They avoid high yield credit bonds for a variety of reasons primarily led by illiquidity and higher risk. High yield credit investing, which focuses on yields above 10%, has stayed in the domain of alternative investment funds, serving a very niche market of investors during its early days.

Emergence into mainstream

High yield credit gained prominence after several macroeconomic events in the aftermath of the IL&FS crisis, leading to NBFCs vacating the lending space, to eventually the change in tax regime governing debt mutual funds in the 2023 budget. The new tax rules sought to remove tax arbitrage from all avenues.

This has led to investors seeking alternatives to debt mutual funds. Market participants have also moved quickly to offer debt solutions to replace or enhance portfolio returns for investors. Options ranging from Long Duration Gilt Funds, Corporate Deposits, Bonds, Credit mutual funds and securities, to AIF alternatives such as performing credit funds, Real Estate Bond funds, Infrastructure Yield Funds, Venture Debt Funds, Distressed Credit funds etc. now form the expanded set of debt investing options.

Driven by the need to earn sufficient returns, investors have turned to such higher yield alternatives to boost their portfolio returns. Many of these options which were earlier not preferred due to the tax advantages of mutual funds have now become part of the regular options.

One such category to have become a mainstream are High Yield credit funds. Popularly termed as "Performing Credit" funds, these usually contain bonds issued by SMEs or structured issuance by corporates for funding specific transaction, event based capital needs, corporate restructuring etc. for which banks typically do not lend. Such bonds are bilateral transactions between issuers and investors, have low or no liquidity and therefore offer high yields to investors. Performing credit, which has an established presence in the Western world, has also found traction in India in recent times.

A word of caution

Higher yields earned from underlying debt investments are due to their bespoke nature and the higher risks in the underlying investments. These underlying investments are fairly illiquid and require longer holding periods from investors. Also, since they are structured to suit the primary lender, they are mostly unlisted. Overall, higher the yield earned by investors, higher is the risk borne by them. Investors need to be cognizant of the underlying risk and returns characteristics when they invest in higher yield alternatives.

On the flipside

Despite these risks, High Yield credit investments have features that make them valuable to investor portfolios. These investments are less sensitive to macroeconomic events as they are bespoke in nature. Also, due to illiquidity, the underlying investments do not witness panic selling or market valuations drawdowns. Another feature which sets them apart is the several covenants included in the terms between the borrower and lenders, which allows the lenders to take preventive action in case of early signs of trouble with the borrower.

High Yield credit investments are well suited for portfolios with longer time horizon which focus on higher yields or cashflows and are not looking for high liquidity. Many institutional investors find them suitable in matching liabilities with their cash flows.

Category for the future

There is growing interest from both sides as both borrowers seek specialized credit solutions and investors seek higher yields for their portfolios. Overall, this space of High Yield Credit investing is due for exponential growth in the days ahead, expanding debt options for the Indian investor.

(The author Sameer Chhabra is Executive Director, Private Wealth, JM Financial. Views are own)

(Disclaimer: Recommendations, suggestions, views and opinions given by the experts are their own. These do not represent the views of The Economic Times)