HIGH YIELD MARKET

INVESTMENT COMMENTARY & REVIEW

by Michael Yean

First Quarter 2021

The Bloomberg Barclays U.S. High Yield Corporate Index (Index) returned a modest 0.85% during the first quarter of 2021.

The CCC-rated cohort returned 3.58%, compared to 1.16% and -0.15% for the B-rated and BB-rated cohorts, respectively. The Index option-adjusted spread (OAS) tightened by 50 basis points (bps) to +310 bps in the first quarter, while the yield-to-worst (YTW) rose slightly to 4.23% from 4.18%. By ratings, BB-rated credits now trade at an OAS of +227 bps and offer a YTW of 3.40%, B-rated credits at an OAS of +334 bps and 4.49% YTW, and CCC-rated credits at an OAS of +548 bps and 6.55% YTW. The average dollar price of the Index declined to $104.16 by quarter end.

The crosscurrents of economic recovery and sharply rising Treasury yields were evident in the varying returns by credit quality within the overall high yield market. While the Index tightened materially and offset the rise in rates, the longer-duration, most rate-sensitive BB bucket produced a negative total return. On the other hand, the lower-rated buckets, which offer greater yield and are broadly more influenced by economic activity and growth, outperformed and generated positive returns for the quarter.

Our outlook for the high yield market for 2021 remains unchanged. We continue to expect accommodative monetary and stimulative fiscal policy along with progress on COVID-19 immunizations to set the stage for an economic recovery and a constructive environment for credit. The PIA Investment Strategy Group (ISG), using the 10-year Treasury as our proxy for interest rates, continues to see 2021 bond market yields range-bound between 1.35% – 2.05%. However, the combination of accommodative policy and economic activity may also further pressure Treasury yields upwards. As such, we expect the intra-market dynamics on display in the first quarter to broadly continue, and we believe the fund is positioned to take advantage of this trend.

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High Yield Portfolio Manager

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Bloomberg Barclays U.S. Corporate High Yield Index covers the universe of fixed rate, non-investment grade debt. Eurobonds and debt issues from countries designated as emerging markets (e.g., Argentina, Brazil, Venezuela, etc.) are excluded, but Canadian and global bonds (SEC registered) of issuers in non-EMG countries are included. Original issue zeroes, step-up coupon structures, 144-As and pay-in-kind bonds (PIKs, as of October 1, 2009) are also included. The index includes both corporate and non-corporate sectors. The corporate sectors are Industrial, Utility, and Finance, which include both U.S. and non-U.S. corporations. The Yankee sector has been discontinued as of 7/1/00. The bonds in the former Yankee sector have not been removed from the index, but have been reclassified into other sectors. You cannot invest directly in an index.

The Barclays' Quality sectors discussed above use the following rating methodology. Securities that are rated by three rating agencies, will receive the middle of the three ratings. Securities that are rated by only two agencies will receive the lower of the two ratings. Securities rated by only one agency will receive that rating while securities not covered by any of the three agencies will receive a non-rated (NR) rating. Bond ratings start at Aaa (denoting the highest investment quality) and usually end at D (meaning payment is in default). In limited situations when the rating agency has not issued a formal rating, the rating agency will classify the security as non-rated (NR).

Option-adjusted spread (OAS) is the measurement of the spread of a fixed-income security rate and the risk-free rate of return, which is adjusted to take into account an embedded option. Typically, an analyst uses the Treasury securities yield for the risk-free rate.

Basis point (bp)- A unit that is equal to 1/100th of 1%, and is used to denote the change in a financial instrument.

Yield to worst - the lowest potential yield that can be received on a bond without the issuer actually defaulting.

Duration - A commonly used measure of the potential volatility of the price of a debt security, or the aggregate market value of a portfolio of debt securities, prior to maturity. Securities with a longer duration generally have more volatile prices than securities of comparable quality with a shorter duration.

Fiscal Policy - The means by which a government adjusts its spending levels and tax rates to monitor and influence a nation's economy.

Monetary Policy - consists of the actions of a central bank, currency board or other regulatory committee that determine the size and rate of growth of the money supply, which in turn affects interest rates.

Yield - the income return on an investment, such as the interest or dividends received from holding a particular security.

Spread - The difference in yields between two fixed-income securities with the same maturity, but originating from different investment sectors.

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Past performance does not guarantee future results.

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