

# Distressing debt

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It's been a tough time for short sellers lately. The 'dash for trash' that I wrote about in this column last week, has been indiscriminate. Even real no-hoper shares have benefited. The most headline-grabbing example of investors' willingness to overlook all fundamentals in their hunt for 'trash' has been the strong performance of shares in US companies that have already declared bankruptcy or are about to (Hertz, JC Penny and Cheapsake being a few stand-outs).

There is actually an easy-to-overlook logic to this bankruptcy trade. This type of stock can see a short-term fillip as investors that have shorted the shares cover their positions, creating a so-called 'short squeeze'. Over recent weeks, this phenomenon may well have been exacerbated by enthusiasm about economic recovery prospects. Still, this is a trade few would want to take on given the likelihood shares in bankrupt companies will ultimately prove worthless.

But looking more widely at the share price gains from some of these truly diabolical situations, it may be tempting to think investors who

want to play the 'dash for trash' should simply seek out shares in the lowest quality companies; the worst-of-the-worst, if you like. However, ignoring 'quality' when it comes to buying beaten-up stocks (the kind of shares found on these pages in our tables of shorts, downgrades and 52-week lows) is rarely wise.

Intrigued by the price movement of bankrupt-company stocks, Verdad – a US investment firm that specialises in investing in the shares of cheap, indebted, smaller companies – trawled its database. It looked for the long-term relationship between share price performance and the level of distress shown by a company's debt. Based on data from the end of 1996 to the end of May this year, the research found a clear linear relationship between the pricing of a company's bonds and the performance of its equity (see chart below).

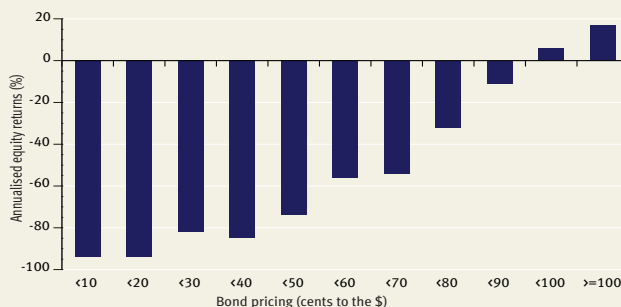
The average annualised equity return for companies with bonds trading at less than 20c versus each dollar issued was a negative 94 per cent; a total car crash. In fact, equity returns were negative all the way through to companies with bonds trading at 90c to the dollar. Companies with debt trading at between 90c and 100c delivered a positive 6 per cent. And the best returns were from shares in companies with debt valued at or above

the issue price. A similar story was found when Verdad compared equity performance with credit quality based on the scores of rating agencies. Here the research found share performance started to deteriorate when ratings fell below a high single B rating. The annualised equity return from stocks in the least creditworthy category (CC and below) was a negative 34 per cent.

This research holds an important lesson for investors targeting the grubbier end of this recovery. Rather than buying the worst-of-the-worst, it's the best-of-the-worst that should provide the optimal trade-off between risk and reward.

We continue to recommend selling shares in companies we believe face challenges based on their fundamentals, even if this sometimes means missing out on a great recovery play at ground-floor level. One of the stocks in our tips section this week is a case in point. **Signature Aviation (SIG)** (see page 37) has recovered 70 per cent from its lows, but has also recently appeared in both our table of most-shorted shares and forecast downgrades. We think the recovery has got ahead of itself. In the interest of balance, credit rating agency S&P gave its bonds a BB rating in April, putting it outside what Verdad found to be the credit-quality danger zone.

## Equity returns to bond pricing (end 1996 to end May 2020)



Source: Verdad bonds database. Data for US\$ corporate high-yield and investment-grade

## Health fund manager best ideas

Based on top 5 holdings

17/06/2020	No of funds		
Vertex Pharmaceuticals Inc	4	Sarepta Therapeutics Inc	1
Roche Holding AG Dividend Right Cert.	4	Alexion Pharmaceuticals Inc	1
Gilead Sciences Inc	3	Medtronic PLC	1
Abbott Laboratories	3	Becton, Dickinson and Co	1
Boston Scientific Corp	3	Intuitive Surgical Inc	1
UnitedHealth Group Inc	3	Merck & Co Inc	1
Incyte Corp	2	IQVIA Holdings Inc	1
Regeneron Pharmaceuticals Inc	2	Danaher Corp	1
Amgen Inc	2	CSL Ltd	1
Biogen Inc	2	Pfizer Inc	1
AstraZeneca PLC	2	Johnson & Johnson	1
argenx SE	1	Novartis AG	1
Neurocrine Biosciences Inc	1		

Source: Morningstar

## New 52-week highs

Name	TIDM	Price	% from high
Premier Foods	LSE:PF	57p	0.0%
EQTEC	AIM:EQ	1p	0.0%
Scottish Mortgage Investment Trust	LSE:SMT	759p	0.1%
Manchester & London Investment Trust	LSE:MNL	628p	0.3%
Allianz Technology Trust	LSE:ATT	2,175p	0.7%
Oncimmune	AIM:ONC	136p	0.7%
Caledonia Mining Corporation	AIM:CMCL	1,378p	0.8%
BH Macro	LSE:BHMG	3,530p	0.8%
BH Global	LSE:BHGG	1,930p	1.0%
Pacific Horizon Investment Trust	LSE:PHI	454p	1.2%
Octopus Renewables Infrastructure Trust	LSE:ORIT	111p	1.3%
Baillie Gifford US Growth Trust	LSE:USA	202p	1.5%
Fidelity China Special Situations	LSE:FCSS	254p	1.6%
Polar Capital Technology Trust	LSE:PCT	1,950p	1.7%
Bango	AIM:BGO	163p	1.8%
YouGov	AIM:YOU	785p	1.9%
Pebble Beach Systems	AIM:PEB	13p	1.9%
Oxford Biomedica p	LSE:OXB	808p	1.9%
Capital Gearing Trust	LSE:CGT	4,400p	2.0%
Personal Assets Trust	LSE:PNL	43,850p	2.0%
JTC	LSE:JTC	454p	2.1%
JPMorgan Japanese Investment Trust	LSE:JFJ	514p	2.1%
boohoo	AIM:BOO	389p	2.2%
Bunzl	LSE:BNZL	2,149p	2.3%
Jarvis Securities	AIM:JIM	593p	2.4%
The Monks Investment Trust	LSE:MNKS	1,010p	2.5%
Reckitt Benckiser	LSE:RB	7,054p	2.6%
Civitas Social Housing	LSE:CSH	109p	2.7%
Codemasters	AIM:CDM	348p	2.7%
Games Workshop	LSE:GAW	7,950p	2.8%
Hipgnosis Songs Fund	LSE:SONG	114p	2.9%
Cardiff Property	LSE:CDF	1,725p	3.0%

Source: S&P Capital IQ, as at 17 June 2020

## New 52-week lows

Name	TIDM	Price	% from low
Craven House Capital	AIM:CRV	79p	0.0%
Gem Diamonds	LSE:GEMD	26p	0.0%
Impellam	AIM:IPEL	234p	1.7%
Worsley Investors	LSE:WINV	25p	2.0%
Pittards	AIM:PTD	41p	2.4%
Macau Property Opportunities Fund	LSE:MPO	59p	2.5%
Town Centre Securities	LSE:TOWN	93p	2.7%

Source: S&amp;P Capital IQ, as at 17 June 2020

## Shorts

Company	Short interest	No of shorters	1-week change in short interest
Hammerson	11.1%	7	0.4%
Metro Bank	9.7%	4	3.7%
Premier Oil	8.7%	3	-10.9%
Royal Mail	8.7%	7	0.0%
Tullow Oil	7.8%	6	0.6%
Pearson	7.3%	8	0.1%
Babcock International	6.4%	6	0.0%
Intu Properties	5.4%	3	0.0%
Wm Morrison Supermarkets	5.2%	4	-0.4%
GW Pharmaceuticals	5.2%	4	0.0%
Petropavlovsk	5.1%	1	0.0%
Capita	5.0%	4	-0.4%
Pets At Home	4.8%	2	0.0%
IQE	4.8%	3	0.0%
Sainsbury (I)	4.7%	4	0.3%
Dignity	4.6%	3	0.0%
Easyjet	4.6%	4	-1.2%
Croda International	4.4%	5	0.0%
Cineworld	4.2%	6	1.5%
Petrofac	4.2%	3	0.0%
Future	4.1%	3	0.0%
Vodafone	3.9%	4	0.0%
Wood Group (John)	3.9%	6	0.6%
TUI	3.9%	4	0.0%
Blue Prism	3.8%	4	-0.2%
Ascential	3.7%	4	-0.8%
Keywords Studios	3.5%	4	0.0%
Smith (David S)	3.4%	5	0.1%
Aggreko	3.4%	3	0.0%
Marks & Spencer	3.2%	2	0.0%
AA	3.2%	3	0.6%
Weir Group	3.1%	3	-0.1%
Auto Trader	3.1%	5	0.0%
Daily Mail & General Trust	3.1%	3	-0.2%
AG Barr	3.1%	2	0.0%
Primary Health Properties	3.1%	4	0.1%
Ultra Electronics	3.0%	2	New
Ashmore	2.9%	3	0.0%
Domino's Pizza	2.9%	4	New
Virgin Money UK	2.8%	3	-0.3%
Valaris	2.8%	1	0.0%
Restaurant Group	2.6%	3	0.0%
Burberry	2.5%	3	New
Victrex	2.5%	3	-0.5%
Signature Aviation	2.4%	4	-0.6%
Crest Nicholson	2.4%	1	NEW

Source: FCA, as at 17 June 2020

## 1-month EPS upgrades (top 25)

Wednesday, 17 June 2020		FWD EPS CHG		
Name	TIDM	1mth	3mth	1yr
SDX Energy	AIM:SDX	191.7%	-43.5%	-69%
Best of the Best	AIM:BOTB	148.4%	267.4%	385%
Luceco	LSE:LUCE	75.8%	-44.2%	-38%
McCarthy & Stone	LSE:MCS	68.2%	-86.9%	-
Ramsdens	AIM:RFX	56.7%	-53.4%	-54%
CMC Markets	LSE:CMCX	48.4%	68.7%	143%
4imprint	LSE:FOUR	40.4%	-76.6%	-76%
Titon	AIM:TON	37.6%	37.6%	-27%
Frasers	LSE:FRAS	35.5%	-48.2%	-26%
Orchard Funding	AIM:ORCH	29.7%	29.7%	-24%
Venture Life	AIM:VLG	27.6%	62.8%	85%
Bank of Georgia	LSE:BGEO	26.7%	-	-
Bloomsbury Publishing	LSE:BYM	24.1%	-48.8%	-51%
Urban&Civic	LSE:UANC	22.2%	-18.2%	-36%
CRH	LSE:CRH	19.6%	-23.4%	-26%
Mattioli Woods	AIM:MTW	18.6%	18.6%	12%
Frontier Developments	AIM:FDEV	15.3%	24.3%	35%
B&M European Value Retail S.A.	LSE:BME	14.4%	2.6%	-4%
McBride	LSE:MCB	14.4%	14.1%	-
Ebiquity	AIM:EBQ	13.6%	-49.5%	-50%
CVS	AIM:CVSG	12.4%	-52.9%	-43%
Totally	AIM:TLY	9.9%	9.9%	-
boohoo	AIM:BOO	9.1%	-10.3%	5%
Bunzl	LSE:BNZL	9.1%	-18.1%	-21%
Airtel Africa	LSE:AAF	9.0%	-31.7%	-

Source: S&amp;P Capital IQ

## 1-month EPS downgrades (top 25)

Wednesday, 17 June 2020		FWD EPS CHG		
Name	TIDM	1mth	3mth	1yr
Cineworld	LSE:CINE	-98.9%	-99.3%	-100%
MJ Hudson	AIM:MIJH	-95.5%	-	-
Young & Co's Brewery	AIM:YNGA	-89.9%	-94.6%	-95%
Renewi	LSE:RWI	-87.4%	-89.8%	-93%
WH Smith	LSE:SMWH	-83.3%	-	-
Henry Boot	LSE:BOOT	-73.4%	-73.4%	-74%
MJ Gleeson	LSE:GLE	-70.7%	-82.2%	-82%
C&C Group	LSE:CCR	-69.0%	-81.5%	-
Draper Esprit	AIM:GROW	-68.4%	-68.4%	-72%
Biffa	LSE:BIFF	-67.2%	-78.4%	-78%
The Vitec Group	LSE:VTC	-63.8%	-82.6%	-87%
Fuller, Smith & Turner	LSE:FSTA	-57.9%	-69.3%	-
Steppe Cement	AIM:STCM	-57.6%	-57.6%	-63%
Blanco Technology	AIM:BLTG	-52.0%	-59.1%	-59%
Grafton Group	LSE:GFTU	-50.1%	-66.9%	-72%
Yourgene Health	AIM:YGEN	-50.0%	-50.0%	-
Amigo	LSE:AMGO	-48.5%	-52.1%	-
Iofina	AIM:IOF	-47.3%	-47.3%	-2%
Beazley	LSE:BEZ	-44.4%	-95.2%	-97%
Mediclinic International	LSE:MDC	-44.1%	-50.0%	-53%
Vp	LSE:VP	-42.8%	-47.4%	-49%
Howden Joinery	LSE:HWDN	-42.0%	-50.3%	-49%
Royal Mail	LSE:RMG	-41.6%	-58.9%	-
Countryside Properties	LSE:CSP	-40.4%	-50.1%	-51%
Joules	AIM:JOUL	-37.6%	-62.2%	-76%

Source: S&amp;P Capital IQ