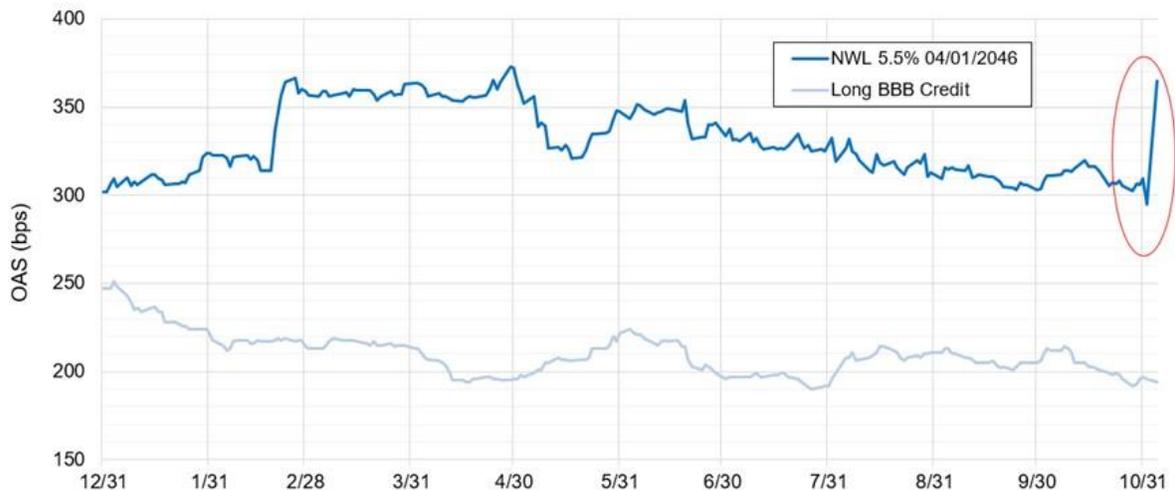




## Fallen Angels, Ratings, Active Management, and the Value of Security Avoidance

Last week (11/1/2019) Newell Brands' (NWL) bonds were officially downgraded to junk when S&P joined Fitch in rating NWL BB+. Ratings sensitive owners become "forced sellers" and passive Index managers get handed losses. In this example, the forced selling occurs as NWL moves from the US Credit Index to the High Yield Index at the end of this month. The graphic below highlights NWL's underperformed YTD but this also illustrates the "forced sellers" in action:



*NWL spreads have widened 63bps year to date, while Long BBB credit has tightened 53bps*

*Source: Bloomberg, 11/4/2019*

In our experience the market generally begins to front-run a ratings move long before the rating agency's eventually act. Fundamental active managers start to price in the increasing risks and probability of a downgrade associated with a company. Security avoidance, as in this case, can be an extremely important part of portfolio construction and risk-adjusted, fundamental active management.

At Smith Capital Investors we strongly believe in the importance of security avoidance, validated by the recent spread widening in NWL.

We see additional fallen angels (investment grade company being downgraded to junk) on the horizon.

Caution is warranted. Research is essential. Opportunities ahead.

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