Seeking Alpha α

Closed End Funds

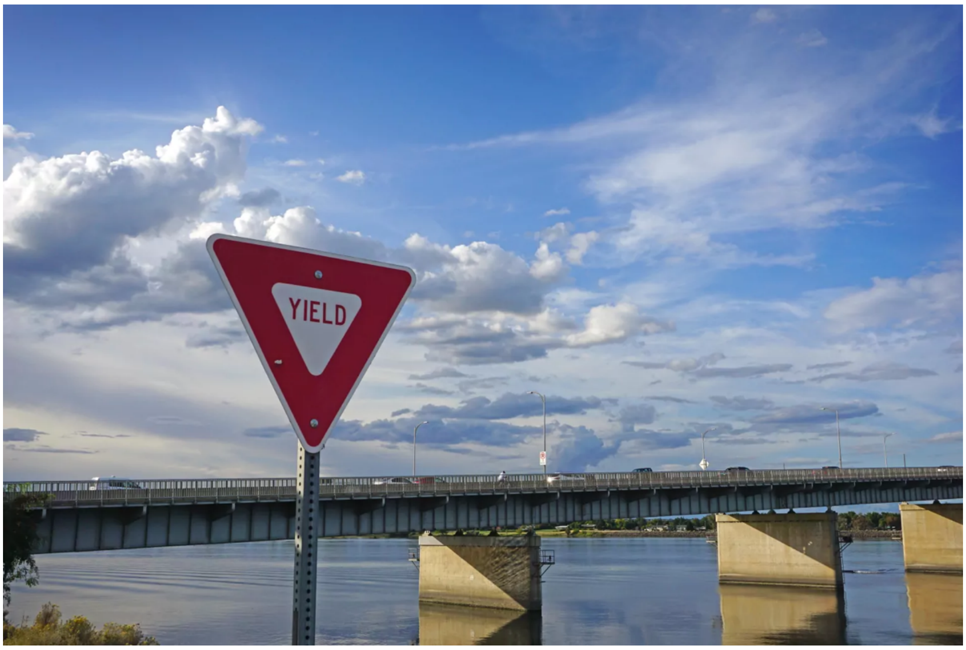
Prudential's PGIM Global High Yield Fund Stands Out From The Pack

Jun. 27, 2021 3:43 AM ET | **PGIM Global High Yield Fund (GHY)** | MCI, MPV | 41 Comments | 36 Likes

Summary

- Prudential's PGIM Global High Yield Fund rings my bell on several accounts.
- 8% yield, 7% discount, 9% annual total return over 5 years.
- Great parent with lots of expertise in corporate credit.
- Over 50% of its ownership by other large institutional and mutual fund investors.
- Less risky credit profile than many other high yield funds.
- This idea was discussed in more depth with members

of my private investing community, Inside the Income Factory. Learn More »



smodj/iStock via Getty Images

PGIM Global High Yield Fund Stands Out

Two weeks ago I told my Inside the Income Factory® members that I was buying PGIM Global High Yield Fund (GHY) and listed some of the key things I liked about the fund.

PGIM is Prudential Global Investment Management (i.e. the "Pru"), one of the best in the business when it comes to private corporate credit. When I had my first journalism job 30 years ago covering the private placement market for *Investment Dealers Digest*, there were a few major insurance companies that dominated the private credit business, and Prudential was one of them. It was firms like Prudential and other firms (including Mass Mutual which owns Barings, whose funds we also like and have written about) that essentially started the business of what we now call "high yield credit" back in the mid 1900s.

There was a time when commercial banks only made short-term loans to corporations. Bankers gradually extended them out to several years and they came to be known as "term loans" in the 1950s. Beyond a couple years, companies that were big and well-known enough to have credit ratings in the investment grade category (i.e. triple-A, double-A, single-A and triple-B) could float public bonds and obtain longer term credit that way. Other companies were essentially out of luck.

Life insurance companies, which had "long-tailed" liabilities (i.e. future death claims that could be actuarially projected) needed longer-term assets, and realized that credit had more easily modeled and predictable cash flows than equity. So when a few creative commercial bankers, who had good borrowing clients that needed longer term loans than commercial banks were capable of providing, began to introduce these clients to their local life insurance companies, the insurers were happy to step up and begin making longer term loans to these bank clients.

That was how the "private placement" market was born. The corporate borrowers were non-investment grade, but they had good credit records and were in good standing with their local commercial bankers. Otherwise the bankers wouldn't want to introduce them to their life insurance counterparts, since the bankers wanted to keep on recommending and introducing other clients, and they didn't want to ruin their reputation and poison the relationship by introducing potential deadbeats.

So for years, the only practical way a non-investment grade company could get longer term credit was by tapping the private placement market, which was primarily dominated by life insurers, who had billions of dollars of long-term money and were happy to make the additional basis points spread on the investments that the private placement market offered over the public bond market.

You might ask, "Well, weren't these riskier credits than the public bonds that were all investment grade credits?" The answer was, "Well, not necessarily." That was because in the privately placed credit market, lenders often obtained collateral and/or "protective covenants" which gave them lots more control over the borrower during the life of the credit (e.g. the ability to accelerate payment if certain performance and operating leverage ratios weren't maintained, etc.) or a "second way out" in the event of default.

Things changed when Michael Milken and Drexel Burnham introduced "high yield bonds" that created a whole new market for long-term non-investment grade corporate credit.

Privately placed bonds and notes, of the sort Barings Corporate Investors (MCI) and Barings Participation Investors (MPV) still originate, are more tightly covenanted and/or have equity features, warrants, convertibility, etc. While GHY appears to be more of a conventional high yield bond fund than MCI and MPV, its sponsor PGIM shares that credit tradition. And it's this rich credit culture and experience that firms like PGIM/Prudential and Barings/Mass Mutual bring to the high yield credit market today that give them, to my mind, a certain credibility.

So that is data point number 1 in my approach to GHY, the quality of its sponsor and the professional resources behind it.

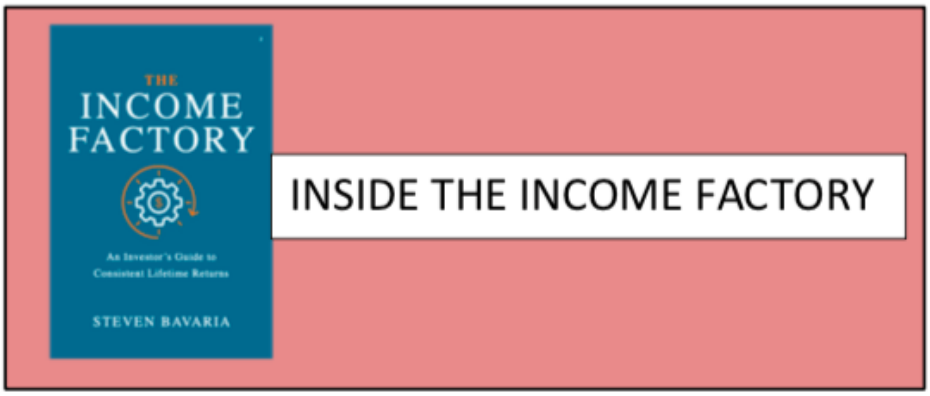
Turning to the numbers, GHY is unusual in the high yield fund arena in that it pays a distribution yield above 8%, and sells at a discount of about 7%. There is not a single fund in the high yield or senior loan category that yields over 8% and has as high a discount as GHY. It has also earned an annual total return over the past 5 years averaging about 9%, which isn't spectacular but certainly adequate, especially including as it does the market crash of early 2020.

From a credit risk perspective, GHY is unusually "non-junky" in its portfolio, in that a full 42% of its portfolio is double-B and above. While double-B is non-investment grade, it is at the high end and substantially less default-prone than lower-rated high-yield credits.

Finally, GHY is 52% owned by institutional investors and other mutual funds. Whether this means that it is being targeted by activists or merely represents a quality investment that appeals to other professional investors is immaterial to me. But with an 8% yield, a still pretty healthy discount, highly professional and capable management, and with a large group of knowledgeable and well-heeled co-investors, this looks like an opportunity to me.

It declares its monthly distributions three months ahead, which I also like.

Despite all these positives, GHY gets very little attention here on Seeking Alpha, with the last public article written about it over two years ago.



I launched **Inside the Income Factory** because many of my 11,500 followers and readers of my book **The Income Factory®** (McGraw-Hill, 2020) said they wanted more interactive dialogue than I could provide through public articles. It allows me to answer more member questions about how to use an **Income Factory** to earn "equity returns" from more predictable "non-equity" asset classes.

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Thanks,

Steve Bavaria

This article was written by

Steven Bavaria
11.6K Followers

Author of **Inside the Income Factory**
Real-time insights and alerts on all our Income Factory™ model portfolios

Disclosure: I am/we are long GHY, MCI. I wrote this article myself, and it expresses my own opinions. I am not receiving compensation for it (other than from Seeking Alpha). I have no business relationship with any company whose stock is mentioned in this article.

36 Likes

41 Comments

Comments (41)

Sort by Newest

WealthVenue Yesterday, 2:56 PM

Comments (7) | + Follow

aren't you worried that those shares are trading near 52wk high in this overbought market?

Reply Like (1)

Steven Bavaria Today, 8:48 AM

Marketplace Contributor Premium Comments (3.22K) | + Follow

Author's Reply @WealthVenue I like the 7% discount, which gives us a margin of safety. The fund only has to earn 7.5% on its assets in order to pay us 8.1%. That's a "bonus yield" where we only have to take a 7.5% risk in order to earn an 8.1% yield. If buying assets at par, you'd have to buy a riskier portfolio to earn 8.1% than you would to only earn 7.5%. So we're getting that extra yield for no additional risk.

Reply Like

BeaJawa

Yesterday, 1:23 PM

Comments (6.88K) | + Follow

the h/y total bond index is now yielding less than the latest CPI print..so there is a negative real yield in the unlevered aggregate of h/y bonds.. nearly all CEF's are horribly overvalued due to the yield chasing going on- compounded by the recent influx of retirees in developed markets because of covid..
aided by a 39yr bull market in bonds overall, these funds will be horrible producers in the coming years when rates turn up -or even at flattish rates. The zombie corps were either pushed out of biz or have taken advantage of income mania to push out maturities and some got lower rates in the bargain--but that does not 'negate' the lack of FCF to support eventual repayment.. tread lightly!

Reply Like (1)

Steven Bavaria

Yesterday, 2:08 PM

Marketplace Contributor Premium Comments (3.22K) | + Follow

Author's Reply @BeaJawa I wouldn't confuse the "bond market," essentially investment grade bonds, and which is primarily a bet on interest rates (i.e. not much of a credit bet), with high yield corporate bonds and loans, which are true credit investments with much shorter repricing periods where you get more of a reasonable equity-like return for the risk you are taking. Especially if you invest in them via the closed end fund market with its other advantages, like discount prices and cheap institutional leverage. As I explain in my article, "The Alchemy of Closed-End Funds..." referred to in other comments. seekingalpha.com/...

Reply Like (1)

BeaJawa

Yesterday, 2:20 PM

Comments (6.88K) | + Follow

@Steven Bavaria confused I am not dearest.. have been investing in CEF as a student of Herzfeld since the 80's.. now is not the time to buy for sure

the market is offering CNC 2.45% for 7yrs on it's recent junk bond sale..think of that.. even at 2% inflation, you have negligible returns assuming you get the principal back. Also many of the bonds today are covenant light..a look at how that worked out in energy bonds is a glimpse of principal being crushed. **

There is nothing wrong w GHY..in Feb/Mar '16..or Nov/Dec 18...or in the covid swoon.. these funds are always a trade and 'past performance is not an indicator of future returns'.. something so many forget..important sure..but don't keep your fingers crossed on 9% going forward.

**The top holding of GHY is Chesapeake Energy SHARES..which I am sure they got as a result of bond 'restructuring'.. recent S&P and Moodys' corp upgrades helped GHY and others avoid looking 'junkier' ..we'll see how long that lasts

Reply Like (2)

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etfman

Yesterday, 10:34 AM

Comments (102) | + Follow

I am long GHY.

Reply Like

Monthly Income Investor Yesterday, 10:22 AM

Comments (273) | + Follow

This fund is interesting and I am putting it on my list. My concern is 2012-2016... Nav was getting killed, and they kept cutting the distribution. Then the Nav sort of levelled between 2016-2021, yet they kept cutting the distribution til 2019..seems they were trying to find the level where the distribution was covered. Makes me nervous that a company of this size and skill, took 7 plus years to figure out how to cover the distribution, and not lower nav. Seems like they have figured it out, over the last couple of years, now that nav is flat, and distribution is covered(even raised twice), just not sure if to contribute it to the pandemic... or if PRU has figured it all out. I might take a flyer on it.

Reply Like

Ron1634 Yesterday, 10:32 AM

Comments (296) | + Follow

@Monthly Income Investor - The current NAV is lower than it was in 2013 and the distribution is lower than it was in 2015. That does not bother you?

Reply Like (3)

Monthly Income Investor Yesterday, 10:45 AM

Comments (273) | + Follow

@Ron1634 absolutely! I guess my point didnt come across like I wanted it too. From 2012-2016...Nav and distribution fell and got cut...that makes me very nervous. Seems like 2016-2021 they started to figure out nav vs covered distribution. Nav is flat, and distribution is increasing again. Heck if they can keep Nav flat, and give a 8-9% distribution, I would be happy. I need to figure out, what happened between 2012-2016, and what changed to improve from 2016 to 2021.

Reply Like (1)

Ron1634 Yesterday, 10:52 AM

Comments (296) | + Follow

@Monthly Income Investor - You already own UTG, as I do. That has consistently grown its NAV and raised its distribution several times in the last 10 yrs. That is the kind of CEF that I want. Otherwise, I focus on ETFs

Reply Like (3)

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alohabernie Yesterday, 10:09 AM

Comments (25) | + Follow

Great article been following this cef for a long time looking closely at it now

Reply Like

ChristopherSmith

Yesterday, 9:02 AM

Comments (650) | + Follow

Great article, and I agree and am long GHY. I believe that Prudential has done well managing this fund. Two other of their offerings ISD and SDHY are also worth a look......

Reply Like (1)

growtheretirement

Yesterday, 8:58 AM

Premium Marketplace Comments (153) | + Follow

Is this CEF related to the mutual fund PBHAX?

Reply Like

Steven Bavaria

Yesterday, 9:23 AM

Marketplace Contributor Premium Comments (3.22K) | + Follow

Author's Reply @growtheretirement
PBHAX is a traditional open-end, mutual fund also managed by Prudential, that holds high yield bonds. It is more domestic US and less global than GHY.

Without the cheap leverage and discounted price offered by GHY, PBHAX hasn't been able to earn as high a total return, for reasons outlined in the comments below and the article cited: seekingalpha.com/...

But it has a respectable average 6-7% total return over the past 5-10 years, not as high as GHY's 9% over the past 5 years (GHY hasn't been around 10 years yet.)

Reply Like

sc21 Yesterday, 9:40 AM

Comments (2.91K) | + Follow

@Steven Bavaria
Thank you for an interesting piece. While they may be different, in your view can you suggest which of the two funds GHY and MCI runs a greater downside risk. From your comments within the piece it sounds like you think GHY may run a slightly higher risk level but the wording is less than clear to me. TIA SC

Reply Like

wwn2001 Yesterday, 3:12 PM

Comments (4.22K) | + Follow

@sc21 I assume that the one with the higher distribution yield has the higher risk (GHY).

Reply Like

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Texas_bullet Yesterday, 8:15 AM

Premium Comments (7) | + Follow

Thanks for the coverage. I own this and have not seen any coverage on SeekingAlpha.

Reply Like

gastro4 Yesterday, 6:10 AM

Premium Marketplace Comments (1.24K) | + Follow

Are the distributions covered by the NII are is there ROC?

Reply Like

Ron1634 Yesterday, 8:35 AM

Comments (296) | + Follow

@gastro4 - For at least the last 12 months it has been covered by income, but I don't like the deterioration of the NAV over the long term.

Reply Like

Steven Bavaria Yesterday, 8:51 AM

Marketplace Contributor Premium Comments (3.22K) | + Follow

Author's Reply @gastro4. The five year total return averages over 9% per year, fully covering the distribution on NAV of 7.5% and the distribution paid to shareholders (due to the discount) of just over 8%. Whatever return of capital exists in that distribution is therefore "constructive" and has NOT eroded the price or NAV of the shares over the past five-year period.

This Eaton Vance classic article of "demystifying" return of capital may be useful: funds.eatonvance.com/... *(edited)*

Reply Like (1)

Ron1634 Yesterday, 8:57 AM

Comments (296) | + Follow

@Steven Bavaria - Steven, Looking at the NAV history on GHY (morningstar), I see that it was 19 in 2013 and now it is 16.6. Is that deterioration or am I missing something?

Reply Like (1)

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sumurand

Yesterday, 5:03 AM

Comments (21) | + Follow

In fairness I think your article should have warned more conservative investors the fund's results are dependent on using 27% leverage.

Reply   Like (4)

Mason Peck

Yesterday, 8:17 AM

Comments (83) | + Follow

@sumurand Precisely 27 to 50 percent leverage are capital eaters if when anything at all goes wrong for lack of a better word!

Reply   Like (2)

Steven Bavaria Yesterday, 8:43 AM

Marketplace Contributor Premium Comments (3.22K) | + Follow

Author's Reply @sumurand The ability to access cheap leverage at rates available to institutional investors (1-2%) is one of the big advantages of investing in closed-end funds. Along with the ability to buy funds at a discount and have more assets working for you than you actually have to pay for.

GHY offers both of those advantages. Those features are why closed-end funds can routinely hold assets that may offer a "natural" yield (if held in an un-leveraged, un-discounted portfolio) of, say, 6%, and pay a fully-earned distribution of 7.5 or 8%.

I wrote about this - the "alchemy" of closed-end funds - several months ago.
seekingalpha.com/...

The "more conservative investors" you speak of in your comment may wish to forego these sorts of 7-8% yields and accept the "safety" of 2-3% yields offered by traditional bond portfolios or whatever else you regard as "safe" asset classes.

Reply Like (12)

efrith

Yesterday, 12:15 PM

Comments (58) | + Follow

@Steven Bavaria thanks for another great recommendation. Just a suggestion / request for a future article, based on your answer above: I would love to see a rack-and-stack of CEFs and/or fixed income ETFs that you like from safest/least volatile to higher risk/higher reward. For example, maybe it would go SHY, LQDH, BHK, DSL, GHY. (Just off the top of my head.) I know diversifying asset classes within CEFs is a key part of your strategy, but I know when I'm filling my income portfolio, I also like to think about "what can I count on to maintain a fairly stable value in case I need to dip into this" (for a home purchase, e.g.). Thanks again for all the great public work.

Reply Like