US High Yield Still Positive Despite Coronavirus Woes

Looking Beyond the Headlines . . .

Losses Minimal for the US High Yield Market – While the headlines are horrific and the daily volatility is painful, the broad US high yield market, as represented by the ICE BoFA US High Yield Index, was down 1.55% in February as well as for the year through February 29th.
- US high yield broke even for January and was off to a healthy start for the first two weeks of February, until fear of COVID-19 took control of the market.
- Global high yield has done somewhat better, as it was off 1.40% in February and 1.05% for the year through Feb 29th, supported in part by much stronger performance from emerging markets.

Dispersion Increasing – As opposed to the start of the year, there are now significant dispersions between sectors. Energy is the obvious victim, with exploration and production (E&P) sector returns down 13.85% through Feb 29th, while midstreams/pipelines were only down 3.78% YTD.
- We view the increased dispersion as an opportunity.
- Our outlook for the energy sector improved in January and with recent market volatility we are seeing opportunities in E&P companies, particularly midstreams.

Credit Spreads Have Moved Wider – As US Treasury yields have plummeted (the yield on the 10-year was just under 1% on March 3rd), high yield spreads have also gapped higher with the option-adjusted spreads (OAS) at 497bp at last night’s close, which is 137bp wider than where we started the year and 98bp wider than where we started the month of February.
- While spreads have widened over the MTD and YTD, they are not as wide as they were at the end of 2018.
- The drop in Treasury yields is primarily responsible for the increase in spreads, as yields are back to where they were in the first half of 2019.
- The Federal Reserve’s 50 basis point reduction yesterday to its short-term interest rate target demonstrates their willingness to provide an extraordinary level of support to the market. We expect additional monetary and fiscal stimulus from other countries.

Fundamentals Still Generally Solid – After three days of meeting with high yield companies at a recent conference, we believe news at a company level is still generally favorable, with some obvious exceptions.
- Despite the recent sell-off, we expect demand to remain robust as the thirst for yield remains unquenched.
- Net new supply is expected to be light this year as high yield M&A and LBO activity has been light.

In summary, despite market volatility, we believe the outlook for the high yield asset class is still favorable. While we are proceeding with caution, we remain relatively optimistic about the year ahead for high yield.
Definitions:

- **Basis Point** – A unit of measure used to describe the percentage change in the value or rate of a financial instrument. One basis point is equivalent to 0.01% (1/100th of a percent) or 0.0001 in decimal form. In most cases, it refers to changes in interest rates and bond yields.
- **Spread** – The difference between two prices or interest rates.
- **Spread Widening**: US treasury prices to rise and yields to fall while corporate bond prices fall and yields rise.

Important Information

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