HIGH YIELD MARKET

INVESTMENT COMMENTARY & REVIEW

Fourth Quarter 2022

The Bloomberg U.S. High Yield Corporate Index (Index) returned 4.17% during the fourth quarter, improving the 2022 full year total return to -11.19%. Despite the fourth quarter rally, 2022 total returns marked the second worst year on record for high yield bonds, driven primarily by the greatest historical annual increase in the fed funds rate and future recession expectations.

For the fourth quarter, the BB-rated, B-rated, and CCC-rated categories recorded gains of 4.31%, 4.93%, and 0.51%, respectively. The Index option-adjusted spread (OAS) tightened 83 basis points (bps) in the quarter to +469 bps, while the yield-to-worst (YTW) declined to 8.96% from 9.68%. By ratings, BB-rated credits now trade at an OAS of +295 bps and offer a YTW of 7.21%, B-rated credits at an OAS of +489 bps and 9.21% YTW, and CCC-rated credits at an OAS of +1008 bps and 14.26% YTW. Including distressed exchanges, the high yield bond market default rate increased 129 bps year-over-year to 1.65%, which is roughly half the historical average of 3.2%. The average dollar price of the Index increased to $86.22 at quarter end.

The year-end all-in yield near 9% is highly attractive for high yield, particularly within the context of a disinflation trend and a Federal Reserve that is closer to the end of a hiking cycle rather than the beginning. However, the current (as of this writing on 1/16/23) Index YTW is approximately 8%, which still offers historically attractive valuations, yet not as remarkable as year-end.

The key swing factor for the high yield market in 2023 will be the depth and length of any economic contraction. Regardless, we believe PIA High Yield remains invested in the pockets of high yield that offer compelling long-term value propositions and, will thus, provide relative outperformance through this cycle.

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