



HIGH YIELD MARKET INVESTMENT COMMENTARY & REVIEW

Third Quarter 2023

The Bloomberg U.S. High Yield Corporate Index (Index) returned 0.46% during the third quarter, bringing 2023 year-to-date total returns to 5.86%.

BB-rated bonds lost -0.39%, while the B-rated and CCC-rated categories recorded gains of 0.84% and 2.51%, respectively. The Index option-adjusted spread (OAS) widened slightly by 4 bps in the third quarter to +394 bps, while the yield-to-worst (YTW) rose from 8.50% to 8.88%. By ratings, BB-rated credits now trade at an OAS of +264 bps and offer a YTW of 7.61%, B-rated credits at an OAS of +399 bps and 9.00% YTW, and CCC-rated credits at an OAS of +848 bps and 13.28% YTW. The average dollar price of the Index declined to \$88.12 by quarter-end.

The summer rally came to an abrupt end in September, as resilient domestic economic data and the market's recognition of the Federal Reserve's (Fed's) "higher-for-longer" outlook resulted in a "bear steepening" of the Treasury curve, driven by a 73 bps increase in the 10-year Treasury yield. The Fed finally achieved a level of tightening in U.S. financial conditions commensurate with the rate hike cycle that began more than 18 months and 500 bps ago. We believe the significant third quarter increase in interest rates across the yield curve was a reflexive market acknowledgement that the Fed intends to make good on their anti-inflation fight, thus drastically reducing hopes for rate cut relief, while increasing the risks of a deeper economic contraction. As the bond market digested higher-for-longer yields and considered whether the delayed economic reckoning will eventually be brought to the forefront, high yield

investors reassessed the future impact on credit profiles, as issuers refinance at higher coupons, while questioning whether certain segments of the high yield market will have the ability to refinance at all.

The PIA high yield investment thesis emphasizes investing in businesses that can weather a full economic cycle, including difficult economic times. We believe good businesses can attract capital, markets don't truly shut for extended periods, and there are more financing alternatives to public capital markets than ever before. We do not anticipate a meaningful spike in defaults and continue to focus on businesses with tangible assets that tend to retain their value in bankruptcy, which we believe is critical to protecting portfolios during a market drawdown.

That said, while we recognize the concerns of the impact on the US economy and corporate credit profiles from higher-for-longer interest rates, the current market yield of 9.2% supports continued investment in high yield. History informs us that when entry points are above 9% yield, the average total returns for the forward 3-month and 12-month periods are greater than 3% and 10%, respectively (Bloomberg as of June, 2023). With attractive all-in yields, the Federal Reserve nearing the end of its hiking cycle, and data supporting the ongoing resiliency of domestic economic activity, the high yield market should continue to provide positive returns.

PIA Investment Strategy Group

Pacific Income Advisers is an investment management firm registered with the U.S. Securities and Exchange Commission under the Investment Advisers Act of 1940. PIA manages a variety of fixed income and equity assets for primarily United States clients.

Past performance is not a reliable indicator or a guarantee of future results. All investments contain risk and may lose value. Investments in debt securities typically decrease in value when interest rates rise. This risk is usually greater for longer-term debt securities. Investing in lower-rated and non-rated securities presents a greater risk of loss to principal and interest than higher-rated securities.

Indexes are unmanaged, do not incur management fees, costs, and expenses, and cannot be invested in directly.

This document does not constitute advice or a recommendation or offer to sell or a solicitation to deal in any security or financial product. It is provided for information purposes only and on the understanding that the recipient has sufficient knowledge and experience to be able to understand and make their own evaluation of the proposals and services described herein, any risks associated therewith and any related legal, tax, accounting or other material considerations. To the extent that the reader has any questions regarding the applicability of any specific issue discussed above to their specific portfolio or situation, prospective investors are encouraged to contact Pacific Income Advisers or consult with the professional advisor of their choosing.