

Global High Yield Year in Review

Performance/Market Highlights of 2024

Global High Yield saw a surprisingly good year in 2024, with spreads tightening by 77 bps overall. Despite periods of intermittent volatility in August and September triggered by weak data releases in the US, investors held on to their “risk on” sentiment in the wake of strong corporate earnings, still resilient growth — particularly in the US, and global inflation that had largely continued tracking downwards.

Figure 1
Total Returns of High Yield in Recent Periods

Returns	3m (%)	6m (%)	12m (%)	YTD (%)
Global HY (\$- Unhedged)	-1.14	4.63	7.46	7.46
Global HY (\$- Hedged)	0.53	5.52	9.24	9.24
Global HY (€- Hedged)	0.15	4.61	7.47	7.47
Global HY (£- Hedged)	0.54	5.35	8.92	8.92
US HY (in \$)	0.16	5.44	8.20	8.20
Euro HY (in €)	1.77	5.32	8.61	8.61
EM HY (in \$)	-0.20	4.99	11.54	11.54

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

Figure 2
Spread Changes by Region

OAS (bps)	Current Level	Δ 3m	Δ 12m	Δ YTD
Global HY	307	-15	-77	-77
US HY	292	-11	-47	-47
Euro HY	311	-31	-85	-85
sEM HY	365	-3	-161	-161

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

Figure 3
Return Breakdown of Global High Yield

Returns	3m (%)	6m (%)	12m (%)	YTD (%)
Global HY (\$- Hedged)	0.53	5.52	9.24	9.24
Spread Return	1.41	2.87	6.05	6.05
Treasury Return	-0.88	2.65	3.19	3.19

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

Both the strong carry in rates and outright spread compression aided total returns for the year. Lower quality maintained its significant lead for the year in excess return terms (BB: 4.8%, Single-B: 5.2%, CCC & Lower: 14.0%). All industries were up on the year in excess return terms — with the highest from Real Estate (14.2%), which saw a sharp bounce back from 2023's underperformance, and Healthcare (7.4%). Gross issuance in 2024 for US HY totalled \$289.4bn, and for EUR HY they totalled €118.6bn — even though these numbers are ahead of equivalent 2023 values, 2024 has been only an average year for primary market activity, if we look at past 5 years in aggregate. Net issuance numbers come out to be quite a bit smaller, at \$78.9bn for US HY and €3.1bn for EUR HY.

US HY Realized default rate was 1.5% L12M, and YTD's US HY defaults/distressed exchanges of just \$17.2bn ranks as among the lowest annual total on record. EUR HY defaults have seen a sharp pickup from ultra-low levels of 2023, following a handful of large capital structures defaulting — with L12M par default rate moving to 3.5%. Rising stars have significantly outpaced fallen Angels YTD in US HY (\$38.1 bn vs 10.0 bn), aiding further to the supportive technical of strong fund flows — both in US HY (+\$16.4bn YTD) and EUR HY (+€12.4 bn YTD).

2025 Outlook

We look at the factors that would influence expected returns for 2025 through the usual 4 pillars:

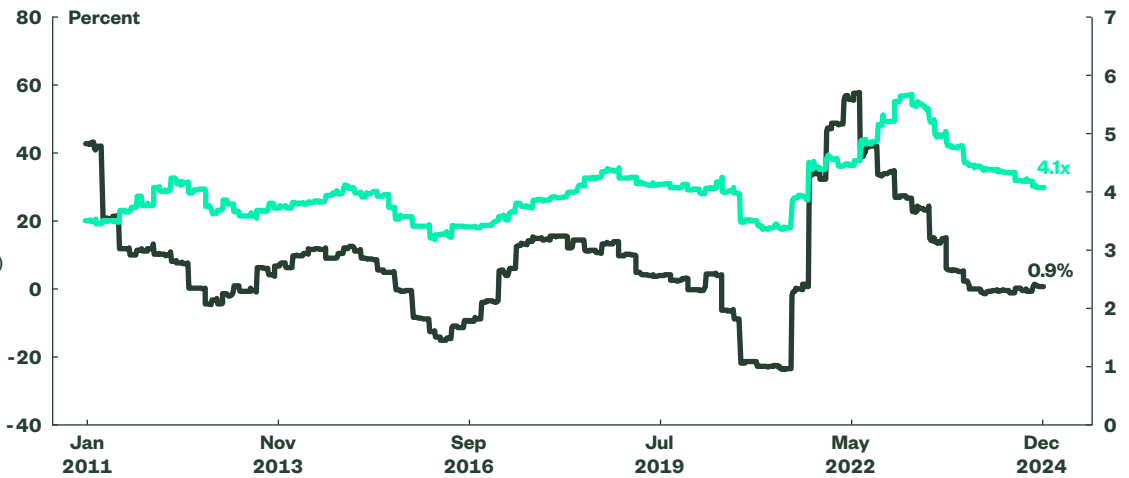
- 1 Macroeconomics and Fundamentals
- 2 Default Outlook
- 3 Demand/Supply technicals, and
- 4 Valuations

The overall **macro** backdrop remains supportive for credit, with steady global growth, no recession expected in the near term and continued delivery of the global rate cutting cycle — even though isolationist US foreign policy remains a risk. The US economy remains remarkably strong, with real GDP currently expected to grow 2.7% YoY in 2024, with a modest slowdown to less than 2.5% in 2025. Real GDP growth for the US stands nearly 4% points above its pre-pandemic potential path, and strong productivity gains versus rest of the world and additional fiscal loosening could lend further support. European growth of 0.8% -1.0% expected for 2024/2025 looks sluggish — with political headwinds all around, and further drag expected to be caused by trade uncertainty and spillovers from China tariffs. However, the full extent of implementation of those tariffs is uncertain — and for European corporates, those tariffs would at least be partially offset from FX moves and policy response.

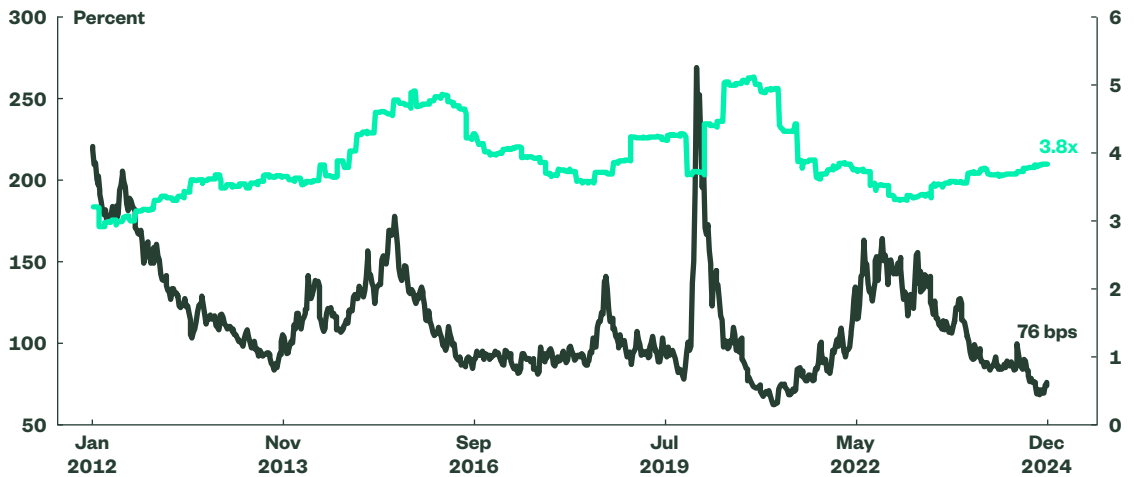
HY **fundamentals** retain their position of strength with L12M EBITDA growth turning flat, rather than the typical negative teen numbers expected at this stage of the rates cycle, and EBITDA margins have been stable. Net leverage is firm at 3.8x, off a record low (3.3x) albeit still below where it stood pre-pandemic, and the long-term average (4.0x). While the interest coverage ratio has declined to 4.1x, 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 3.8x and total debt/EV of 39% near cycle lows. Even though Cash/debt has declined from its pandemic highs, for the median HY issuer it stood at 26%, still 8 percentage points above the long-term average. Coverage ratios have declined here however, with the EBITDA based ratio at 4.1x, as the median issuer experienced an increase in interest expense. (Source: BofA, Morgan Stanley).

Figure 4
The Deterioration in Fundamentals from Strong Levels has Slowed — US HY

■ EBITDA, L12M % change
 ■ Interest Coverage Ratio (x) (RHS)



■ US HY Spread-per-turn, bps/x
 ■ Net Leverage (x) RHS



Source: BofA. As of December 31, 2024.

Credit conditions have been showing all the typical signs of mid-cycle rather than late-cycle last year, with low levels of corporate aggression, absence of material balance sheet stress, and easing policy paths from global central banks. However, that is changing now as the more favourable regulatory backdrop in the US from the new administration would provide a significant uptick to corporate optimism and in turn supply through M&A and dividend recap activity. We still don't see cause for **default** rates to spike up into the mid-to-high single digits this cycle in both US and Europe, given broad access to capital and relatively easy credit conditions. Low and steady distress levels of around 4–8% for both US and European HY (Fig 5), which had persisted even amid the dichotomy across higher and lower rated segments in EUR HY, corroborates our view. 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 2.0% range. Even though EUR HY has seen a sharp pickup, we expect it to decline slightly from current levels to 2.5% in 2025 as the troubled issuer restructuring cycle there seems to have peaked.

Figure 5a
Credit Conditions have Moved Back to Easy and There is Medium to Low Distress

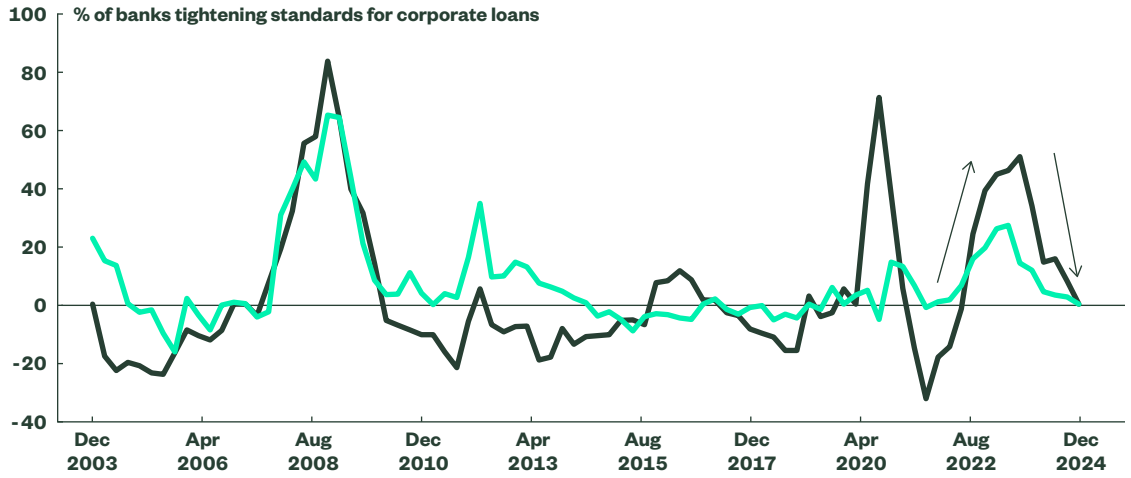


Figure 5b
US High Yield

Legend: L12M Default Rate (Black), Distress Ratio (RHS, Shifted by 3 Quarters) (Red), Defaults at Current Level of Distress (Blue)

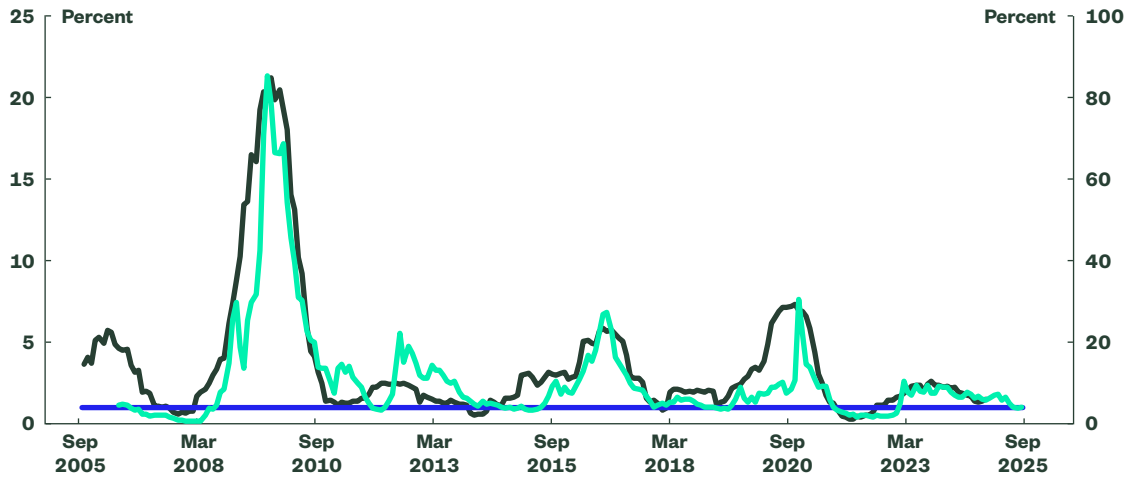
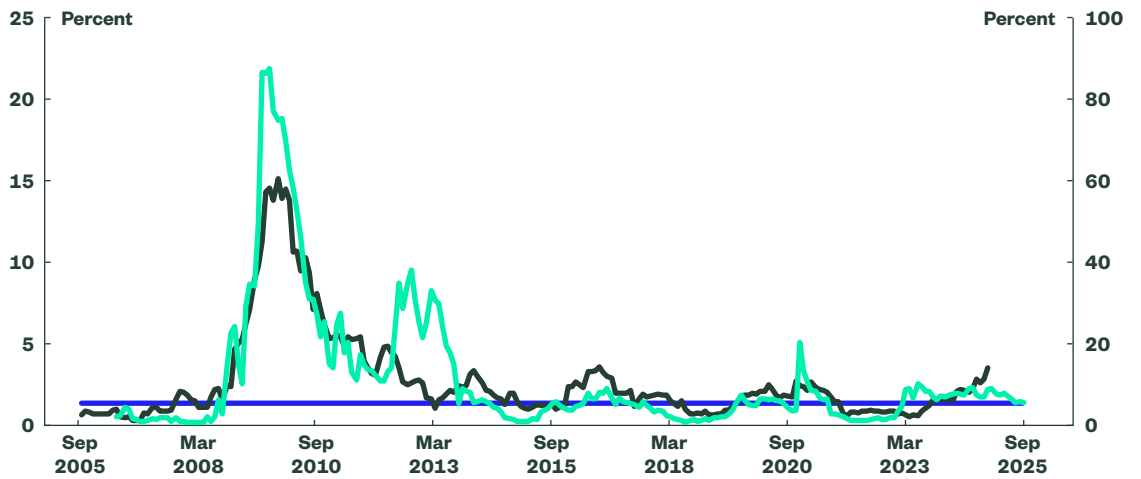


Figure 5c
EUR HY

Legend: L12M Default Rate (Black), Distress Ratio (RHS, Shifted by 3 Quarters) (Red), Defaults at Current Level of Distress (Blue)



Source: BofA. As of December 31, 2024.

Demand has been very robust from investors with sizeable inflows to credit (both IG and HY) funds, as yields are still attractive compared with recent history, break evens are generous, and there are no major near-term catalysts to bring in anxiety over recession risk in the near term. If curves steepen on policy cuts, we could even see greater demand as investors move out of cash equivalents and into higher yielding products. Supply across both US and Europe has been insufficient to satisfy this level of demand — this shortfall has been a major driver of 2024's strong returns, and is set to carry over into early-2025.

Valuations have reached quite stretched levels, but that has been true across most of credit, and even in other asset classes such as equities. Global High Yield spreads at 308 bps are at their richest decile since inception, and close to their lowest levels in two decades. While all-in yields at 7% stay near the 30th percentile compared to history, this remarkably thin level of spreads does place a high hurdle for giving up liquidity to get additional yield, as the likelihood of incurring negative excess returns grows with the passage of time. One point to mention however is that the Global HY market is of a better-quality mix and has a lower dollar price now, compared to other historical spread tight periods — a partial justification for being so.

Figure 6a

Global HY Index Avg Prices 6.5 pts Lower than Previous Cycle Tights = a Better Convexity Profile, and it is more BB Weighted Compared to History

█ Index Price History
█ Current Index Price
● Index price at Historical Spread Tights

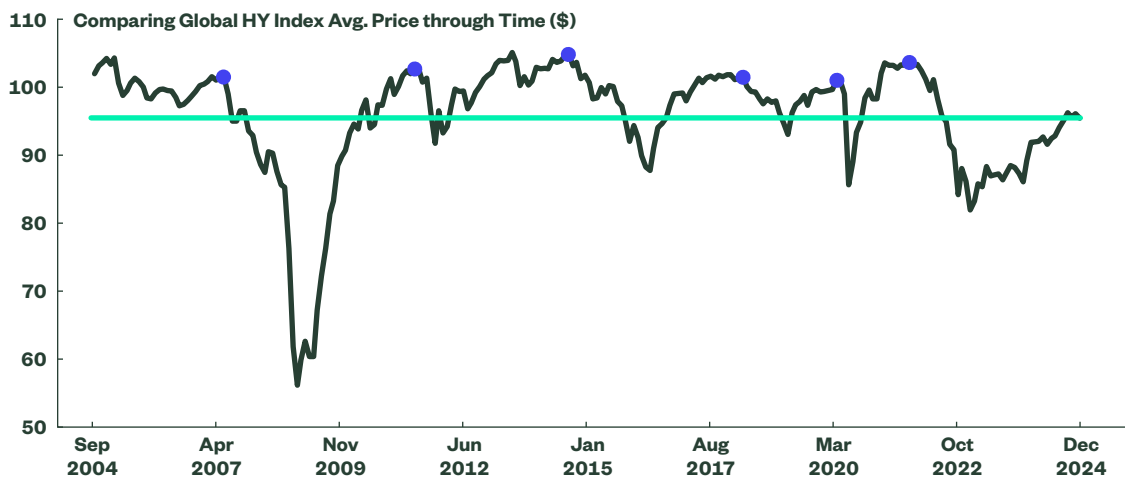
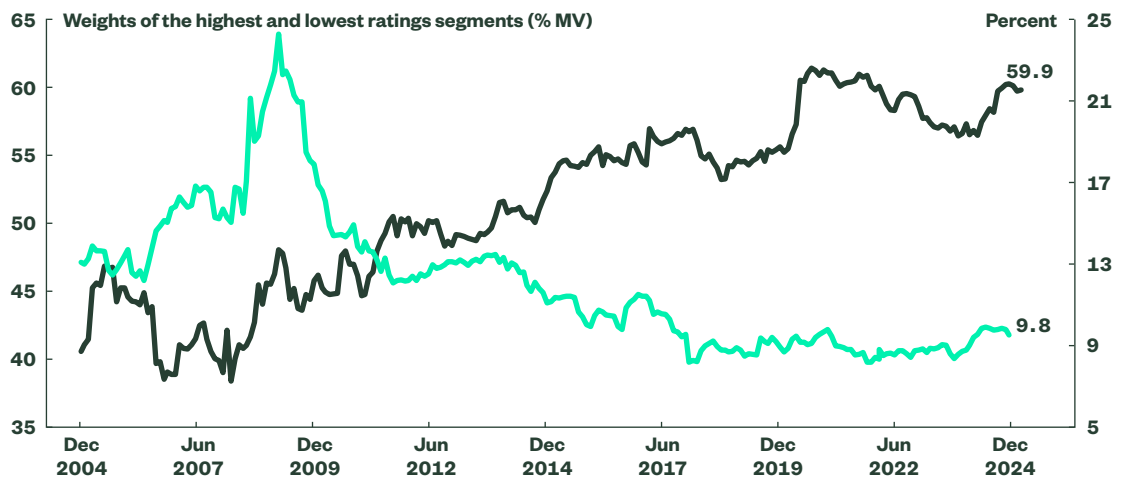


Figure 6b

█ BB
█ CCC & Below (RHS)



Source: BofA. As of December 31, 2024.

With these factors in mind, we outline below some scenarios with various assumptions about future levels of spreads, government bond yields, default and recovery rates and rating migrations for US & Euro High Yield (Figure 7). In our base case for the US, we expect stickier inflationary outlook over Trump's administration priorities and still-strong growth acts to keep rates rangebound, and that the default rate would rise to 2% from current levels. We foresee spreads to end up slightly higher to current levels as today as a balance is achieved between (i) the optimism of a boost in growth from ambitious US fiscal plans (ii) the structural demand of a higher risk premia from credit, especially as supply from M&A picks up. The Bull and Bear cases are around this illustrates that markets have priced in an almost perfect optimistic outcome into current level of spreads, and tail risks remain underpriced. Bringing all this together for both regions, we see both US & EUR High Yield as being in apposition to deliver slightly below carry total returns of 4.4% and 2.1% over 2025 respectively.

Figure 7
Spread Changes by Region

US High Yield	
Effective Yield of US HY (%)	7.3
OAS (bps)	292
5Y UST (%)	4.38
L12M Defaults (%)	1.50
L12M Recovery Rates (%)	46
Effective Duration (yrs.)	3.2
Spread Duration (yrs.)	3.1

Scenarios for 12M Horizon:	20%	50%	30%	
Credit Scenario	Bull	Base	Bear	Probability Weighted
OAS Estimate (bps)	250	325	500	
5 Y UST Estimate (%)	4.50	4.50	3.25	
Default Rate Estimate (%)	1.00	2.00	4.00	
Recovery Rate Estimate (%)	50	40	30	
Yield Carry (%)	7.3	7.3	7.3	
Return From Treasury Component (%)	-0.38	-0.39	3.65	
Return from Spread Change (%)	1.30	-1.02	-6.45	
Loss Given Defaults (%)	-0.50	-1.20	-2.80	
Expected Total Returns (%)	7.72	4.68	1.70	4.4
Expected Excess Returns	4.22	1.90	-3.53	

Source: BofA, State Street Global Advisors Assumptions, Bloomberg. As of December 31, 2024.

US High Yield	
Effective Yield of EUR HY(%)	5.2
OAS (bps)	311
4Y Eurozone Govt Yield(%)	2.07
L12M Defaults (%)	3.50
L12M Recovery Rates (%)	38
Effective Duration (yrs.)	2.7
Spread Duration (yrs.)	3.2

Scenarios for 12M Horizon:	15%	65%	20%	
	Bull	Base	Bear	Probability Weighted
Credit Scenario				
OAS Estimate (bps)	275	350	525	
4Y Eurozone rates Estimate (%)	2.75	2.05	1.00	
Default Rate Estimate (%)	1.00	2.50	3.50	
Recovery Rate Estimate (%)	50	40	30	
Yield Carry (%)	5.2	5.2	5.2	
Return From Treasury Component (%)	-1.85	0.06	3.40	
Return from Spread Change (%)	1.14	-1.24	-6.81	
Loss Given Defaults (%)	-0.50	-1.50	-2.45	
Expected Total Returns (%)	3.99	2.52	-0.66	2.1
Expected Excess Returns	4.25	1.87	-3.70	

Source: BofA, SSGA Assumptions, Bloomberg. As of December 31, 2024.

Conclusions

With credit-friendly macro conditions, solid corporate fundamentals, investor exuberance/reach for yield and possible upside surprises to US growth, we think High Yield Spreads can hold near their current levels in the first half of 2025, before a more challenging 2H. Rich valuations are the major impediment to a more constructive view, as it limits the pathway for a “risk on” spread compression, and any headline risks/disappointments in data releases has the potential to trigger significant volatility given crowded investor positioning. Spreads don’t move in a straightforward line however, particularly in High Yield. They typically overshoot quickly and then compress back over several weeks, so it should not come as a surprise to see spreads peak at higher levels in 2025 before settling down close to our year-end targets, which means investors are likely to get much better entry points next year. We advocate a BB/B exposure and remain cautious on the CCC and lower-quality portion of the market due to strong recent performance, our expectation for higher for longer rates, and the prevalence and market acceptance of Distressed Exchanges/ Liability Management Exercises. For the cohort of investors who are buying for the (high) all-in yield, not the (tight) credit spread — carry & roll still is reasonable and would remain an important driver of total return in a low-spread world.

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* Pensions & Investments Research Center, as of December 31, 2023.

[†]This figure is presented as of December 31, 2024 and includes ETF AUM of \$1,577.74 billion USD of which approximately \$82.19 billion USD 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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