HIGH YIELD MARKET

INVESTMENT COMMENTARY & REVIEW

First Quarter 2022

The Bloomberg U.S. High Yield Corporate Index (Index) returned -4.84% during the first quarter, predominantly driven by the dramatic rise in Treasury yields. The most rate-sensitive rating cohort, the BB-rated category, led with a loss of -5.94%. The B-rated and CCC-rated categories returned -3.53% and -3.88%, respectively.

The Index option-adjusted spread (OAS) widened 42 bps in the first quarter to +325 bps, while the yield-to-worst (YTW) rose to 6.01% from 4.21%. By ratings, BB-rated credits now trade at an OAS of +232 bps and offer a YTW of 5.00%, B-rated credits at an OAS of +342 bps and 6.27% YTW, and CCC-rated credits at an OAS of +625 bps and 9.06% YTW. The average dollar price of the Index fell below par to $97.04 at quarter end.

With the Federal Reserve embarking on an anticipated aggressive tightening of monetary policy in order to combat inflation, coupled with the Russia-Ukraine war, sentiment on economic growth deteriorated rapidly during the quarter resulting in increased risk premiums in the high yield market and materially higher spreads and yields. With a complex mix of macro risks, ranging from the war and possible further geopolitical shocks to a potential Fed-induced U.S. recession to the ongoing pandemic disruptions in China, offset by healthy corporate balance sheets, strong in-place fundamentals, and a very low default rate, it is a challenge to have confidence in the near-term direction of the market at current valuations. That said, at near 6% yield, the total return prospects over a multi-year period for the high yield market are favorable. Furthermore, we are steadfast in our conviction that our high yield strategy, which focuses on well-positioned smaller companies within fundamentally sound industries with bonds offering greater yield yet lower relative default risk, will continue to outperform through any full cycle.

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