

OCTOBER 2021: OUTLOOK AND IMPLEMENTATION

- ▶ In October, market participants began positioning for a potential tightening in global monetary policy, leading to a flattening in the U.S. Treasury curve (rising yields on short maturities with falling yields on long maturities). The uncertainty around the direction of monetary policy pushed the yield on the High Yield index higher while credit spreads stayed flat. High Yield finished October with a small negative return of -0.17%. There was little variation across rating tiers as BBs, Bs and CCCs also finished with slightly negative returns at -0.14%, -0.15% and -0.21%, respectively. Fundamentals were broadly positive in October as the third quarter earnings season started off well; however, supply chain disruptions and labor inflation have been headwinds for certain industries. Concerns also linger over slowing China growth and the possible collapse of its property market. Technicals remained positive – October was the lightest month of issuance in 2021 and the market saw a third consecutive month of inflows.
- ▶ October's best performing industries were airlines (+0.49%), oil field services (+0.48%), independent (+0.43%), automotive (+0.42%) and aerospace defense (+0.32%) while the worst performing industries in October were cable satellite (-1.03%), restaurants (-0.80%), media entertainment (-0.79%), building materials (-0.76%), and retailers (-0.65%).

Fundamentals

- While earnings in aggregate are in-line, dispersion across industries is widening with inflation and pricing power in focus.
- The Upgrade-To-Downgrade ratio, by number of issuers, was 2.3 in October, matching the year-to-date number of 2.3.
- The Issuer-Weighted default rate continued to plummet and as is now below 1% at 0.87% for the last twelve months.

Technicals

- High Yield saw its third straight monthly inflow in October, receiving \$1.4 billion worth of inflows.
- October saw the least amount of new issuance of 2021 with just \$30.2 billion of gross issuance across 50 issues. Year-to-date, we have seen \$440 billion across 664 issues. Refinancing remained the largest use of proceeds, but acquisition finance/LBO issuance continued to increase from 38% in September to 42.7% in October.
- The slowest month of issuance for 2021 and another monthly inflow combined for a supply shortfall of -\$3.4 billion in October.

Pricing

- The High Yield Index spread tightened by 2 bps in October from +287 to +285 with a range of +279 to +301 during the month.
- The Yield-To-Worst for High Yield increased by 19 bps from 4.04% to 4.23% in October while touching a low of 4.03% and a high of 4.29% during the month.
- The High Yield average dollar price started the month at \$104.64 and never saw it again. The average price finished October at \$103.91, down \$0.73, just off its low of \$103.87.

Implementation

- October was characterized by earnings-driven volatility, continued strength in oil and gas prices, and a lackluster primary market. Non-COVID-driven volatility is rising in certain industries such as cable, which traded lower as increased competition from wirelines drives companies to higher capex to retain market share. Restaurants traded lower due to labor shortages and rising wages, while retailers traded lower on weak outlooks due to logistics constraints. The new issue market has become less interesting with declining deal quality and aggressive pricing by underwriters leading to weak performance on the break. Our activity during the month was driven by earnings and a slight increase in exposure to higher quality issuers.

High Yield Market Update

Paul Privitera

Director – Institutional

Paul.Privitera@Newfleet.com

Phone: (860) 839-0705

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