Going global with high yield

Staying engaged with US high yield this summer

June 2023

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"Our view is that the US high yield market is too compelling to ignore, particularly if we look into the details of what has been happening in the high yield market recently."

Tim Leary, BlueBay Senior Portfolio Manager of Leveraged Finance at RBC GAM, touches on why high yield spreads have tightened recently and shares his thoughts on the state of the default market.

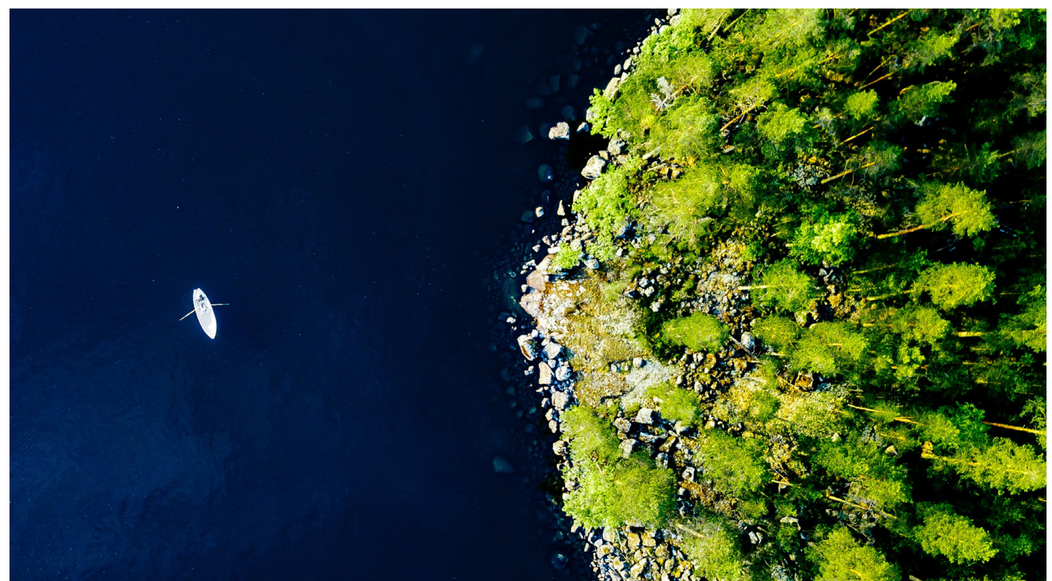
You have probably heard the old saying 'sell in May and go away,' but we do not think that playbook will work for high yield this summer. It is true, there have been a few defaults and distressed exchanges recently, but nothing that surprised the market. In our judgement, the opportunity in high yield remains convincing.

Supply and demand

Our view is that the US high yield market is too compelling to ignore, particularly if we look into the details of what has been happening in the high yield market recently. May saw retail investors redeem about USD2.5 billion out of the asset class at a time when the market printed just under USD23 billion in new high yield supply. Fear not, as 75% of that supply was a refinancing of some kind, and loan and bond issues continue to be paid down and extended. In fact, there are only USD20 billion of high yield bonds left to mature in 2023 and only USD53 billion that mature in 2024. There is simply no maturity wall of any consequence. Spreads have tightened and bond supply is low. A few of those near term maturities belong to troubled issuers trading at a discount, but that is a minuscule part of the market as a whole.

There are headwinds...but they might be diminishing

However, it is not all great news. We anticipate the ongoing tightening of financial conditions, which should contribute to a slower economic environment and we are forecasting a mild recession in late 2024. As a result, we remain vigilant about the longer-term effects of tighter credit conditions for our asset class, which historically have been negative for high yield spreads.



We anticipate a slow and steady rise in default rates, rather than a sudden spike, due to the low level of near-term maturities and the absence of a large problematic sector across European and US sub-investment-grade credit markets. In May, we saw three high yield issuers default and four more completed distressed exchanges. But these issuers have been trading at distressed levels all year, so this did not shock the market. According to JP Morgan, 39% of issuers who had either defaulted or had distressed exchanges in 2023 had actually done so in the past.

The compelling opportunity set

Looking forward to summer, we believe the coast is clear. Supply in both high yield and investment grade bonds will be light. The companies most likely to default over the course of the year are trading like it already, and the Federal Reserve is pausing on raising rates after 15 months of consecutive increases. The opportunity set in US high yield is too compelling to ignore. Those who did not sell in May and go away will be glad they stuck with high yield.

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