HIGH YIELD MARKET

INVESTMENT COMMENTARY & REVIEW

Fourth Quarter 2023

The Bloomberg U.S. High Yield Corporate Index (Index) returned 7.16% during the fourth quarter, bringing the 2023 full year Index total return to 13.45%.

By ratings category, BB-rated, B-rated, and CCC-rated bonds recorded fourth quarter gains of 3.24%, 3.59%, and 5.90%, respectively. The Index option-adjusted spread (OAS) tightened by 71 bps during the quarter to +323 bps, while the yield-to-worst (YTW) declined to 7.59% compared to 8.88%. BB-rated credits now trade at an OAS of +201 bps and offer a YTW of 6.34%, B-rated credits at an OAS of +310 bps and 7.52% YTW, and CCC-rated credits at an OAS of +776 bps and 12.11% YTW. The average dollar price of the Index rose from $88.12 to $93.07 by quarter-end.

The high yield market enjoyed a robust rally in the fourth quarter, driven primarily by an unexpectedly dovish Federal Reserve pivot in December that drew the market's attention away from "higher for longer" and towards underlying attractive valuations. Risk assets benefitted with additional tailwinds from the U.S. economy that seemingly refuse to slow down, continued deceleration in inflation, and default rates that climbed from 1.35% in 2022 to 2.99% by year-end, however, still below historical debt default averages.

We anticipate these tailwinds continuing into 2024. Additionally, all-in yields above 7% remain historically attractive entry points for high yield. The current modest distressed universe of high yield bonds signals a contained forward twelve-month default rate outlook. Combined with a resilient domestic economy and a Fed that has paused and is more likely to ease than to tighten further, the high yield market should produce another year of solidly positive returns.

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