Commentary
Fixed Income

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Quarterly Global High Yield Update

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- Global high yield (HY) markets had a modestly weak quarter overall, with spreads widening by 26 bps over the period. Total returns (in $ terms) were negative at -0.35%.
- Even as the global economic recovery continues and with strong 2Q corporate earnings, risk-off sentiment connected to the regulatory crackdowns in China, more hawkish than expected outcomes at the Fed and the Bank of England meetings, and concerns around high inflation readings all led to negative risk sentiment over the quarter.
- Emerging Market HY underperformed the most due to developments in China, sparked by Evergrande — the second largest property developer in China — missing a coupon payment near the end of September. Even though market participants expect that its likely restructuring would lead to volatility and weakness in China's HY property sector, spillover effects to broader high yield markets are expected to be quite limited, especially regarding any financial or portfolio contagion.

Figure 1
High Yield Spreads

OAS* (bps)	Current Level	Δ 3m	Δ 12m	Δ YTD
Global HY	373	26	-185	-37
US HY	316	10	-226	-71
Euro HY	304	8	-168	-51
EM HY	630	103	-54	107

Source: State Street Global Advisors, as of September 30, 2021.
* Option Adjusted Spreads.

Market Highlights

- US HY bond issuance remained very strong, totaling $108.5bn in 3Q. While this is the seventh highest quarterly volume on record, activity has slowed somewhat following the first half of 2021's record pace. While refinancing was the key reason for new borrowings (56%), other purposes have seen a pickup — with 27% used for acquisition financing and 14% used for general corporate financing. Similar trends were seen in Europe with European HY supply already in record territory at €138bn YTD, already surpassing 2020's total of €131bn.

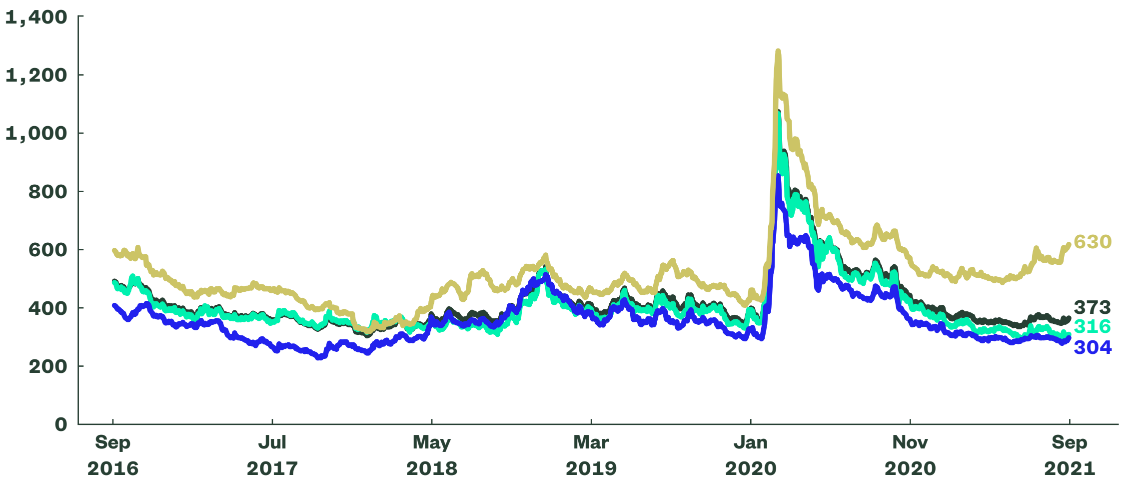
- Default rates continued to decline and remain subdued in Q3. The par-weighted US HY default rate decreased to 0.99% and has declined down 577bp YTD. In total there have been 10 US HY issuers that have defaulted this year, totaling $4.1bn in debt, the lightest nine-month stretch since October 2011.

- European HY saw no defaults at all in 3Q, leaving the trailing 12m default rate to drop by 60bp to 1.5%, comprising €5.5bn in debt from 8 issuers.

- Flows have been moving out of US HY funds YTD (-$11.9 bn) but shifting into leveraged loans (+$34.9 bn) as investors reduce duration from fixed rate to floating rate debt. European HY saw a neutral trend with a small net inflow of €692mm (just 0.8% of AUM).

- The rating cycle has also turned very positive with a wave of upgrades from the rating agencies in recognition of strong earnings, and improvement in leverage and coverage ratios. The ratio of upgrades/downgrades (by $ volume) has been on a sharp-uptrend this quarter, with the US HY ratio reaching 4.3 in 3Q, up from 2.1 in 1Q and 0.3 through 2020. Issuers continue to behave prudently by deploying excess cash raised last year partially towards debt repayment.

Figure 2
OAS History — Last 5 Years (bps)



Source: State Street Global Advisors, as of September 30, 2021.

Figure 3
Total Returns of Global High Yield

Returns	3m (%)	6m (%)	12m (%)	YTD
Global HY (in $ terms)	-0.35	2.20	9.75	2.13
Global HY ($-Hedged)	0.21	2.62	10.13	3.38
Global HY (€-Hedged)	0.02	2.24	9.06	2.77
US HY (in $)	0.95	3.74	11.46	4.68
Euro HY (in €)	0.65	2.10	9.35	3.69
EM HY (in $)	-2.68	-0.49	6.12	-1.43

Source: State Street Global Advisors, as of September 30, 2021. Past performance is not a reliable indicator of future performance.

Figure 4
Return Components of Global High Yield

Returns	3m (%)	6m (%)	12m (%)	YTD
Global HY ($-Hedged)	**0.21**	**2.62**	**10.13**	**3.38**
Spread Return	0.27	2.03	11.28	4.36
Treasury Return	-0.06	0.60	-1.16	-0.98

Source: State Street Global Advisors, as of September 30, 2021. Past performance is not a reliable indicator of future performance.

Performance Highlights

- Treasury returns were modestly negative, as concerns around the spread of the delta variant have eased significantly, and as markets look forward to the tapering announcement from the Fed, as well as less accommodative monetary policy in other developed markets.
- Sector performance in Global HY was in line with the "reopening" theme, with Energy (1.1%), Transportation (1.1%), Retail (1.0%) and Services (1.0%) all performing well in excess return terms. Real Estate (-8.0%) was an underperforming outlier over the quarter.
- The BB-rated segment outperformed in total return terms over the quarter, with +0.62%. CCC- and lower-rated segments of the market saw 0.38% and single Bs underperformed, returning -0.67%. This is a slight contrast from the first half of the year which saw lower-rated segments performing significantly better and BBs underperforming.

Valuations

- Even though the yield on Global HY stands at 4.43% and is close to all-time lows, spreads at 373 bps are at the 21st percentile, and the HY market has seen an improvement in quality over the years. As such, investors are more comfortable considering it in their overall asset allocation within fixed income.
- We are in a recovery phase of the credit cycle, having passed through the repair phase rapidly. Despite the COVID-19 recession being only last year, we are moving through the cycle faster than usual, and conditions now seem 'mid-cycle', where returns from carry tend to dominate — as growth shows signs of moderation from peak levels, and monetary policy starts to shift from a prolonged period of easing.

Further Reading

The Case For Global High Yield
Why Now, Why Indexing

Sources. Bloomberg, JP Morgan. BofA indices HW0C, HUC0, HEC0 and EMUH were used as a representation of the Global HY, US HY, Euro HY and EM HY markets respectively. As of 30 September 2021.

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* Pensions & Investments Research Center, as of December 31, 2020.
† This figure is presented as of September 30, 2021 and includes approximately $59.84 billion of 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.

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