HIGH YIELD COMMENTARY

Stock market momentum continued in 2Q24 with the U.S. bond market relatively flat. The Federal Open Market Committee (FOMC) met twice during the quarter and monetary policy remained unchanged with the Federal Funds rate "paused" at 5.25 to 5.50%, while Quantitative Tightening (QT) continued to reduce the Federal Reserve's (Fed's) balance sheet. The June FOMC statement highlighted, "Recent indicators suggest that economic activity has continued to expand at a solid pace. Job gains have remained strong, and the unemployment rate has remained low. Inflation has eased over the past year but remains elevated. In recent months, there has been modest further progress toward the Committee's 2% inflation objective. The Committee judges that the risks to achieving its employment and inflation goals have moved toward better balance over the past year. The economic outlook is uncertain, and the Committee remains highly attentive to inflation risks." U.S. Real Gross Domestic Product (GDP) increased at an annual rate of +1.4% during the first quarter of 2024, the lowest growth rate since the first half of 2022. Inflation, as measured by the U.S. Consumer Price Index (CPI), rose by 3.3% for the twelve-month period ending May 2024. The Bureau of Labor Statistics (BLS) reported the unemployment rate increased slightly in June to 4.1%, while the U6 measure of total unemployed increased slightly to 7.4%. The Conference Board Consumer Confidence Index declined in June to 100.4, down from its recent high in January of 114.8.

The Barclays U.S. High Yield Corporate Index (Index) gained a modest 1.09% during the second quarter, bringing total returns for the first half of 2024 to 2.58%. By ratings category, BB-rated and B-rated bonds recorded gains of 1.32% and 1.03%, while the CCC-rated cohort loss -0.01% during the quarter, respectively. The Index option-adjusted spread (OAS) widened by 10 bps in the second quarter to +309 bps, while the yield-to-worst (YTW) climbed 25 bps to 7.91%. BB-rated credits now trade at an OAS of +177 bps and offer a YTW of 6.58%, B-rated credits at an OAS of +279 bps and 7.67% YTW, and CCC-rated credits at an OAS of +808 bps and 12.82% YTW. The average dollar price of the Index declined slightly to $93.07 by quarter end. The par-weighted default rate on the ICE BofA High Yield Index as of the end of 2023 was 2.4%, and according to [1]BofA Research, defaults in the Index were almost evenly split between bankruptcy and distressed exchanges.

Capital markets typically don't respond well to mixed signals or ambiguity, but despite increasing levels for both, strong investor sentiment and liquidity continue to fuel positive market momentum.

The bond market remains uncharacteristically optimistic for the onset of rate cuts in 2024 with hopes of providing a more supportive backdrop for achieving a "soft landing", with consensus expectations for the initial cut at the September 17-18 FOMC meeting. The U.S. economy appears surprisingly resilient, and while inflation remains stubbornly above the Fed's stated 2% target, a softening economy gives hope that monetary easing is just around the calendar corner. [2]"As of May 31, Bloomberg's index of financial conditions showed that they were easier than before the Fed began raising interest rates more than two years ago. This is due in large part to a strong stock market and rallies in corporate bonds."

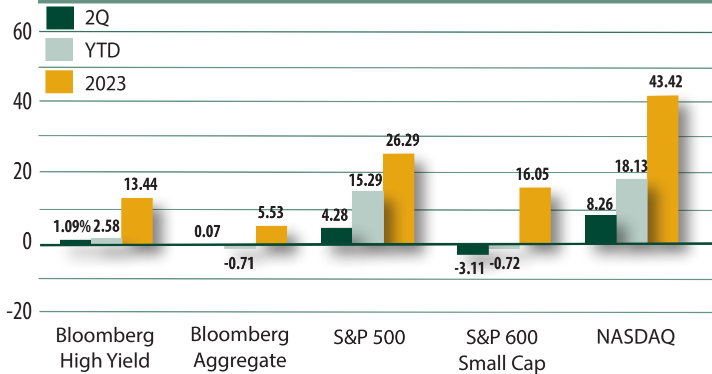
The PIA Investment Strategy Group's (ISG) current investment outlook harkens back to our 4Q22 Investment Commentary, where we stated, "the predominant threat to global economic growth remains post-pandemic related inflation," and "we believe the Fed's 2% inflation target would be difficult to achieve with an economic soft landing," meaning without an actual recession. We are not confident the current economic cycle is "different this time"; however, we do believe the strength of the latter part of this cycle has been fueled by the extraordinarily long period of post-GFC easy money growth/expansion. As previously stated, the modern-era U.S. pre-GFC economy had proven to sustain growth at/above trend with Fed Fund rates at/above 5%. Additionally, we believe the cumulative deterioration caused by persistent inflation on consumer sentiment and spending power represents a significant long-term economic concern relative to the potential for a mild recession. Therefore, we believe rate cuts may not be warranted until unemployment picks up above 4.25% or inflation falls below 2.5% coupled with real GDP continuing to fall below the 2% trend. However, market consensus is that, unlike the "old Fed" inflation hawks, the current Fed may be described as political economists

that put a greater emphasis on their employment mandate than they do on price stability and that this Fed wants to cut rates. Regardless, the optimistic outlook for the onset of rate cuts is to signify victory in the inflation battle and curb the probability of a pending recession.

While financial conditions appear to be accommodative, there are heightened risks of supply chain disruptions and growing concerns over the wars in Ukraine and the Middle East, including their impact on the U.S. The climbing costs of rising national debt and deficits, the risks of rising energy and commodity costs, and the added expense of trade fragmentation, particularly between the U.S. and China, are all potential contributors to inflationary pressures in the long run. The Conference Board Index of Leading Economic Indicators was positive in Q1 for the first time since April 2022; however, it resumed its negative trend in April and May. "There were 346 U.S. companies that filed to either liquidate or re-organize through bankruptcy in the first six months of 2024, the highest half-year level since 2010." – [3]S&P Global Market Intelligence. Given the breadth in macro and idiosyncratic risks and the ambiguity in potential 2025 fiscal policies due to the election year, we remain modestly cautious with our credit selection. However, with due consideration to the revolving door of risks to credit, the primary drivers that shape our positive view of the high yield market remain intact – historically attractive yield, a resilient domestic economy, the Fed on pause and biased to ease, and a modest default rate outlook. And while credit spreads are near historically tight levels, corporate capital structures are quite healthy given over 50% of the amount of high yield bonds outstanding were issued in 2020 and 2021 when yields were very low. As of June 2024, high yield interest coverage remains above the historical average and credit quality has never been stronger – more than half of the high yield market consists of BB-rated credit, up from 41% just 10 years ago. We expect this constructive environment for the high yield market to continue for the remainder of 2024.

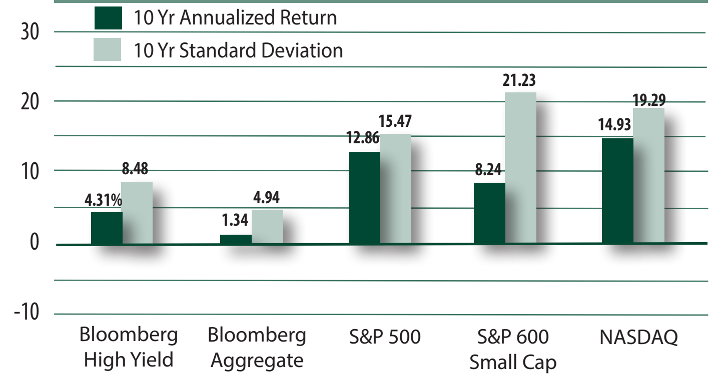
PIA Investment Strategy Group

INDEX RETURNS



Source: Bloomberg, Informais PSN
Past performance is not a guarantee of future results.

HISTORICAL PERFORMANCE



Source: Informais PSN; Annualized 10 Years
Past performance is not a guarantee of future results.

INDEX RETURNS	2Q	YTD	2023
BB	1.32%	2.47%	11.60%
B	1.03	2.41	13.78
CCC	-0.01	2.13	19.84
CC - D	4.68	18.53	16.41
Basic Industry	1.61	3.59	12.18
Capital Goods	1.15	2.81	12.82
Consumer Cyclical	1.30	3.86	16.03
Consumer Non-Cyclical	2.51	4.73	12.93
Energy	1.62	4.18	12.81
Technology	1.67	3.11	12.64
Transportation	0.54	2.53	9.68
Communication	-1.76	-3.63	12.18
Other Industrials	2.20	4.69	15.98
Utility	1.49	1.81	10.10
Financial	1.56	3.39	14.80

Source: Bloomberg, Bloomberg U.S. High Yield Index

INDEX SPREADS	6/30/24	12/31/23	12/31/22
BB	208	232	317
B	315	346	514
CCC	841	760	1,017
CC - D	1,216	785	3,148
Basic Industry	321	364	451
Capital Goods	261	284	424
Consumer Cyclical	272	283	492
Consumer Non-Cyclical	344	407	540
Energy	239	299	388
Technology	353	386	520
Transportation	414	372	433
Communication	672	529	584
Other Industrials	-548	-246	468
Utility	222	272	298
Financial	296	332	528

Source: Bloomberg, Bloomberg U.S. High Yield Index

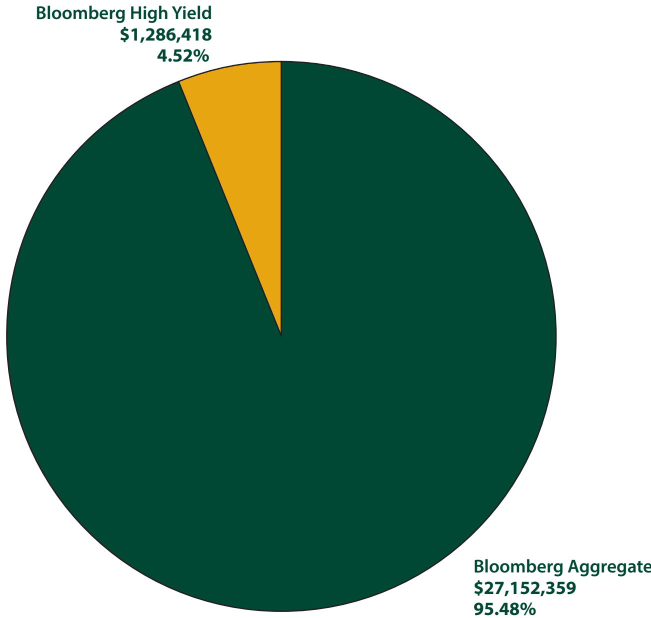
KEY CHARACTERISTICS	6/30/24	12/31/23
Duration	3.1	3.2
Yield To Maturity	8.1	7.8
Current Yield	6.8	6.5
Yield To Worst	7.9	7.6
Weighted Average Maturity	4.9	4.9
% $500mm and under	25.9	26.5
% $501mm and over	74.1	73.5

Source: Bloomberg, Yield Book, Bloomberg U.S. High Yield Index

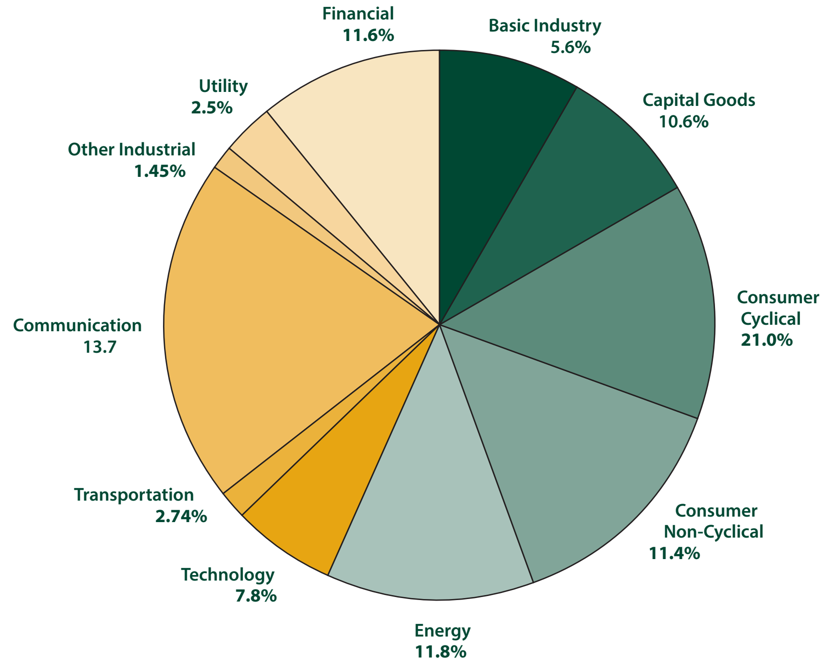
KEY CHARACTERISTICS	6/30/24	12/31/23
% BB or >	50.6	46.1
% B	36.6	41.1
% CCC	11.3	11.7
% CC and below	1.5	1.1
% Debt Maturing in < 3 Years	19.1	20.7
% Debt Maturing in 3 - 5 Years	41.0	33.8
% Debt Maturing in > 5 Years	39.9	45.5

Source: Bloomberg, Bloomberg U.S. High Yield Index

US **DEBT MARKET ($MM)**



BLOOMBERG **HIGH YIELD**



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Bloomberg U.S. 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.

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S&P SmallCap 600 covers approximately 3% of the domestic equities market. Measuring the small cap segment of the market that is typically renowned for poor trading liquidity and financial instability, the index is designed to be an efficient portfolio of companies that meet specific inclusion criteria to ensure that they are investable and financially viable.

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

[1]BofA Research, January 23, 2024

[2]Bloomberg Newsletter, Easy Financial Conditions are Masking 'Anemic' Credit, May 31, 2024, by Chris Anstey and Edna Curran

[3] S&P Global, US corporate bankruptcies lean toward reorganization in H1 2024, July 16, 2024, by Arpita Banerjee and Umer Khan

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