High Yield Market Update

JUNE 2022: OUTLOOK AND IMPLEMENTATION

- In June, the high yield index spread widened at a pace not seen since the Great Financial Crisis in 2008, generating a total return of -6.73% for the month. While the weakness was mostly evenly distributed, Bs generated the worst return of -7.11%. CCCs and BBs returned -7.01% and -6.37%, respectively. Increasing odds of a recession and continued inflation fears despite the FOMC's aggressive tightening of policy by 75 basis points (bps) both weighed heavily on high yield in June.
- June's best performing industries included paper (-3.67%), refining (-3.79%), diversified manufacturing (-4.56%), other industrial (-4.85%), and restaurants (-5.14%). Meanwhile, the worst performing industries in June were leisure (-9.04%), other financial (-9.03%), building materials (-8.53%), cable satellite (-8.22%), and pharmaceuticals (-8.10%).

Fundamentals

- The upgrade to downgrade ratio, by number of issuers, was 1.2 in June, down from 1.5 in May.
- The issuer-weighted default rate for the last twelve months through June remained unchanged at 0.86%.
- Aggregate margins have started to decline as companies struggle to increase prices to fully offset raw material costs, continued supply chain disruptions, and rising labor costs.

Technicals

- June was the sixth straight month of outflows and seventh out of the last eight months. The asset class saw another $7.4 billion depart in June.
- The high yield primary market only saw $9.7 billion of issuance in June. While this was more than the prior month, it is still well below average as volatility continues to keep both issuers and investors on the sidelines.
- Despite a large outflow, the muted calendar, calls, tenders, and coupon reinvestments helped to create a slight supply shortfall in June of -$5.8 billion.

Pricing

- The high yield index spread widened by 167 bps to +569 during June.
- The high yield index yield-to-worst rose to 8.89% at the end of June after starting at 7.09%.
- The average dollar price of the high yield index plummeted to $85.83, down $6.84 points, after starting June at $92.67.

Implementation

- The sharp sell-off led to a muted new issue market, while volatility made trading in the secondary market more challenging. Despite the move wider, we viewed spreads as still low relative to recessionary levels, which seem increasingly likely given weakening economic data and hawkish commentary by the Fed. Consequently, we continued to high grade the portfolio by rotating out of more cyclical credits and into higher-quality, more recession-resistant securities and holding an elevated level of cash. We will re-evaluate the strategy should valuations continue to cheapen and/or the FOMC's posture changes.

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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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