



HIGH YIELD MARKET

INVESTMENT COMMENTARY & REVIEW

Third Quarter 2022

The Bloomberg U.S. High Yield Corporate Index (Index) returned -0.65% during the third quarter, bringing total returns for the first nine months of 2022 to -14.74%. While the quarterly return was nearly flat overall, the high yield market exhibited significant volatility intra-quarter. A strong early summer rally in credit quickly turned decidedly negative in September as the Fed continued to raise rates unabashedly and recessionary concerns remained in the forefront for investors.

The BB-rated, B-rated, and CCC-rated categories recorded losses of -0.71%, -0.66%, and -0.42%, respectively. The Index option-adjusted spread (OAS) tightened 17 bps in the quarter to +552 bps, while the yield-to-worst (YTW) rose to 9.68% from 8.89%. By ratings cohorts, BB-rated credits now trade at an OAS of +354 bps and offer a YTW of 7.77%, B-rated credits at an OAS of +619 bps and 10.23% YTW, and CCC-rated credits at an OAS of +1111 bps and 15.22% YTW. The average dollar price of the Index declined to \$83.86 at quarter end.

As noted in prior commentary, current valuations have historically been compelling entry points in the high

yield market. Given the 3Q quarter-end yield of 9.68%, yields would need to increase by more than another 2% before returns become negative over a twelve-month period (assuming a 3% default rate and historical averages for recovery values). If treasury yields remained unchanged while high yield climbed another 2%+, high yield spreads would grow wider than +750bps.

In addition, low average bond prices, a better rating mix, and the highest concentration of secured bonds on record for the Index provides relative downside protection. These characteristics imply that the aggregate probability of default and potential default-related losses for the high yield market are likely to be less severe than compared to past recessions.

We believe the high market can provide compelling long-term returns, and we believe investing in PIA High Yield will provide relative outperformance through the cycle.

Michael Yean
High Yield Portfolio Manager

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