High Yield Market Update

MAY 2022: OUTLOOK AND IMPLEMENTATION

- A late rally helped the high yield index finish May in positive territory at +0.25% after a dismal start. Concerns over elevated inflation data, rising U.S. Treasury rates, increasing odds of a recession, and the impact these factors would have on corporate earnings, all weighed heavily on the market. After reaching yields in mid-May not seen since late 2020, higher-quality high yield led the rally as BBs finished May with a positive total return of 1.54%. Lower-rated companies lagged, with Bs finishing with a return of -0.63% and CCCs at -2.83%.
- May's best performing industries included health insurance (+2.89%), supermarkets (+2.16%), electric (+2.10%), independent (+1.87%), and wireless (+1.68%). Meanwhile, the worst performers were pharmaceuticals (-8.17%), retailers (-2.79%), leisure (-1.63%), brokerage, asset managers and exchanges (-1.44%), and other industrial (-1.22%).

Fundamentals

- The upgrade to downgrade ratio, by number of issuers, was 1.5 in May, with 25 upgrades to just 17 downgrades.
- The issuer-weighted default rate for the last twelve months through May increased to 0.86%.

Technicals

- May marked both the fifth straight month of outflows, and the sixth month of outflows out of the last seven months, with $3.6 billion leaving the asset class. Year-to-date, we have seen $36.6 billion depart.
- An anemic month of high yield issuance saw the primary market only produce $4 billion – the slowest month since December of 2018.
- Another paltry month of issuance coupled with a jump in rising stars offset outflows and created a supply shortfall of $35.5 billion.

Pricing

- The index spread finished at 402 bps – 24 bps wider from the end of April. The spread peaked in late May at +481, only to see a 79-bps rally at the close of the month.
- After peaking late May at 7.82%, the yield-to-worst for the index finished at 7.09%, or 11 bps higher.
- Thanks to the late rally, the dollar price of the index finished only $3.38 points lower, $92.67, after bottoming out at $89.68.

Implementation

- In early May, we started to increase our exposure to higher-quality paper, which was carried out primarily through the secondary markets as the new issue market remained all but closed due to volatility. We funded these purchases with a combination of cash and lower-quality sales. Unfortunately, this trade was cut short as the "decompression" trade began. Lower-rated risk underperformed dramatically during this selloff. While our cash balance remains elevated entering June, we plan to continue to add opportunistically to higher-quality paper given our overall risk profile.

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