Insights
Fixed Income

March 2024

Global High Yield Quarterly

- Data releases corroborating a soft-landing narrative in the US and stabilisation in Europe's growth have aided market sentiment, and in turn the performance and outlook for growth assets.
- An absence of shareholder-friendly excesses and large problem sectors in this cycle, remarkably strong corporate earnings, solid fundamentals and improving credit-lending conditions are all supportive for the HY asset class to experience a longer, but shallower defaults cycle.
- Global HY spreads can remain well-anchored at the lower ends of the range, even as the market reassesses the prospect of rate cuts. Yields in the range of 7.5% are still at reasonably healthy levels and total-return-oriented investors need not position too conservatively.

Performance/ Market Highlights

Global High Yield spreads ended the quarter tighter by 43 bps in the wake of strong economic data (especially in the US), a remarkably good earnings season, access to capital markets opening-up, and improved risk sentiment as the quarter progressed, even as resilient growth is now pushing markets to reprice for later Fed rate cuts. Growth assets saw an especially strong quarter, led by the S&P 500 which is up by 10.6% in Q1.

Figure 1
Total Returns of High Yield in Recent Periods

Returns	3m (%)	6m (%)	12m (%)	YTD (%)
Global HY ($ Unhedged)	1.47	9.19	11.09	1.47
Global HY ($ Hedged)	2.05	8.87	11.60	2.05
Global HY (€ Hedged)	1.67	7.86	9.36	1.67
Global HY (£ Hedged)	1.99	8.53	10.86	1.99
US HY ($)	1.51	8.69	11.06	1.51
Euro HY (€)	1.63	7.28	10.89	1.63
EM HY ($)	3.90	10.33	11.19	3.90

Source: State Street Global Advisors, BofA. As of 31 March 2024.

Figure 2
Spread Changes by Region

OAS (bps)	Current Level	Δ3m	Δ12m	ΔYTD
Global HY	341	-43	-160	-43
US HY	315	-24	-145	-24
Euro HY	358	-38	-116	-38
EM HY	415	-111	-266	-111

Source: State Street Global Advisors, BofA. As of 31 March 2024.

Figure 3
Return Breakdown of Global High Yield

Returns	3m (%)	6m (%)	12m (%)	YTD (%)
Global HY ($ Hedged)	2.05	8.87	11.60	2.05
Spread Return	2.26	5.22	9.28	2.26
Treasury Return	-0.21	3.65	2.32	-0.21

Source: State Street Global Advisors, BofA. As of 31 March 2024.

All the total returns were from spread tightening, with a slight drag from rates. Lower quality took a slight lead for the year in excess return terms (BB: 2.1%, Single-B: 2.0%, CCC & Lower: 3.8%). All industries were up on the year in excess return terms — with the highest from Real Estate (6.7%), which saw a bounce back from 2023's sharp underperformance, and Retail (3.8%).

Gross issuance in 1Q24 for US HY totaled $87.6bn, and for EUR HY they totaled €26.5bn — a very strong quarter, with the most active primary market activity since 3Q21. Majority of the issuance was for refinancing activity though, with net issuance numbers at $28.9bn for US HY and €5.1bn for EUR HY.

US HY Realized default rate was 2.2% L12M, and in 1Q24 defaults totaled $2.3bn of bonds, and $2.7bn completed a distressed exchange, similar to last year's pace. European HY defaults have seen a pickup from ultra-low levels as well, with L12M par default rate moving to 1.4%, with recent volatility in the distressed names such as Altice France, Intrum, and Ardagh - as the market considers potential outcomes.

Rising stars have significantly outpaced fallen Angels in Q1 (US HY $13.3 bn vs 3.4 bn), a modestly supportive technical for the market, as it has reduced overall net supply, acting as an additive to reasonably healthy flows in US HY (+2.6bn YTD).

Outlook

The global macro backdrop remains quite supportive for high yield — with strong US GDP growth and its labor market which has continued to show momentum, Europe's composite PMI leaving the worst of its weakness behind it, and China's economic recovery slowly gaining a foothold. Despite upside surprises in US inflation this quarter leading to a modest back-up in rates, markets are pricing in that a persistent disinflation in the core should allow the Fed to cut rates this summer.

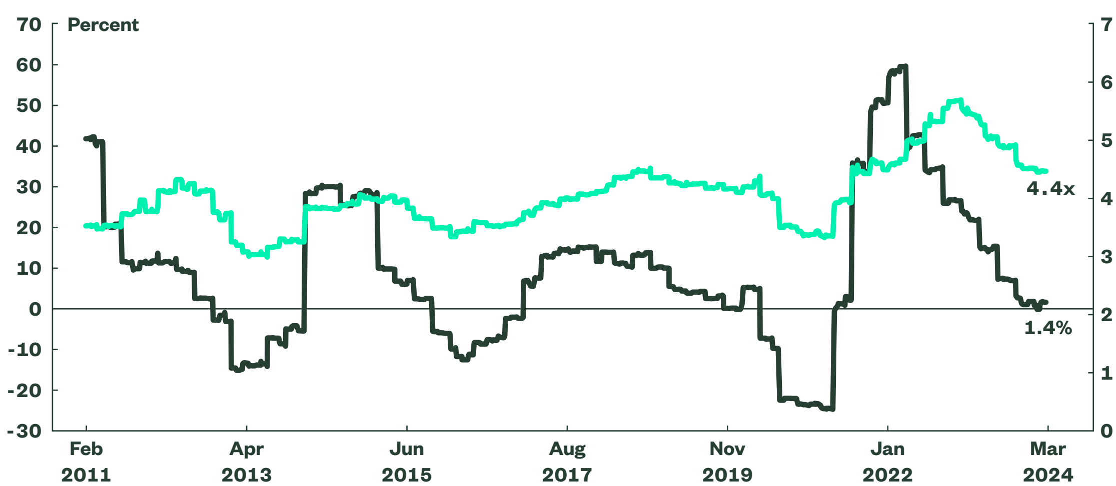
4Q23 High yield earnings showed the resilience of corporate earnings and guidance even in the face of higher rates, with 1.9x High Yield companies beating EBITDA expectations as missed, and in terms of fundamentals, HY balance sheets in 4Q have held up well, with the pace of deterioration from a strong position slowing down. The trend in L12M EBITDA growth decline improved slightly to 1.4% now, and EBITDA margins have seen signs of stabilization. Net leverage is steady at 3.7x, off a record low (3.3x) albeit still below where it stood pre-pandemic, and the long-term average (4.0x). While the interest coverage ratio has declined to 4.4x, coming quickly off 4Q22's record high (5.7x), it is much higher compared to historical levels and has held up better than expected. Similar trends were seen across European issuers as well, with gross leverage of 4.0x and net leverage at 2.6x near cycle lows. Cash/debt for the median HY issuer stood at 25.7%, still 6.5 percentage points above the historical average. However, coverage ratios have declined there, with the EBITDA based ratio at 3.7x, 0.3x below the long-run average.

Figure 4a

The Deterioration in Fundamentals From Strong Levels Has Slowed — US HY

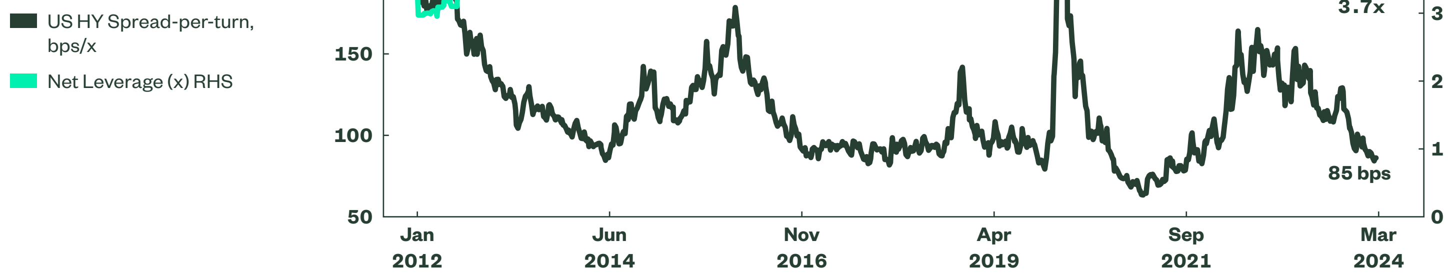
EBITDA, L12M % Change

Interest Coverage Ratio (x) (RHS)



Source: State Street Global Advisors, BofA. As of 31 March 2024.

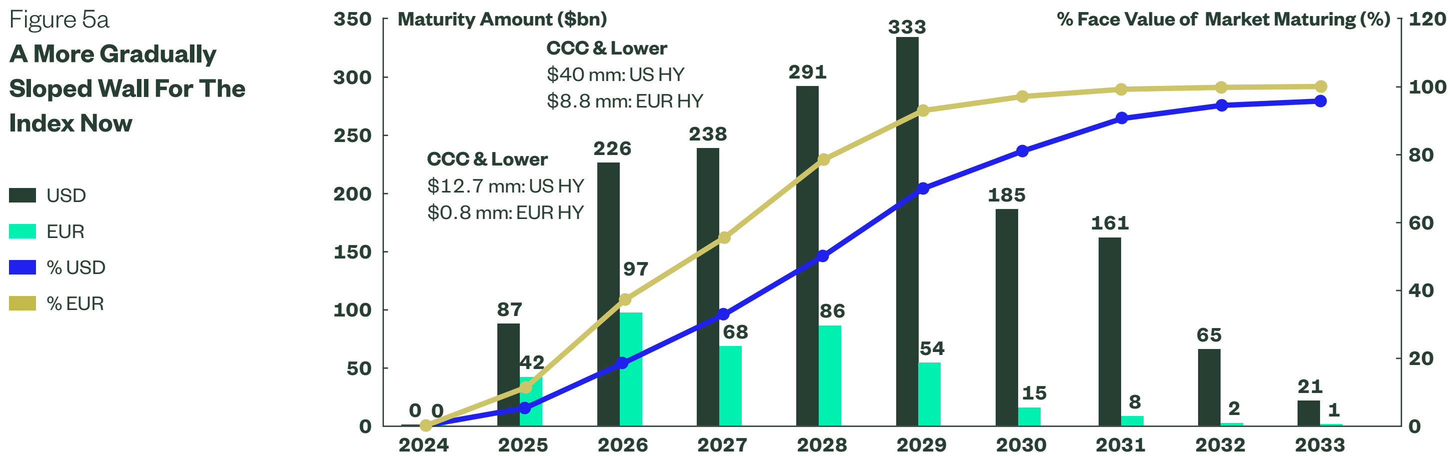
Figure 4b
The deterioration in fundamentals from strong levels has slowed — US HY



Source: State Street Global Advisors, BofA. As of 31 March 2024.

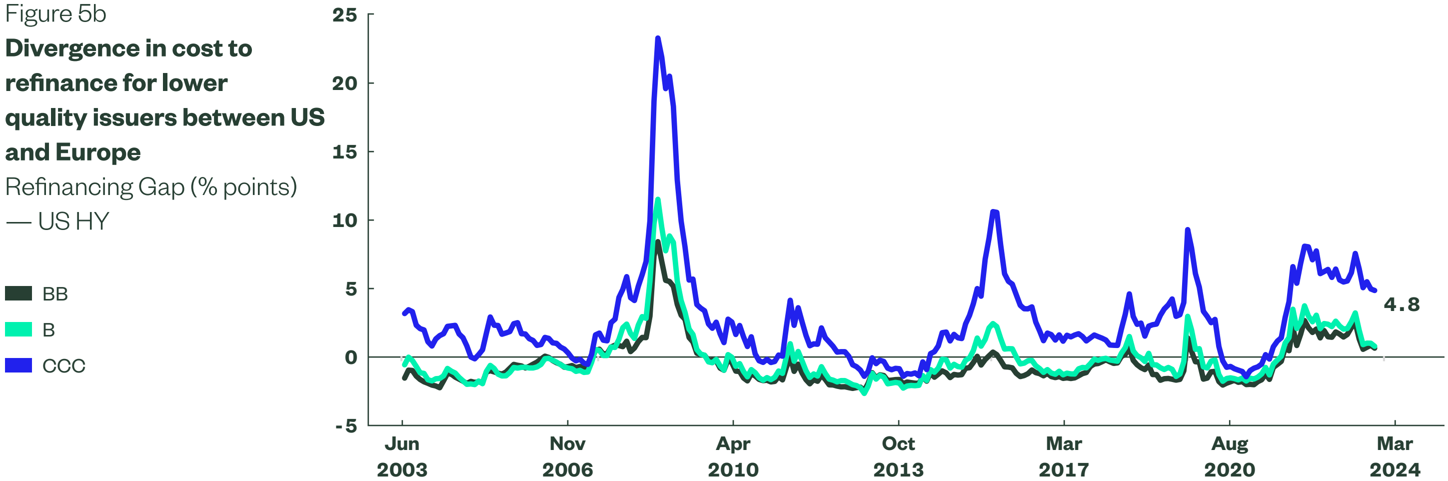
Issuers made some progress in addressing the 2025 & 2026 maturity walls compared to a year earlier, with most of the refinancing activity having taken place in the BB-rated segments, before expanding to Single Bs — while for CCC-& lower-rated issuers, market access remains constrained. This trend is set to continue throughout the year, as the market's acceptance of slower interest rate cuts is offset by tighter spreads. The in-place refinancing gap (yield minus current coupon) has come down to reasonable levels for US HY, whereas the Euro HY market has become sharply bifurcated in recent months, with higher quality spreads trading close to post-GFC lows, while the distressed segment has become more concentrated, and trades at extremely high spreads. The growth in private credit in this cycle is notable, and has proved to be an important buffer/backstop — especially for weaker-quality companies, given the certainty of execution and flexibility in debt structuring there.

Figure 5a
A More Gradually Sloped Wall For The Index Now



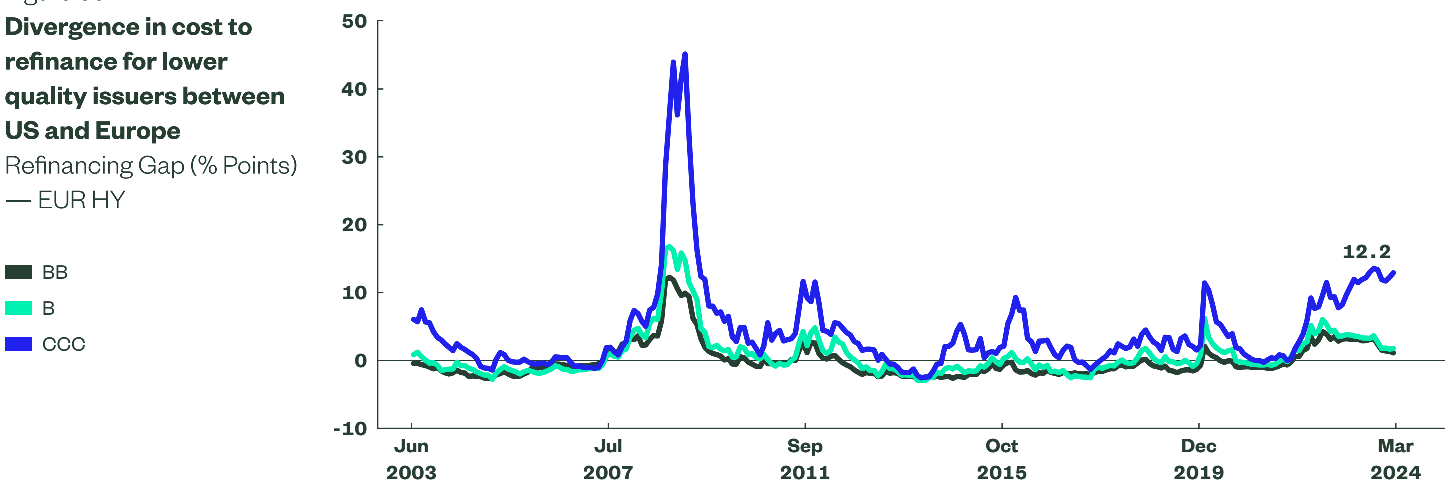
Source: JPM, BofA. As of 31 March 2024.

Figure 5b
Divergence in cost to refinance for lower quality issuers between US and Europe
Refinancing Gap (% points)
— US HY



Source: JPM, BofA. As of 31 March 2024.

Figure 5c
Divergence in cost to refinance for lower quality issuers between US and Europe
Refinancing Gap (% Points)
— EUR HY



Source: JPM, BofA. As of 31 March 2024.

Without a significant, large problem sector in US HY, an unambiguous severe downturn in macroeconomic data, or an immediate risk-off trigger shutting down issuer access to primary markets — we don't see cause for default rates to spike up into the mid-to-high single digits, but believe this cycle will carry a lower peak than previous recessions. The moderate but steady distress levels of around 6-8%, which has persisted even through the recent rally (Fig 7) corroborates our view, and a subjective observation of the default watchlist and the most distressed names — indicates that the next 12M expected defaults in US HY would be in the 3.0% range. Even though EUR HY has been a very low default market in the past decade, presence of a small number of larger distressed capital structures as well as a handful of real estate names which face headwinds from elevated energy and construction costs and increasingly expensive financing, tells us that the next 12M expected defaults in EUR HY could be in the 2.0% range.

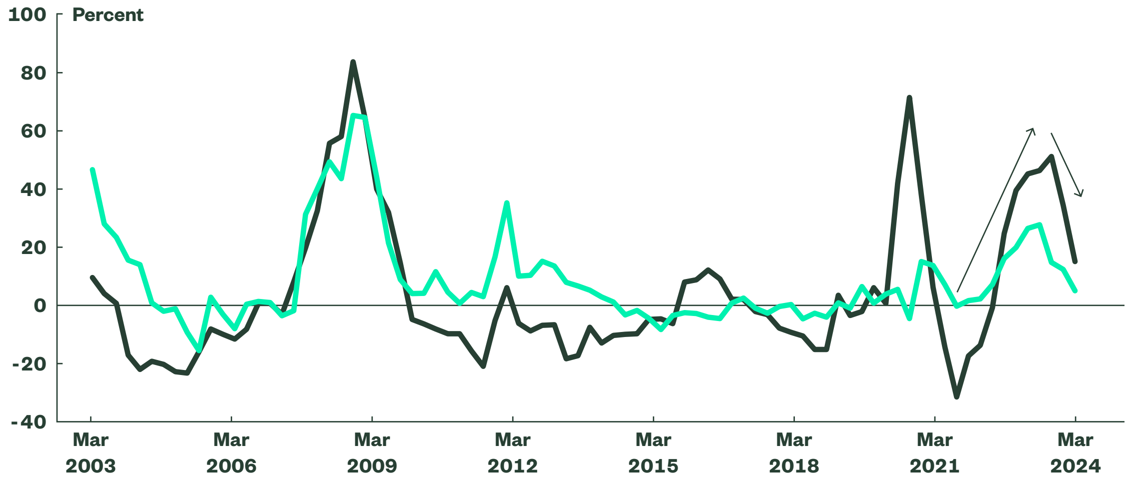
Figure 6

Credit conditions and overall lending appetite has reversed from being too restrictive

% of Banks Tightening Standards for Corporate Loans

US

Eurozone



Source: Bloomberg. US depicts: Senior Loan Officer Opinion Survey on Bank Lending Practices for Commercial and Industrial Loans for large and medium firms. Eurozone depicts: ECB Bank Lending Survey for change in Credit Standards Lending to Businesses. As of 31 March 2024.

Figure 7a

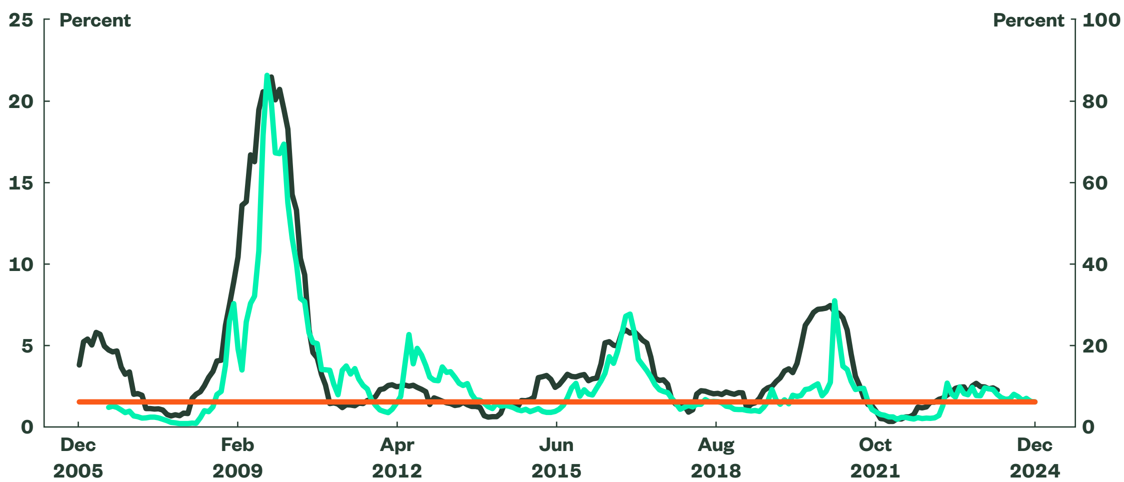
Prolonged Period of Medium Levels of Distress

US High Yield

L12M Default Rate

Distress Ratio (RHS, Shifted by 3 Quarters)

Defaults at Current Level of Distress



Source: BofA. As of 31 March 2024.

Figure 7b

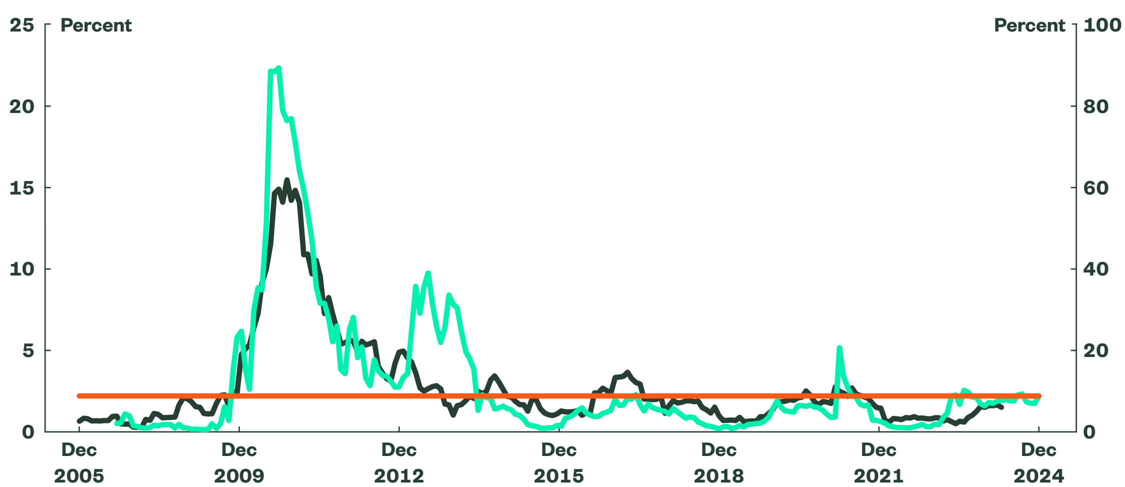
Prolonged Period of Medium Levels of Distress

EUR HY

L12M Default Rate

Distress Ratio (RHS, Shifted by 3 Quarters)

Defaults at Current Level of Distress



Source: BofA. As of 31 March 2024.

The biggest near-term risk to Global High Yield now is from an unwinding of the perfect goldilocks outcome for 2024 that markets had priced in, but the probability of that seems to be quite low, given the direction of recent data releases. Global HY spreads of 341bps are quite rich and don't seem to compensate enough for probable bearish outcomes. However, reasonably strong starting points of balance sheets in this cycle, improved ratings quality of the asset class compared to history, lack of huge volumes of credit negative transactions — such as new buyouts or dividend recaps this cycle, and all-in yields at around 7.5% do provide reasons to attract total return-oriented investors.

Conclusion

Global HY is in a balanced territory now, where still reasonably high yields offer a decent amount of carry and rolldown given the index's short duration- but there is not a lot of excess risk premium in spreads, that would lay the stage for a subsequent outsized spread-return performance. Global growth expectations being revised higher, manufacturing activity set to rebound further, growing CEO optimism supported by resilient consumer demand — all point to a good backdrop for risk assets such as high yield to continue to perform well.

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* Pensions & Investments Research Center, as of December 31, 2022.
† This figure is presented as of March 31, 2024 and includes ETF AUM of $1,360.89 billion USD of which approximately $65.87 billion USD is in gold assets with respect to SPDR products for which State Street Global Advisors Funds Distributors, LLC (SSGA FD) acts solely as the marketing agent. SSGA FD and State Street Global Advisors are affiliated. Please note all AUM is unaudited.

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