High Yield Market Update

MARCH 2021: OUTLOOK AND IMPLEMENTATION

- High Yield posted another positive return in March (+0.15%) as spread tightening and carry offset a backup in rates. Investors continued to reach for yield with CCCs (+1.09%) outperforming the higher quality Bs (+0.45%) and BBs (-0.28%). The overall themes remain the same for the High Yield asset class as sentiment remains strong regarding the vaccine, global growth, rising commodity prices, and a supportive Fed. U.S. Treasury rates rose in March and the yield curve continued to steepen on inflation concerns. The U.S. Treasury 5-year benchmark interest rate increased by 21 basis points to 0.94% and the 10-year interest rate increased by 34 basis points to 1.74%.
- The best performing industries in March were Aerospace/Defense (+2.07%), Airlines (+1.73%), Leisure (+1.15%), Transportation Services (+0.94%), and P&C Insurance (+0.67%). March's bottom performers were Electric (-0.89%), Food and Beverage (-0.64%), Home Construction (-0.58%), Oil Field Services (-0.45%), and Independent Energy (-0.35%).

Fundamentals

- With Q4 earnings now reported, aggregate credit metrics have improved from the prior quarter but remain at elevated levels.
- The upgrade to downgrade ratio trend remains positive. On an issuer basis, we saw yet another month of more upgrades than downgrades with a ratio of 1.2.
- The issuer-weighted default rate for the 12 months ending in March decreased to 5.50%.

Technicals

- March saw another month of outflows for High Yield as $5.9 billion left the asset class. So far in 2021, every month has seen outflows that now total $10.3 billion year to date.
- Another month of record new issuance in High Yield was set in March with $64.8 billion of gross new issuance. The first quarter of 2021 was also the largest quarter of issuance on record, surpassing the second quarter of 2020.
- Due to the record-breaking month of issuance, March saw a supply surplus of $25.1 billion.

Pricing

- The average spread tightened 16 basis points in March to finish at +308. The range for March was +308 to +337.
- The yield to worst decreased by 2 basis points to 4.23% in March with a range of 4.13% to 4.57%.
- The average dollar price peaked in early March at $104.83 and bottomed at $103.40 a couple of weeks later only to finish the month at $104.16 after starting at $104.55.

Implementation

- A record month in the primary markets had us, and the rest of the High Yield investor community, combing through issuance once again. The final stats were 95 issues totaling almost $65 billion in issuance. Most of this issuance remains earmarked for refinancing so net supply is much lower – which is fortunate, given the asset class is currently seeing outflows. We continue to favor credits that would benefit the most from a continued economic recovery and this was expressed through our activity during the month as we selectively added risk. We are also balancing lack of convexity (meaning limited upside due to the ability for issuing companies to call the bonds) with duration (sensitivity to interest rate risks) as the market is heavily bifurcated between bonds that are trading above call prices but that have low duration and lower dollar price bonds that have significant exposure to rising rates.

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The **Bloomberg Barclays U.S. High-Yield 2% Issuer Capped Bond Index** is a market capitalization-weighted index that measures fixed rate non-investment grade debt securities of U.S. and non-U.S. corporations. No single issuer accounts for more than 2% of market cap. The index is unmanaged, its returns do not reflect any fees, expenses, or sales charges, and is not available for direct investment.

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