High Yield Market Update

JUNE 2024

Performance

The U.S. high yield market continued to rally with a gain of 0.94% due to favorable economic data and strong technicals. May inflation data surprised to the downside, which revitalized the prospects for earlier rate cuts and contributed to lower U.S. Treasury yields, with 5-year and 10-year U.S. Treasuries lower by 13 basis points (bps) and 10 bps, respectively. Additionally, economic data pointed to a slowing, but resilient economy. Fund flows remained supportive in response to the macro data and the relatively high yields. Higher-quality credits continued to outperform with the rally in rates as BB, B, and CCC credits gained 1.05%, 0.96%, and 0.55%, respectively. Spreads widened 1 basis point to 309 bps and excess returns were 0.13%. The yield-to-worst (YTW) decreased from 8% at the end of May to 7.9% at the end of June.

Sectors

The best-performing sectors were food and beverage, lodging, and other financials, which returned 1.59%, 1.41%, and 1.39%, respectively. Food and beverage outperformed due to the announcement of an all-stock merger of equals between BlueTriton and Primo Water. Lodging and other financials benefitted from the outperformance of higher-quality, longer-duration issues. The worst-performing sectors were wirelines, wireless, and transportation services, which returned -0.39%, 0.54%, and 0.61%, respectively. Wirelines underperformed due to secular challenges and balance sheet concerns. Wireless underperformed due to weaker fundamentals and liability management expectations from a large issuer. Transportation services was negatively impacted by an issuer's financial results, including a much larger cash burn than anticipated, that necessitated a large capital raise.

Fundamentals

There were no defaults and only one distressed exchange for $855 million. This resulted in a drop in the trailing 12-month par value default rate of 23 bps to 1.79%, or 8 bps lower to 1.17% excluding distressed exchanges. The ratio is 109 bps lower year-to-date. The default rate also moved 45 bps lower on an issuer basis to an 11-month-low of 3.59% (1.80% excluding distressed exchanges). The distress ratio increased from 7.1% to 7.3% as "higher for longer" continues to negatively impact more stressed credits.

Credit quality continued to strengthen in June, with upgrades greater than downgrades for the third consecutive month and four of the last five months. A significantly greater par amount of bonds continues to be upgraded versus downgraded. In June, 26 issuers were upgraded for $50 billion, and 13 issuers were downgraded for $16 billion. The upgrade-to-downgrade ratio was strong in June at 2x by issuer and 3.2x by par, improving the year-to-date issuer ratio from 1.1x to 1.2x and the par ratio from 1.2x to 1.4x. LTM ratios were relatively unchanged, with the par ratio at 1.41x and the issuer ratio at 1.14x. During the month, there were no rising stars or fallen angels.

Technicals

Market technicals were positive in June as fund flows remained strong and new issuance declined. Fund inflows amounted to $1.9 billion in June, increasing the second quarter inflow to $4.1 billion and increasing the year-to-date inflow to $10.4 billion. New issuance declined 47% from the prior month with 33 bonds pricing for $18 billion. In June, 79% of issuance went toward refinancings. Only 7% of new issuance was from CCC-rated companies.

Outlook

The market environment remains volatile, with growth and inflation data in focus as the market keys in on the inflation path and labor market environment and what that means for the path of interest rate cuts and economic growth. We continue to expect a bumpy landing as the Federal Reserve 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 from 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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