High Yield Market Update

Newfleet ASSET MANAGEMENT
A Virtus Investment Partner

DECEMBER 2021: OUTLOOK AND IMPLEMENTATION

- ► While the emergence of the Omicron variant of COVID-19 pushed the high yield index lower in late November, both news that the variant might be less severe than earlier strains and a supply shortfall helped propel the index to a positive return of +1.87% for the month of December. The positive performance was equally distributed across all ratings categories as BBs were +1.82%, Bs were +1.96% and CCCs were +1.90% in December. As more data emerged showing Omicron causes milder symptoms, the markets began to recoup their losses from November with the hardest hit industries rebounding the most. Meanwhile, the fifth monthly inflow of 2021 and lower supply due to the holiday season helped to create a supply shortfall. This positive technical backdrop paired with the Omicron data helped to push high yield asset valuations higher on light secondary volumes.
- ► December's top performing industries were oil field services (+3.38%), midstream (+2.88%), independent energy (+2.83%), wirelines (+2.41%) and refining (+2.40%). Meanwhile, the worst performing industries in December were banking (+0.54%), electric utility (+1.00%), food & beverage (+1.10%), environmental (+1.11%) and gaming (+1.21%).

Fundamentals

- The December upgrade to downgrade ratio, by number of issuers, was 2.9 up from 1.5 in November and above the 4Q average of 2.1.
- Through December, the issuer-weighted default rate for the last twelve months dropped to 0.86% after increasing to 0.98% through November.
- Aggregate leverage levels have returned to pre-COVID levels.

Technicals

- The high yield asset class saw just its fifth monthly inflow of 2021 in December totaling $3.8 billion, while -$13.6 billion came out of the asset class for the twelve-month period.
- High yield saw its slowest month of primary activity in December with just $10.7 billion. We saw a record $483 billion price in 2021.
- A light primary calendar combined with positive fund flows helped to create another supply shortfall of -$19.3 billion this month.

Pricing

- The spread on the high yield index retraced the 50 basis points it lost in November while tightening to +283 at the end of December. It traded in a range of +333 at the wide end to a tight of +271 during the month.
- The high yield index yield-to-worst finished December at 4.22% − 0.59% lower than where it began the month. The range for December was 4.80% to 4.08%.
- The dollar price for the high yield index increased by $1.44 to $103.56 in December. The dollar price only went up from the November close of $102.125 and peaked at $103.665.

Implementation

- December is a seasonally slow time of year for the markets as the year ends and the holidays begin. This year was no different as we saw just $10.7 billion of issuance. We participated in the muted calendar selectively as concessions remained scarce. While we were positioned well for the December rally, we continue to monitor the impact of Omicron on corporate results with particular emphasis on labor costs, input costs and the bottlenecks on the supply chain. We head into 2022 with the bias to opportunistically rotate to higher quality paper while being cognizant of volatility in U.S. Treasury yields.

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The **Bloomberg 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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