

MARCH 2024

Performance

- The U.S. high yield market climbed 1.18%, with late March spreads reaching levels not seen since late 2021. The strong performance came as economic data eased inflationary concerns from earlier in the year and the labor market and the economy remained strong. Additionally, Chairman Powell indicated that a strong labor market would not necessarily prevent falling inflation and lower rates. This brought markets back to “Goldilocks” euphoria, with expectations for near-term rate cuts while the economy remained strong. In addition to the positive macro data, earnings remained supportive of tighter spreads, and the positive technicals enabled companies to be very active in refinancing near-term maturities. Returns were fairly even across ratings categories, with higher-quality issues benefitting more from the move lower in Treasury yields and lower-rated issues boosted by the positive economic data and earnings. BB, B, and CCC credits returned 1.25%, 1.06%, and 1.10%, respectively. Spreads tightened 13 basis points (bps) to 299 bps, with CCC spreads tightening 33 bps. The yield-to-worst (YTW) decreased from 7.9% at the end of February to 7.7% at the end of March.

Sectors

- The best-performing sectors were retailers, building materials, and transportation services, which returned 2.16%, 2.05%, and 1.97%, respectively. Retailers outperformed due to the strong labor market and consumer resilience. Home Depot’s acquisition of SRS Distribution for 16x EBITDA caused SRS bonds to surge higher and boosted other building materials bonds due to the very strong multiple. Transportation services outperformed as bonds of car rental companies rebounded after weak earnings. The worst-performing sectors were wireless, cable & satellite, and packaging, which returned -6.97%, -0.15%, and 0.34%, respectively. Wireless and cable & satellite underperformed after Altice France’s earnings call conveyed expectations for bondholders to take significant haircuts in their bond prices. Packaging underperformed after Ardagh hired advisors to assist with near-term debt maturities.

Fundamentals

- No companies defaulted in March, but two companies completed distressed exchanges. This resulted in a relatively unchanged trailing 12-month par value default rate of 2.59%, or 1.67% excluding distressed exchanges. We expect the default rate to remain near the post-Global Financial Crisis average of 2.5%. The default rate also remained unchanged on an issuer basis at 4.36%. The distress ratio declined from 6.1% to 5.9%.
- Credit quality returned to its negative bias after a rebound in February, with more issuers downgraded than upgraded for the fifth time in the last six months. Upgrades remained higher than downgrade volumes, 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 1.08, 1.28, and 0.47, respectively. In March, 25 issuers were upgraded for \$49 billion and 30 issuers were downgraded for \$38 billion. The upgrade-to-downgrade ratio deteriorated from 1.1x to 0.9x by issuer and improved from 0.8x to 0.9x by par. LTM ratios have stabilized, with the par ratio at 1.22x and the issuer ratio at 1.0x. During the month, there were three rising stars for \$7 billion and one fallen angel for \$2 billion.

Technicals

- Market technicals remained strong in March as money continued to come into the market with minimal new net supply. Fund inflows increased to \$1.6 billion. New issuance increased slightly from February, with 40 bonds pricing for \$28 billion. In March, 72% of issuance went toward refinancings as issuers remained focused on extending maturities.

Outlook

- More benign inflation combined with healthy labor markets sparked a return to a “Goldilocks” environment for spreads. However, the impact of inflation and rates on economic growth are still potential sources of credit volatility. After peaking in the first quarter, credit quality has shown signs of stabilizing among larger, higher-rated firms as stronger economic growth translated into profit improvement. However, smaller lower-rated issues appear to be suffering more in the higher-rate environment. Risks remain around the future path of monetary policy, tighter lending conditions, availability of credit, slowing growth, inflationary pressures, and geopolitical events. Additionally, spreads have priced in a successful soft landing and multiple rate cuts in 2024, making the market more vulnerable to softer economic growth or sticky inflation.

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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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