High Yield Market Update

Newfleet ASSET MANAGEMENT
A Virtus Investment Partner

APRIL 2022: OUTLOOK AND IMPLEMENTATION

- April was another challenging month for high yield − with the index down 3.56%, this brings the year-to-date index return to -8.22%. BBs and CCCs were both down approximately 3.7% for the month, but for different reasons. The increase in U.S. Treasury yields had a larger impact on higher-quality BBs, while CCCs saw spreads widen more than BBs and Bs due to increasing concerns that the FOMC may not be able to navigate a soft landing. Meanwhile, Bs were down 3.32%. The same factors that plagued the high yield market for the last few months persist: the war in Ukraine rages on, supply chain issues remain unchanged, and U.S. Treasury yields rose by as much as 0.60% in April as the market tries to handicap the levers the FOMC will pull to quell inflation.
- April's best performing industries were refining (+0.08%), oil field services (-1.54%), airlines (-1.58%), transportation services (-1.84%) and paper (-2.38%). Meanwhile, the worst performing industries in April were building materials (-4.96%), brokerage, asset managers and exchanges (-4.95%), cable satellite (-4.79%), pharmaceuticals (-4.66%) and health insurance (-4.66%).

Fundamentals

- The upgrade to downgrade ratio, by number of issuers, was 3.1 in April, with 34 upgrades to just 11 downgrades.
- The issuer-weighted default rate for the last twelve months through April decreased to 0.64%.

Technicals

- 2022 has not yet seen a positive high yield monthly inflow. April was the fourth consecutive month of outflows, with another $4.8 billion leaving the asset class.
- Only 16 bonds priced in April for a total of just $10.9 billion. We have only seen $57.4 billion issued year-to-date in 2022. By contrast, in 2021, the market issued $207.1 billion through April.
- Despite another month of outflows, a muted primary market coupled with few fallen angels created a $15 billion supply shortfall.

Pricing

- The high yield index spread was as low as 309 basis points (bps) in early April but finished at the highest level of the month at +378, or 57 bps wider.
- The yield-to-worst for the index, in April, ranged from a low of 5.99% to a high of 6.98%, where it finished the month.
- With the yield-to-worst 1% higher in April, the index dollar price decreased 4 points from $97.04 to $93.06.

Implementation

- Another month of volatility kept the primary markets at bay and constrained secondary activity. Despite the volatility, we were active with relative value swaps as we waited for the FOMC meeting and the first quarter earnings season. Early indications on earnings are that while fundamentals are holding strong, headwinds from supply chain issues and labor inflation persist, prompting companies to moderate their forecasts. We continue to carry elevated levels of cash and are focused on trimming some risk in the portfolio and extending duration given the sharp move wider in Treasury yields year-to-date. We continue to remain overweight energy and commodity firms. Lastly, we have started analyzing higher-quality names trading at large discounts that could be attractive acquisition targets. We see limited downside for these names in a risk-off scenario, but significant upside should they be acquired.

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AR 2193081 5/2022