PM Spotlight: A stock-picker at heart manages high yield bonds

Sarah Harrison, Senior Portfolio Manager, Plus Fixed Income

This issue of *PM Spotlight* profiles **Sarah Harrison**, senior portfolio manager for Allspring's Plus Fixed Income team. From starting her career during the Global Financial Crisis to managing a high yield climate transition fund, Sarah embodies Winston Churchill's motto, "Never let a good crisis go to waste."

Q: WHAT LED YOU TO BECOME A PORTFOLIO MANAGER FOR HIGH YIELD FUNDS?

A: It's always been about companies for me—even in college. I studied business because I was very interested in how companies operate, how they set strategy, what makes a company succeed when another fails. I've always enjoyed investing—especially at the company level. But early on, I had actually ruled out working in fixed income as an asset class. In fact, my university investment club bio said that I'd like to work in any asset class other than fixed income. Then I discovered credit during my internship in 2008 and realized it was really another way to think about companies, along with a multitude of other factors. That year also happened to be a very interesting time to delve into credit. I've analyzed and managed a wide array of sub-asset classes within fixed income, including short maturity, convertibles, financials, and investment-grade credit, but I've always come back to broad-market high yield credit.

So, obviously a company's fundamentals are first and foremost when you're investing in a high yield bond. I'm a stock-picker at heart, and you can generate considerable returns by picking the right credits at the right levels. But there are so many other things that we look at. There are different market forces contributing to the technical. There are the funky structural anomalies. You can put on event-driven trades. There are loads of really interesting niche things that you can do as a high yield investor. It's just a great asset class—especially if you tend to be a little bit nerdy.

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Q: WAS THERE ANY PARTICULAR MOMENT OR TRADE THAT MADE YOU FALL IN LOVE WITH HIGH YIELD?

A: I enjoy the credit underwriting process and getting under the hood of companies that aren't necessarily well covered or well understood by the market. I like the market aspect as well—where issues are trading, what moves the markets. It's quite exciting and dynamic. Especially now, with inflation and rising rates creating volatility, I'm looking forward to exploiting more opportunities for the portfolios.

My first great high-conviction trade in high yield was during my early analyst years. It was in an independent power producer that ticked all the right boxes from a fundamental perspective and also had another interesting aspect to it. With high yield, there is a lot of documentation associated with every company and every bond issued. That documentation differs from company to company and bond to bond, laying out the structure of a specific bond deal. When you're deciding which company and which bond to own, you have to carefully consider this structure. In this case, the bond included a make-whole provision in a non-call life structure. Essentially it meant that the company could choose to repay bondholders at any given time, as long as it also paid the net present value of all coupons. This particular bond had a significant coupon and no call protection, and so the repayment amount would be chunky.

There are many reasons a company might use its make-whole call, but in practice it's very rare. We made the call that one of the firm's largest shareholders would eventually want to acquire the company and the bonds would eventually be taken out to make the combined company's capital structure more efficient. That gave us significant upside potential to the acquisition, whereas bond investors are often disadvantaged when a company is acquired, if the bond is trading at a high level and a change of control affects that. The acquisition went through, giving us that upside in a position we owned in size in every possible strategy it would fit in. Finding these technical things that affect valuation is, for me, the most interesting part of being a high yield investor. There are just so many things that you need to identify, consider, and incorporate into your analysis beyond fundamentals, which makes high yield such an exciting asset class.

Q: YOUR CAREER STARTED IN THE AFTERMATH OF THE GLOBAL FINANCIAL CRISIS AND THE GREAT RECESSION. THAT TIMING MUST HAVE HAD QUITE AN IMPACT ON YOU.

A: I think it helped shape my attitude toward risk—seeing how wrong things can go and how quickly markets can move. That happened again during the eurozone debt crisis in 2011 and, of course, during the COVID-19 pandemic sell-off in 2020. Those experiences can help you better understand the parameters of the market so you know what a bear case really looks like. If there's a 5% chance that things could go wrong, you end up thinking about that 5% chance even more and what the world might look like if you hit that tail scenario. You plan for that potential and you get better at quickly adapting to a changing market environment after you've managed capital through so many extreme cycles.

Q: THERE'S BEEN A LOT OF FOCUS ON GENDER DIVERSITY IN THE INVESTMENT INDUSTRY OVER THE PAST SEVERAL YEARS, BUT IT SEEMS THAT THERE'S BEEN LESS PROGRESS IN FIXED INCOME THAN OTHER ASSET CLASSES.

A: There haven't been many female portfolio managers in high yield generally across the industry. It would be great to see that change, and it's great to see that Allspring has many women in very senior portfolio management roles—especially within fixed income. What you see across the industry is a huge effort to make sure there's diversity at the junior level, but it drops off around mid-career point. Then when organizations start thinking about filling senior-level roles, the pipeline just isn't there. I look at the sheer number of women at Allspring who are running very successful businesses and I see a path for women, which I think is why there's been such good retention at the mid-level to get to the very senior level.

The firm also values other forms of diversity beyond gender. The Plus Fixed Income team has many seasoned investors who've experienced multiple cycles, and I think we all bring different views to the asset class. So, for example, I might be more open to a technology company than someone 20 years my senior. Someone from a different region might have unique insight into solar energy providers. We really do value different experiences and different backgrounds and how that contributes to diversity of thought.

Q: YOUR PORTFOLIO RESPONSIBILITIES INCLUDE A CLIMATE TRANSITION HIGH YIELD FUND. WHY COMBINE THE ENVIRONMENTAL FACTOR WITH HIGH YIELD EXPOSURE?

A: I am a huge proponent of environmental, social, and governance (ESG) integration. I truly believe that it can contribute to generating alpha, and I can think of many examples where ESG factors have helped me avoid landmines and identify true credit improvement stories. Data is improving, but it's still difficult to demonstrate the impact on a portfolio's performance beyond the outliers. And so, understandably, some investors want to know how can they audit outcomes, what's the data around it, how can you prove that you're doing what you say you're going to do? To me, that shows investors are looking for something that's data driven, that's quantifiable, that's transparent and auditable. And I think our climate transition framework is all of those things.

There's quite a lot of capital that's financing the transition to an economy with net-zero emissions. We're investing in companies knowing that it's a long path to get to net zero by 2050. The transition will take decades.

Climate transition is another lever that we can pull to analyze companies, manage risk, and generate return. No company can abstain from the climate question—the transition will affect everyone. This is just another way of taking high yield risk for high yield returns while supporting companies in their transition and not giving up performance. Allspring has set our priorities, with climate being number one, because we believe it affects everything.

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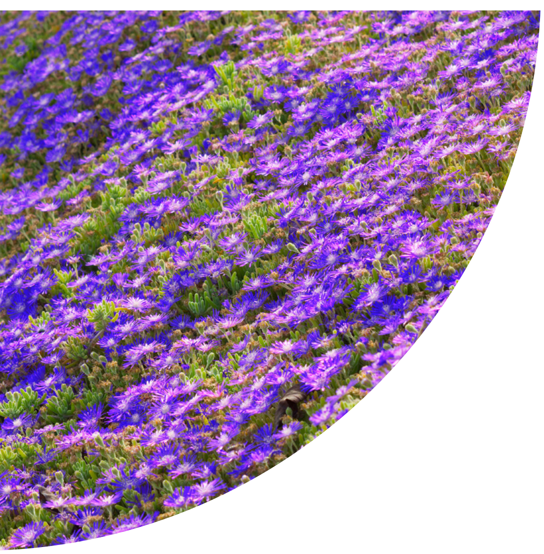

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