High Yield Market Update

FEBRUARY 2023: OUTLOOK AND IMPLEMENTATION

- January's strong performance carried forward into the first week of February until a strong employment number caused the high yield market to reverse course. The January jobs data prompted U.S. Treasury yields to increase as fears of a surging economy and untamed inflation resurfaced. The yield on the U.S. Treasury 2-year note increased by 62 basis points in February, while the 10-year note increased by 41 basis points. The high yield index finished with a -1.29% return for the month. BBs, the ratings tier most sensitive to changes in Treasury yields, led the way lower with a -1.82% return over the four-week span, while Bs finished with a -1.07% return. CCCs finished with a positive return as the "compression trade" continued. Despite a relatively mundane new issue calendar, the market could not overcome the move in rates and sizable outflows. Additionally, fourth quarter earnings took up much of the investor community's time as we saw our heaviest weeks of releases in the latter half of the month. While earnings have been generically in line, we have seen more dispersion in earnings across industries, particularly within wirelines and cable satellite.
- The top performing industries were transportation services (+0.58%), leisure (+0.31%), other REITs (-0.27%), pharmaceuticals (-0.49%), and brokerage, asset managers, exchanges (-0.53%). February's bottom performers were wirelines (-3.81%), cable satellite (-2.74%), midstream (-2.00%), banking (-1.75%), and electric (-1.69%).

Fundamentals

- The issuer-weighted rate of defaults over the last twelve months rose over 1% to 1.07% from 0.86% in January.
- By number of issuers, downgrades outpaced upgrades in February, taking the upgrade-to-downgrade ratio to 0.07.

Technicals

- After a small inflow in January, we saw $8.4 billion exit high yield in February.
- The primary calendar was less active in February due to the increased volatility, but we still saw $14.4 billion price.
- Despite a less active primary calendar and a substantial outflow, maturities, rising stars, and coupon payments created a small shortfall of -$1.2 billion in February.

Pricing

- The average spread of the high yield index finished +412 – 9 basis points tighter from January's close of +421.
- The yield-to-worst of the high yield index ended February at 8.63%, or 0.49% higher from January's close.
- The average price of the high yield index closed February at $87.72 – $1.5 points lower on the month.

Implementation

- February's weakness created opportunities for us in both the primary and secondary markets. While the new issue calendar was not as robust as last month's, we selectively took advantage of new issue concessions. We also participated in the secondary market by adding to existing positions along with new credits. We funded these purchases with cash we had built up leading into fourth quarter earnings. Heading into March, we will continue to sort through earnings releases and the associated price actions. Given the uncertain economic environment, we will be focused on forward guidance and global economic conditions. The Federal Open Market Committee meets again in the latter half of the month, but we will continue to monitor inflation and jobs data as we wrap up the first quarter of 2023.

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Past performance is not indicative of future results.

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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