Q. What is the opportunity you see in high yield?
A. We believe high yield focused on real assets may be a way for institutional investors to find attractive yields with lower risk than those yields imply. We define real asset high yield as the high-yield issues of companies backed by tangible real assets—infrastructure, real estate and natural resources assets. Real asset high-yield debt currently has leverage levels at multi-year lows and less default risk than non-real asset debt.1

Defaults on high-yield bonds have been increasing, and they are expected to continue to grow. These defaults have been more prevalent outside real asset sectors. Real asset companies are generally higher-quality businesses compared with non-real asset companies, as many own assets with monopolistic characteristics that are less exposed to competition or cyclicality. Additionally, we believe their more stable and visible collateral—in the form of real assets—may potentially lead to better outcomes for credit investors.

Q. What potential portfolio benefits can real asset high yield provide?
A. We believe that investing in real asset high yield can potentially help enhance institutional investors’ fixed-income portfolios, thanks to the unique characteristics of real asset businesses. These businesses are backed by long-lived assets that tend to appreciate over time, offer strong collateral, face limited competition, have less economic sensitivity, and deliver stable cash flows. As a result, U.S. real asset high yield has better credit quality, lower default rates and higher recovery rates than non-real asset U.S. high yield. These relative benefits historically come through most notably during recessions or other periods of market distress.

Adding an allocation could potentially improve the overall quality of a fixed-income portfolio and help provide diversification benefits via access to real assets’ differentiated business models vs. broad high yield.2 Despite real asset debt’s defensive nature and higher credit quality, we find it has historically offered attractive yields similar to those of broad high yield, including during market dislocations, as well as attractive risk-adjusted returns.
Q. What is Brookfield’s approach to investing in high yield?

A. To access the opportunity in listed real asset high yield, we believe it is key to have real asset experience and an active approach rooted in superior fundamental credit analysis. We have deep experience investing in real asset debt across multiple market cycles and are able to leverage our Firm's broader expertise in real assets. When you think of Brookfield, you might think of very large-scale assets, many of which very few of our peers can own and operate as successfully as we can. We think we have a real edge at Brookfield in understanding these assets—across infrastructure, real estate and natural resources.

So, our approach starts with evaluating assets from a valuation standpoint, and understanding the fundamentals, risks, trends, etc. at the asset level. This analysis is an important part of our process because these are the types of assets on the balance sheets of the issuers we are investing in, so ultimately they are the collateral. And this analysis applies to other parts of the capital structure that we look at, as well.

We invest in public credit exposures across Brookfield’s real asset sectors of expertise (infrastructure, real estate and natural resources), aiming to add value through our security selection, sector allocations and credit allocations. We employ rigorous analysis to determine our exposures, building our portfolios based on investment conviction and the risk-adjusted attractiveness of individual issues. We prioritize capital preservation and income capture, which we believe allows us to deliver more stable returns with below-market risk over the credit cycle.

Q. What priorities do your clients seek to tackle with an allocation to real asset high yield?

A. Some clients and consultants are looking at real asset high yield through a traditional fixed-income lens, seeking to allocate alongside broad fixed income or private credit. For them, it can be used effectively as a strategic high-yield allocation to complement existing fixed-income or credit exposures, such as broad high yield, emerging market debt, leveraged loans and private credit. Other clients consider allocations as a liquid and stable part of their broader real asset exposure. Regardless, our clients’ aim is often to improve risk-adjusted returns across a cycle and during periods of economic weakness.

Q. Why would high yield focused on real assets be particularly attractive for insurers?

A. Our insurance clients like the underlying economic exposure real asset debt offers, as well as its more attractive liquidity relative to private markets. We believe insurance companies have an attractive opportunity today to “lock in” higher interest rates over longer periods. Real asset high yield may be an attractive option for insurers to lower the risk profile of their alternatives allocation without sacrificing returns. We have also had insurance clients work with us to customize the duration and credit quality profile of a portfolio, often taking advantage of longer-duration investment-grade-rated opportunities. The relative benefits associated with real asset issuers also are present within investment grade, where we are very active.

Many lower-quality businesses and issuers have gravitated toward private credit and leveraged loans in recent years, rather than focusing on traditional bond markets. This has impacted the credit quality mix, enabling the overall credit quality of the U.S. high-yield market to improve significantly after the COVID-19 pandemic waned. We also find superior liquidity and transparency in this market relative to private credit and leveraged loans. Further, recent stress in credit markets has been more concentrated in leveraged loans relative to high yield (this type of data is less widely available for private credit).
ENDNOTES
1 Brookfield classifies the following sectors as real asset debt: Cable & Satellites, Chemicals, Energy, Gaming Lodging & Leisure, Housing, Metals & Mining, Telecommunications, Transportation and Utility. Brookfield classifies other sectors as non-real asset.
2 We define broad high yield as the broad high yield universe represented by the ICE BofA U.S. High Yield Index.

DISCLOSURES
All investing involves risk. The value of an investment will fluctuate over time, and an investor may gain or lose money, or the entire investment. Real assets include real estate securities, infrastructure securities and natural resources securities.

High-yield bonds may have speculative characteristics and present significant risks beyond those of other securities, including greater credit risk and price volatility in the secondary market. Investors should be careful to consider these risks alongside their individual circumstances, objectives and risk tolerance before investing in high-yield bonds. High-yield bonds should comprise only a limited portion of a balanced portfolio.

The market value of debt instruments including high-yield bonds may fluctuate, and proceeds from sales prior to maturity may be more or less than the amount originally invested or the maturity value due to changes in market conditions or changes in the credit quality of the issuer. Investments in debt securities typically decrease in value when interest rates rise. This risk is usually greater for longer-term debt securities.

As an asset class, private credit is comprised of a large variety of different debt instruments. While each has its own risk and return profile, private credit assets generally have increased risk of default, due to their typical opportunistic focus on companies with limited funding options, in comparison to their public equivalents.

Because private credit usually involves lending to below investment grade or non-rated issuers, yield on private credit assets is increased in return for taking on increased risk.

Diversification does not assure a profit or protect against loss in declining financial markets.

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INDEX DEFINITION
The ICE BofA U.S. High Yield Index tracks the performance of U.S. dollar-denominated below-investment-grade corporate debt publicly issued in the U.S. domestic market.