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Bond Buyers Focus on Shortages

By Julia-Ambra Verlaine
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Labor shortages and supply-chain disruptions have become make-or-break factors for some investors weighing bets on corporate debt.

Tom Murphy, portfolio manager and head of global investment-grade credit at Columbia Threadneedle, said the asset manager is placing companies in two buckets: those that can offset increased wages, bottlenecks and shortages with higher prices, and those that can't without losing business. That has him avoiding packaged-goods makers and department stores.

"There is a labor shortage and companies are now paying more for wages. So we think about investing from a margin standpoint as opposed to 'Is there inflation, yes or no,' " he said. "The wage piece is a big part of it."

Debt investors tend to have a different perspective on businesses than stock investors. They typically care more about whether a business will generate enough cash to make its interest and principal payments than they do about its growth potential. That is because their returns are more or less capped, even if the business keeps expanding or increasing its profit, but they can still lose money if the business fails.

Rick Rieder, head of fixed income at BlackRock Inc., the world's largest asset manager, said labor and supply dynamics are now the biggest risks on his radar before selecting which companies to invest in or not. Recent reports from FedEx Corp. have changed his more moderate view on inflation.

On Sept. 21, FedEx cut its financial outlook, saying labor shortages and supply-chain disruptions lifted expenses and slowed demand for shipping in the latest quarter. The delivery company said it is raising wages to attract more workers and announced shipping rates would go up an average of 5.9% next year across most of its services, garnering attention from Wall Street.

"My opinion is evolving. I was pretty much in the camp that most inflation is transitory except for shelter and still believe that on the major reopening shocks," said Mr. Rieder. "But now supply-chain disruptions, labor issues, input costs and wages are slowing the economy, not demand."

Swings in the labor market and the pandemic's complications have made analyzing broader trends difficult, muddling data, some analysts said. Changes in payrolls, a Labor Department metric Wall Street uses to predict hiring trends, have been erratic, compounding uncertainty.

Hiring slowed sharply in August, and while U.S. employment has recovered since last April when the pandemic shut down businesses across the country, it remains below pre-Covid levels.

That leaves some investors looking at smaller scale. Joseph Lind, senior portfolio manager at Neuberger Berman Group, said a group of 25 internal analysts put together a survey of around 100 companies in June and July to compile forecasts around costs and margins.

Mr. Lind said price increases in commodities are attractive to bond investors because they strengthen balance sheets and can prompt upgrades by rating agencies.

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