NYLIM GF US High Yield Corporate Bonds

Market Overview

Markets reconsider rates.

- The ICE BofA US High Yield Index gained just 0.04% in the month of January, after returning 8.38% in November and December.
- US rates paused their steep decent as the market reevaluates the future path of interest rates. The US 10-Year Treasury yield rose 20bps from 3.86% to 4.06% (after hitting a peak of 5.00% in mid-October).
- Yields on the ICE BofA US High Yield index rose 19bps in January to 7.84% with spreads widening 18bps to 379bps.

Fund flows continue; new issuance picks up considerably due to refinancings.

- US high yield mutual funds/ETFs posted inflows of $2.8bn in January, a continuation from the $5.3bn that entered funds last quarter.
- January gross issuance was $31.6bn – the largest monthly volume since November 2021. Most of the volume was opportunistic refinancings, with net issuance at just $5.9bn.

Market drivers in Q4 generally gave up some gains in January.

- CCCs were down 0.50% for the month, compared with BBs and Single-Bs, which were up 0.09% and 0.08%, respectively.
- Banking outperformed all other sectors this month, up 1.31%. Retail and Energy followed, gaining 0.97% and 0.77%, respectively, in January.
- Telecommunications was down 1.81%, followed by Media, which lost only 1.73%. Technology & Electronics was down 0.30% this month.

Portfolio Highlights & Strategy Review

The portfolio's underweight to CCCs was positive for relative returns as the segment lagged during the month.

Selection within Cable & Satellite TV was positive as the portfolio was underweight EchoStar/DISH, whose bonds fell significantly. Not owning Lumen Technologies was beneficial in the Telecom-Wireline sector.

Gulfport Energy lagged in the Energy sector. WW International bonds were down in January, which was negative for returns in the Services sector

Fund Outlook

High yield valuations have tightened considerably. The BofA ICE US High Yield Index's spread of 379bps as of January 31 is tighter than the historical average of 454bps, and not far from the low end of the post-GFC non-panic range of 350-550.

However, credit trends remain stable within US high yield. The leverage level of high yield issuers remains near its lows, according to JPM Morgan. Likewise, the "upgrade-to-downgrade" ratio for the high yield bond market remains above one (i.e., for every $1 of high yield bonds downgraded by credit rating agencies, $1.3 in high yield bonds were upgraded). While this ratio has declined sharply from the 2021 high, it suggests that broad credit trends remain firm.

The good news is for the high yield market is on a relative basis. Yields are also reasonable relative to historical levels given higher interest rates. Starting yields of 7.9% (as of January 10) have generally been good indicators for strong subsequent 5-year performance for the market. Moreover, US High Yield looks attractive relative to equities with the spread between the yield on the ICE BofA US High Yield Index and the earnings yield of the S&P 500 Index now at 4.1%.

There are many risks in financial markets today. However, stable fundamentals and reasonable valuations suggest that US high yield continues to represent a reasonable, lower duration fixed income investment option.