# HIGH YIELD COMMENTARY

Stock market momentum retreated in the first quarter, falling into negative territory, while bond investors enjoyed positive returns, as interest rates declined across the yield curve. The Federal Reserve target funds rate remained unchanged at 4.25% to 4.50% in the first quarter of 2025. The Federal Open Market Committee's (FOMC) March statement highlighted, "Looking ahead, the new Administration is in the process of implementing significant policy changes in four distinct areas: trade, immigration, fiscal policy, and regulation. It is the net effect of these policy changes that will matter for the economy and for the path of monetary policy. While there have been recent developments in some of these areas, especially trade policy, uncertainty around the changes and their effects on the economic outlook is high." The "hard" economic data reported in the first quarter continued to be solid. U.S. Real Gross Domestic Product (GDP) increased at an annual rate of 2.4% during the fourth quarter of 2024. Inflation, as measured by the U.S. Consumer Price Index (CPI), rose by 2.4% for the twelve-month period ending March 2025. The Bureau of Labor Statistics (BLS) reported the unemployment rate remained steady at 4.2% in March, while the U6 measure, which includes not only the unemployed but also underemployed workers and those marginally attached to the labor force, increased slightly to 7.9%. However, "soft" economic data, generally interpreted as leading indicators, reported significant declines throughout the first quarter. The Conference Board Consumer Confidence Index declined dramatically to 92.9 in March. Similarly, the closely followed University of Michigan Consumer Sentiment Survey posted a March reading of 57.9. a 10.5% decline from February.

Mid-quarter, the S&P 500 reversed its upward trajectory to post a negative return of -4.27% by quarter-end, while the tech-heavy NASDAQ 100 fared even worse returning -8.07% for the quarter. The Bloomberg U.S. Aggregate Index generated a positive return of 2.78% for the quarter. The 2-year Treasury yield declined by 35 bps to 3.89%, while the 10-year Treasury yield declined by 36 bps to finish the quarter at 4.21%. During the quarter, U.S. Treasuries returned +2.92%, while all other major investment grade bond sectors were also positive – Investment Grade (IG) corporate bonds (+2.31%), U.S. Agency Securities (+2.25%), Mortgage-Backed Securities (+3.06%), Commercial MBS (+2.57%) and Asset-Backed Securities (+1.53%). The Barclays U.S. High Yield Corporate Index (Index) produced a 1.00% first quarter gain, amidst a backdrop of negative consumer sentiment. By ratings category, BB-rated and B-rated bonds recorded solid returns of 1.49% and 0.74% respectively, while the CCC-rated cohort reversed course with a negative return (-0.44%) in the first quarter. The Index option-adjusted spread (OAS) widened notably by 60 bps in the first quarter to +347 bps, while the yield-to-worst (YTW) rose by 24 bps to 7.73%. BB-rated credits now trade at an OAS of +219 bps and offer a YTW of 6.45%, B-rated credits at an OAS of +346 bps and 7.77% YTW, and CCC-rated credits at an OAS of +677 bps and 10.95% YTW. The average dollar price of the Index declined marginally to $95 in the first quarter. In spite of a dramatic negative shift in sentiment and recession concerns, the trailing 12-month par-weighted U.S high yield bond default/distressed exchange rate declined to 1.20%, as compared to the 25-year average default rate of 3.4%. The upgrade to downgrade ratio remains in healthy territory, although well off it's 2021 peak (JP Morgan).

Our investment outlook can be distilled down to the two most common talking points in today's investment vernacular—tariffs and uncertainty. This is why, in this quarterly investment outlook, we're referencing events a bit beyond the first quarter into early April to include "Liberation Day." Unfortunately, for all those "wait and see" investors seeking greater clarity, Liberation Day and the weeks to follow delivered even greater ambiguity with "worst-case" tariff announcements followed by a "pause" and then industry specific exceptions. During the week of April 7th, according to Jim Reid, Global Head of Macro Research at Deutsche Bank, the U.S. capital markets experienced the biggest stock market sell-off since 2020, the biggest stock market rally since 2008, and the biggest upward surges in 10-year and 30-year Treasury yields since 2001 and 1987, respectively. Additionally, the U.S. dollar (DXY) declined roughly 2% during this same week, adding to the DXY's more than 8% slide from it's 2025 high set in early January.

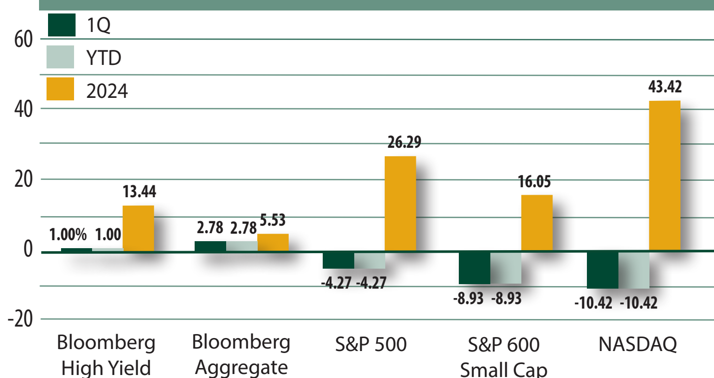
PIA entered 2025 with a "wait and see" attitude, predominantly due to the wide range of potential policy implications, including the economic impacts of tariffs. Our economic and market optimism was based on visions of deregulation and lower taxes driving U.S. investment and capital inflows. U.S. GDP-per-capita remains the highest worldwide, and U.S. exceptionalism

was never stronger. We were legitimately concerned about the climbing U.S. national debt fueled by our $2+ trillion budget deficit (roughly 7% of the annual U.S. GDP). However, unemployment was near a historical low, consumer spending and sentiment were strong, real GDP was at/near trend, and while inflation remained stubbornly above the 2% target, CPI/PCE appeared to be trending lower. The stage was set for the U.S. to pull in global capital with favorable regulatory and tax policies that would expand and grow our economy, leading to deficit reduction. So what changed?

U.S. fiscal policy didn't lead-off with lowering prices, lowering taxes, or deregulation. Instead, policymakers leaned in the direction of global trade tariffs, governmental closures/lay-offs, and imperialistic overtones directed at U.S. allies, including Canada, Greenland, and Panama. Importantly, the frequent changes in tariff targets and levels have added to the opacity in U.S. tariff objectives. Tariffs are a consumption tax that increases economic friction, leading to slower growth while also putting upward pressure on prices, leading to higher inflation, at least in the short-term. The combination of dramatic tariff rhetoric, with expectations for lower interest rates and GDP growth, unveiled significant incongruence in fiscal objectives and exacerbated the preexisting level of uncertainty. Fed Chairman Powell, in his March 19th FOMC press conference, estimated the impacts of tariffs would likely lead to a year-over-year increase in PCE of 3.5%, a decline in GDP to 1%, and a rise in unemployment to 4.4%. These estimates portend potential stagflation – declining growth, rising unemployment, and rising inflation. Stagflation concerns also raise the level of uncertainty as it limits Federal Reserve options to ease monetary policy at a time when recession concerns have increased substantially. An essential component of U.S. exceptionalism has been effective monetary policy and protecting the world's reserve currency. We are mindful that the pace and perceived magnitude of policy impacts on many of our trading partners may raise concerns regarding future demand for dollar-denominated financial assets. While it appears the risks of U.S. economic contraction have risen notably over the past several weeks, we are increasingly concerned about stagflation risk and the potential for rising interest rates at a time when economic growth may be under pressure. Fortunately, the bond market offers debt issuers with solid balance sheets that offer attractive income opportunities regardless of the near-term direction of the U.S. economy.

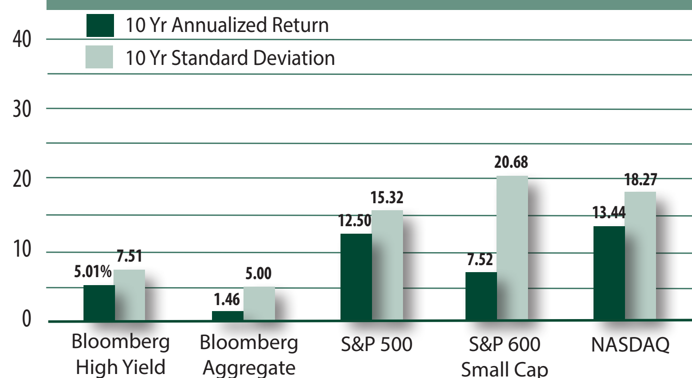
PIA Investment Strategy Group

## 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 | 1Q | YTD | 2024 |
|---|---|---|---|
| BB | 1.49% | 1.49% | 6.30% |
| B | 0.74 | 0.74 | 7.38 |
| CCC | -0.44 | -0.44 | 15.09 |
| CC - D | 1.61 | 1.61 | 48.29 |
| Basic Industry | 0.58 | 0.58 | 8.18 |
| Capital Goods | 0.73 | 0.73 | 6.38 |
| Consumer Cyclical | 0.91 | 0.91 | 8.15 |
| Consumer Non-Cyclical | 1.17 | 1.17 | 9.92 |
| Energy | 1.13 | 1.13 | 7.40 |
| Technology | 0.34 | 0.34 | 9.19 |
| Transportation | -1.44 | -1.44 | 9.02 |
| Communication | 1.53 | 1.53 | 8.46 |
| Other Industrials | 0.86 | 0.86 | 7.46 |
| Utility | 0.52 | 0.52 | 5.70 |
| Financial | 1.77 | 1.77 | 8.53 |

*Index is Bloomberg U.S. High Yield Index. Source: Bloomberg*

| INDEX SPREADS | 3/31/25 | 12/31/24 | 12/31/23 |
|---|---|---|---|
| BB | 244 | 203 | 2.32 |
| B | 380 | 309 | 346 |
| CCC | 696 | 582 | 760 |
| CC - D | 1,796 | 1,588 | 785 |
| Basic Industry | 352 | 284 | 364 |
| Capital Goods | 340 | 276 | 284 |
| Consumer Cyclical | 328 | 272 | 283 |
| Consumer Non-Cyclical | 384 | 331 | 407 |
| Energy | 349 | 288 | 299 |
| Technology | 376 | 294 | 386 |
| Transportation | 446 | 319 | 372 |
| Communication | 535 | 481 | 529 |
| Other Industrials | 302 | 246 | -2.46 |
| Utility | 304 | 219 | 272 |
| Financial | 313 | 269 | 332 |

*Index is Bloomberg U.S. High Yield Index. Source: Bloomberg*

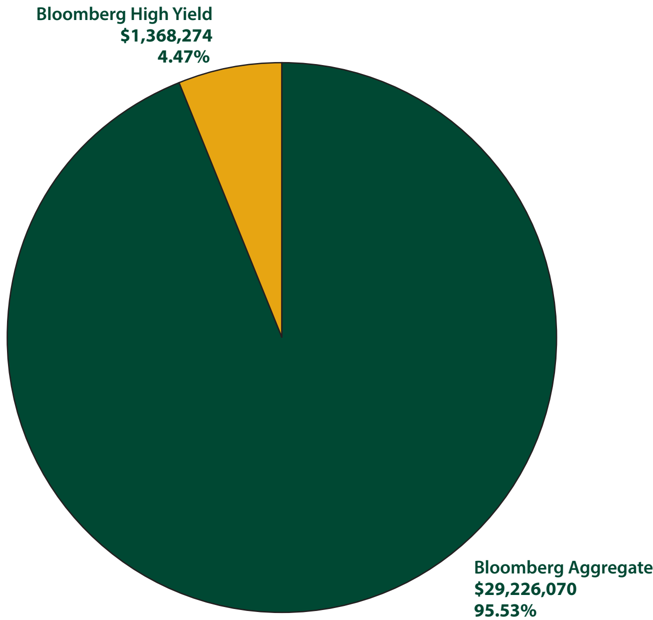
| KEY CHARACTERISTICS | 3/31/25 | 12/31/24 |
|---|---|---|
| Duration | 3.1 | 3.1 |
| Yield To Maturity | 7.9 | 7.6 |
| Current Yield | 6.8 | 6.7 |
| Yield To Worst | 7.7 | 7.5 |
| Weighted Average Maturity | 4.7 | 4.7 |
| % $500mm and under | 24.0 | 24.5 |
| % $501mm and over | 76.0 | 75.5 |

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

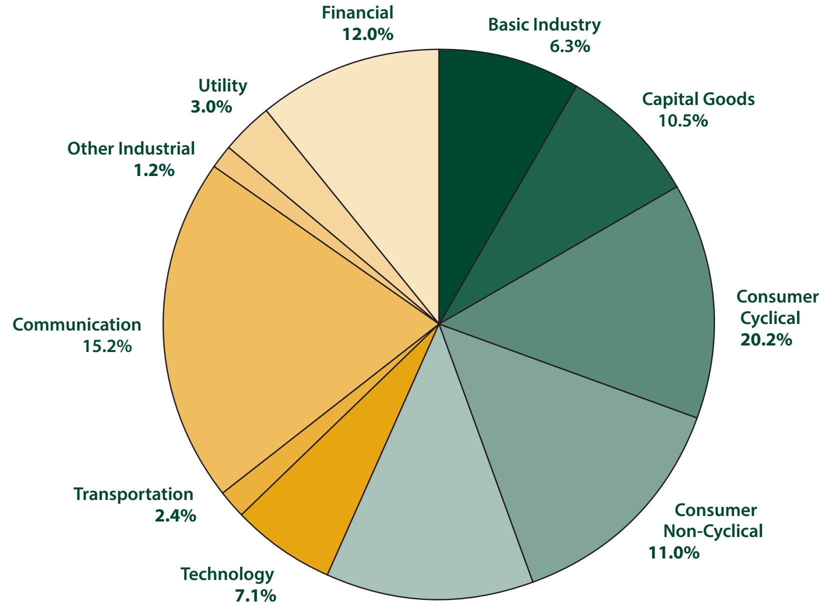
| KEY CHARACTERISTICS | 3/31/25 | 12/31/24 |
|---|---|---|
| % BB or > | 51.7 | 50.8 |
| % B | 35.1 | 35.2 |
| % CCC | 11.1 | 12.0 |
| % CC and below | 2.1 | 2.0 |
| % Debt Maturing in < 3 Years | 21.7 | 19.6 |
| % Debt Maturing in 3 - 5 Years | 41.4 | 42.1 |
| % Debt Maturing in > 5 Years | 36.9 | 38.3 |

*Index is Bloomberg U.S. High Yield Index. Source: Bloomberg*

## US DEBT MARKET ($MM)




## BLOOMBERG HIGH YIELD




*Source: Bloomberg*

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*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.*

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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.*

*Bloomberg U.S. Aggregate Bond Index is an unmanaged index that covers the investment grade fixed rate bond market with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities. The issues must be rated investment grade, be publicly traded, and meet certain maturity and issue size requirements. You can not invest directly in an index.*

*S&P 500 Index – The S&P 500 index includes 500 leading companies in leading industries of the U.S. economy. The S&P 500 is designed to be a leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of the large cap universe.*

*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.*

*Nasdaq Composite is a stock market index of the common stocks and similar securities (e.g. ADRs, tracking stocks, limited partnership interests) listed on the NASDAQ stock market, meaning that it has over 3,000 components. It is highly followed in the U.S. as an indicator of the performance of stocks of technology companies and growth companies. Since both U.S. and non-U.S. companies are listed on the NASDAQ stock market, the index is not exclusively a U.S. index.*

*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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