High Yield Market Update

Newfleet ASSET MANAGEMENT
A Virtus Investment Partner

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Performance

The U.S. high yield market rally continued, returning 1.94% as the market soared. Treasury yields had a large move lower as inflation data continued to improve. June inflation data surprised to the downside, which opened the door for rate cuts to begin as early as the September meeting. This contributed to a large decline in Treasury yields, with 5- and 10-year U.S. Treasuries lower by 46 basis points (bps) and 37 bps, respectively. Additionally, economic data pointed to a slowing but resilient economy as payrolls showed the labor market moving into better balance. In response to the positive data, technicals showed strength and provided support to the market. Lower-quality credits outperformed on prospects for the rate cutting cycle to begin, with BB, B, and CCC credits gaining 1.55%, 1.77%, and 3.64%, respectively. Spreads widened 5 bps to 314 bps and excess returns were 0.36%. The yield-to-worst (YTW) decreased from 7.9% at the end of June to 7.6% at the end of July.

Sectors

The best-performing sectors were wirelines, cable satellite, and wireless, which returned 6.81%, 3.77%, and 3.43%, respectively. Wirelines rallied as a major issuer reported several large AI-related deals that will boost near-term cash flows. Cable satellite outperformed on improved risk sentiment. Higher-quality credits in wireless benefitted from the rate rally. The worst-performing sectors were airlines, packaging, and chemicals, which returned 0.57%, 0.80%, and 0.98%, respectively. Airlines underperformed as excess capacity drove weaker earnings. Packaging suffered due to weaker-than-anticipated glass demand. Chemicals underperformed as the macro environment failed to support an anticipated volume recovery and drove lowered 2H24 guidance.

Fundamentals

There was only one default for $375 million and one distressed exchange for $10 million. Default rates dropped for the seventh time in the last eight months and declined to an 18-month low. This resulted in a drop in the trailing 12-month par value default rate of 1 bp to 1.78%, or 1 bp lower to 1.16% excluding distressed exchanges. The ratio is now 110 bps lower YTD. The default rate moved 11 bps higher on an issuer basis to 3.71% (1.80% excluding distressed exchanges). The distress ratio decreased from 7.3% to 6%.

Credit quality continued to strengthen in July, with upgrades greater than downgrades for the fourth consecutive month and five of the last six months. In July, 21 issuers were upgraded for $30 billion and 11 issuers were downgraded for $16 billion. The upgrade-to-downgrade ratio remained strong in July at 1.9x by issuer and 1.9x by par, keeping the YTD issuer ratio at 1.2x and the par ratio at 1.4x. LTM ratios were relatively unchanged, with the par ratio at 1.26x and the issuer ratio at 1.13x. For July, there was one rising star for $2.6 billion and one fallen angel for $100 million.

Technicals

Market technicals were strong in July due to positive fund flows and subdued new issuance. Inflows soared to $8.4 billion in July, increasing the YTD inflow to over $18 billion. New issuance increased 9% from the prior month with 31 bonds pricing for $19.5 billion. In July, 65% of issuance went toward refinancings. Market access improved, with 13% of new issuance coming from CCC companies.

Outlook

Recent economic data has increased expectations for the Federal Reserve (Fed) to begin its much-anticipated rate cutting cycle. Though inflation data has continued to improve, certain other data has increased concerns that the Fed is behind the curve, increasing risks of a recession. We still expect a bumpy landing as the Fed attempts to bring inflation to target while also allowing the labor market and the economy to retain their overall strength. However, the impact of inflation and rates on economic growth remain potential sources of credit volatility. Earnings growth has been stronger than expected, but higher-for-longer interest rates have contributed to a delayed volume recovery and concerns about slower growth ahead. In addition, the higher rate environment has had a more negative impact 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.

For information about Newfleet's retail fixed income strategies, please visit www.Virtus.com.

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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