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BARRON'S ROUNDTABLE

Jeffrey Gundlach: Bullish on Commodities and Bank Loans

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Barron's: So, Jeffrey, how does the world beyond equities look?

Jeffrey Gundlach: We take the 50,000-foot view. One of our higher-conviction ideas is that the dollar will have another big move down. We talked about the potential for rhetoric to turn more hawkish in the euro zone. Also, trends in the dollar have a high degree of cyclicality. They tend to last about eight years. We've had about an eight-year rally in the dollar that ended, and we had a down year of significance last year. Usually, these things come in groups. When you have a down year that breaks the dollar trend, very often it is followed by the same type of weakness in the future.

Also, as we discussed this morning, the global economy appears to be in good shape. It seems impossible to find a catalyst for a recession, absent some sort of tremendous geopolitical type of shock.

My first idea is tied to commodities. Broadly, commodities are very, very cheap.

Commodities have long cycles, as well. A fascinating chart has been circulating in the investment industry. It compares the total return of the Standard & Poor's 500 index to the total return of the Goldman Sachs Commodity Index, and it goes in tremendous cycles. In the 1970s, commodities started to outperform. They outperformed the S&P by 800%, and then gave it all back. Then there was another wave up, and commodities outperformed again by 800%—actually, 900%—and that continued into 2008.

At which point everything crashed.

Gundlach: You will notice that levels are strangely repetitive. With the global economy doing well and perhaps accelerating, and with the dollar weak, commodity prices seem to have an attractive appeal. I don't want to recommend a commodity fund because I don't know of one that seems economic, other than the DoubleLine fund, and I don't want to recommend my own fund. But I'm going to talk about other ways of potentially making money on these ideas.

Energy has been one of the weakest sectors of the S&P 500 for a multiyear period. The Energy Select Sector SPDR [XLE] is an exchange-traded fund that invests in energy and has underperformed the S&P 500 by something like 100% in recent years. That has stopped with the price of oil no longer declining. It is unlikely that you are going to have a bear market in oil.

You might have some manipulation by the Saudis, and that could give you a hiccup. But I don't see a bear market.

Meryl Witmer: Also, the big guys have stopped drilling offshore and the like.

Gundlach: The XLE ETF strikes me as a good way to also get some exposure to the stock market. The relative performance of the XLE versus the S&P 500 has turned positive recently, and it is now above its 200-day moving average. I like that as a way of investing in this commodity idea.

But what is interesting as a bond-surrogate investment is master limited partnerships, which don't need oil to go up. You just don't want it to go back down to $20, so you don't worry about a bankruptcy situation. MLPs have tremendously underperformed the XLE. We aren't looking to triple our money here; we are looking for an income vehicle that has a lower risk profile. I'm having a hard time finding more-traditional bond investments that look good, but I like a particular closed-end fund that owns MLPs. It tends to own MLPs with attributes that we find reduce risk. Its very name gives you a sense of its investment philosophy. It is called the Tortoise MLP fund [NTG]. It has a funny tag line that goes along with the philosophy of managing the downside and looking for higher-quality assets: Steady Wins. It sounds like the tortoise against the hare, but has a double meaning: steady income.

NTG has about a $1 billion market cap. It has a sister fund, which owns almost exactly the same assets, called Tortoise Energy Infrastructure [TYG]. I chose NTG because it is a little bit cheaper. The yield on NTG is almost 9%, and if you agree with this underlying thesis, that you aren't looking at tanking oil prices but reasonably strong commodities broadly, this is a good way of getting income.

Witmer: Does the fund use leverage to get that yield?

Gundlach: It is 32% leveraged now, according to the fund website. MLPs have been on a bumpy ride. They're risky, so you want to make sure you buy them at the right time. This is interesting as a bond proxy because if yields go up, it is likely that this commodity thesis is playing out. That would improve the situation. But if interest rates go down—and I have a hard time seeing a big rally in rates—I've got a feeling that the yield starvation around the world remains with us, and perhaps that supports the price of NTG.

What else appeals to you?

Gundlach: For those who want income and are worried about rising interest rates, and who might want to benefit from Libor [the London interbank offered rate] going up, I like the PowerShares Senior Loan Portfolio ETF [BKLN]. It invests in bank loans, which are senior in

Jeffrey Gundlach

CEO and
chief investment officer

DoubleLine Capital

Los Angeles

the capital structure. Bank loans are illiquid, but BKLN is an ETF, so it is easy for an individual investor to buy. Libor has been going up, so the fund yields 4%, net of fees. When Libor goes up now, it isn't like a couple of years ago, when Libor would go up and you wouldn't get a dividend increase.

Because of the floors on the loans' rates.

Gundlach: For investors who want low volatility based on interest rates, and yet a yield that's nearly double that of a 10-year Treasury, BKLN is OK.

We talked earlier today about the risks in ETFs. What happens to BKLN in a crisis, given the illiquidity of bank loans?

Gundlach: If I felt there was that risk, I wouldn't be recommending it. It begins with the idea that the lack of recessionary signals makes it pretty clear sailing. To me, it is one of the safer ways to get a decent yield in the fixed-income market.

Oscar Schafer: I just looked at the chart of NTG. It is trading in the high teens. Yet it was $30-plus a while ago. I don't understand why something like this would be that volatile.

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There can be a lot of tax-loss selling at the end of the year.

Scott Black: I spoke to a lot of MLPs recently. A lot of them sell at 2.5 to three times book value. What holds them up is the dividend. If something goes wrong with the dividend, they collapse. That's what happened before, and it's why these stocks got dropped in the past couple of years.

Gundlach: You are right, they are bought for income. We try to screen for those that have been reducing leverage and have much better coverage of distributable income. There's risk; on [a 9% yield], you're going to have risk.

ROUNDTABLE PART 2

- Henry Ellenbogen: The Case for a Credit Bureau, a Ski Resort, and More
- Mario Gabelli: Bullish on Media and Entertainment
- Jeffrey Gundlach: Bullish on Commodities and Bank Loans
- Abby Joseph Cohen: Drilling for Oil and Making Gadgets
- William Priest: Bullish on Screen Technology and Chip Gear
- Scott Black: Making Chips and Crushing Sand
- Meryl Witmer: Used Cars and Carbon Black
- Oscar Schafer: Loading Up on Auto Parts, Off to the Movies
- Paul Wick: How to Play the Big Trends in Tech

Finally, the iShares MSCI Brazil ETF [EWZ] is risky, but it is the best play on the commodity trend without being a commodity fund. It has roughly doubled off the bottom, as have emerging markets broadly. But as a portfolio holding, it is motivated by my commodity thesis.

Now, many argue that we're not late-cycle in the global economy, but you can't argue that we are early- or mid-cycle, given that we are at month 103 in the expansion. The world record, I think, was around 120 months.

Which means what, to you?

Gundlach: It is incredibly repetitive historically that commodities rally late-cycle. In fact, every recession in the U.S. since 1970 has been preceded by a massive commodity rally. The best way to play where we are in an economic cycle is through commodities. Remember, back in 2008, the last man standing was commodities. Everything else tanked, and commodities were up. It was partly because hedge funds were still trying to play them. People talk about buying them after they've rallied a lot. The strangest thing is when investment committees say, maybe we should add commodities; we don't have any, and they are a good diversifier. They try to justify buying momentum high with the Trojan horse of diversification.

Jeff, what are your thoughts on gold?

Gundlach: Gold is going up. Gold has been going up. The price looks like it might have broken out. I talk a lot about bases; the base in gold is huge. Gold peaked above $1,300 an ounce, but it has been trading around $1,200 for years. Here's the chart [holds up a gold-price chart]. You can see that this base is four years in the making—four years! When we break above it, as I believe will happen, the measured-move target is about a thousand-dollar increase. [The measured-move target is achieved by projecting upward from the current chart move the height and length of the previous move.] Gold is headed higher with the commodity complex.

Another market I recommended last year also shows a tremendous breakout. That is the Nikkei. I don't have a great understanding as to why it is doing so well lately. There hasn't been much currency movement. It was underperforming for the first half of the year. It's got momentum now, and I could include it as a recommendation, as well, because the [Bank of Japan] is going to continue quantitative easing, while other central banks are doing less. The Japanese economy has finally improved and is growing again, and [the stock market] is cheaper than the U.S.

Thank you, Jeffrey.

Email: editors@barrons.com