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.

PIA Investment Strategy Group

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Bloomberg 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.

Yield - The income return on an investment. This refers to the interest or dividends received from a security and is usually expressed annually as a percentage based on the investment's cost.

Bond ratings provide the probability of an issuer defaulting based on the analysis of the issuer's financial condition and profit potential. Bond rating services are provided by credit rating agencies currently registered as Nationally Recognized Statistical Rating Organizations ("NRSROs"). Bond ratings start at AAA (denoting the highest investment quality) and usually end at D (meaning payment is in default). Securities not covered by any agency will receive a non-rated (NR) rating.

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.

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

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

Opinions expressed are subject to change, are not intended to be a forecast of future events, a guarantee of future results, nor investment advice.

Past performance does not guarantee future results.

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