High Yield Market Update

APRIL 2024

Performance

- The U.S. high yield market had its worst performance since October, declining 0.94% as stronger-than-expected economic data pushed U.S. Treasury yields higher (5-year and 10-year up 50 basis points (bps) and 48 bps, respectively) and once again repriced expectations for fewer and later Fed rate cuts. Inflation data, including the CPI, came in above expectations and triggered renewed concerns that interest rates would need to stay higher for longer to bring inflation lower. The robust economic data, including better-than-expected retail sales and nonfarm payrolls, indicated a firm economy with continued consumer strength. Renewed geopolitical tensions also negatively impacted the market and the overall appetite for risk. These factors contributed to increased market volatility and fund outflows, which contributed to the negative market performance. The main factor supporting the market and relatively stable spreads during the month was a solid start to quarterly earnings reports that reflected good first-quarter results and an improving outlook for many industries. Returns were fairly consistent across ratings categories, with distressed issues the main underperformers. BB, B, CCC, and Ca-D credits declined 0.93%, 0.89%, 0.99%, and 2.38%, respectively. Spreads widened two bps to 301 bps, and excess returns were 0.13%. The yield-to-worst (YTW) increased from 7.7% at the end of March to 8.1% at the end of April.

Sectors

- The best-performing sectors were airlines, drillers, and healthcare, which returned 0.23%, 0.05%, and -0.03%, respectively. Airlines outperformed due to strong earnings from VistaJet, which showed continued strong demand and improved cash flow. Drillers benefitted as oil prices increased due to geopolitical tensions. Healthcare outperformed due to strong earnings from hospitals. The worst-performing sectors were cable, wirelines, and transports, which declined 3.68%, 3.49%, and 1.88%, respectively. Wirelines and cable underperformed due to longer-term fundamental concerns and fear the companies will seek to use liability management exchanges to manage near-term funding issues and to de-lever balance sheets. Transports underperformed due to poor results from Hertz as the company works to undo its electric vehicle strategy.

Fundamentals

- There was only one default in April for $350 million, but two distressed exchanges. This resulted in a drop in the trailing 12-month par value default rate of 26 bps to a seven-month low of 2.33%, or 12 bps lower to 1.55% excluding distressed exchanges. We expect the default rate to remain near the post-Global Financial Crisis average of 2.5%. The default rate also moved 33 bps lower on an issuer basis to 4.14% (2.24% excluding distressed exchanges). The distress ratio increased from 5.9% to 6.4%.
- Credit quality improved in April, as it was the second month in the last three that had more issuers upgraded than downgraded. Additionally, a significantly greater par amount of bonds were upgraded versus downgraded, indicating healthier credit among larger companies. Additionally, lower-quality issuers are suffering more than higher-quality issuers, with the year-to-date upgrade-to-downgrade ratio for BB, B, and CCC-rated issuers at 1.21, 1.29, and 0.77, respectively. In April, 35 issuers were upgraded for $61 billion, and 20 issuers were downgraded for $19 billion. The upgrade-to-downgrade ratio was strong in April at 1.8x by issuer and 3.2x by par, improving the YTD issuer ratio to 1.1x and the par ratio to 1.2x. LTM ratios also increased slightly, with the par ratio at 1.34x and the issuer ratio at 1.06x. During the month, there were no rising stars and one fallen angel for $1.4 billion.

Technicals

- Market technicals deteriorated with the risk-off environment in April as fund flows turned negative in response to the move higher in U.S. Treasury Yields and the geopolitical uncertainty. Fund outflows amounted to $3.2 billion in April, decreasing the YTD inflow to $3.1 billion. New issuance declined 6% from March levels, with 42 bonds pricing for $26 billion. In April, 75% of issuance went toward refinancings as issuers remained focused on extending maturities. While gross issuance is up significantly from $59 billion to $114 billion, net issuance is flat at $22 billion. Less than 2% of new issuance was from CCC companies.

Outlook

- Once again, the “Goldilocks” environment was short-lived as economic growth and inflation have been hotter than market expectations. We continue to expect a bumpy landing as the Fed attempts to bring inflation to target while also allowing the labor market and the economy to remain strong enough. However, the impact of inflation and rates on economic growth remain potential sources of credit volatility. The positive impact of stronger growth has been solid earnings as demand begins to improve and destocking is largely finished. However, the shift to "higher for longer" has had more negative impacts on certain companies, especially distressed credits with near-term maturities. Risks remain around the future path of monetary policy, tighter lending conditions, availability of credit, slowing growth, inflationary pressures, and geopolitical events.

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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.

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