With the behaviour of high yield bonds so closely linked to economic performance, US high yield has rebounded strongly over the last 12 months. While US high yield spreads have recovered to pre-pandemic levels (Fig. 3), we believe the fundamental picture for the asset class remains compelling. This is especially the case if rates rise; high yield spreads can absorb rate moves more readily than higher-rated asset classes. Fundamentals are also stronger because many companies have been extending debt maturity profiles, streamlining operations, managing inventory levels and proactively raising liquidity to weather the Covid-19 storm. As a result, the reopening of the US economy has led to strong cashflows and earnings for many companies. On the back of these events, we have seen declining leverage ratios, improving coverage ratios and stronger equity cushions. Default rates have also fallen dramatically since last March and are at their lowest levels since before the great financial crisis (Fig. 1). The forecasted default rate for high yield bonds and loans for the whole of 2021 is 0.65% for each asset class. A bullish outlook for economic growth over the next 18 months and a favourable year to date upgrade/downgrade ratio of 3-to-1 ratio, point to an overall positive outlook for US high yield credit.

1. ICE Index Platform ICE BofA ML US Cash Pay High Yield Index (J0A0) as of 31st August 2021
2. JP Morgan Default Monitor, 2nd August 2021

We believe low default rates and robust fundamentals offer a compelling investment case for US high yield, underpinned by a strong economic backdrop.
What about inflation? While we are seeing inflation pressure, which could impact profit margins, it is quite possible that this pressure may be transitory. We are already seeing corporates passing through higher costs to consumers. 4

There may be a change in this trend going into 2022, but for the remainder of the year we believe it is unlikely to be an issue. Another positive indicator is the rating migration of the asset class. The number of BB-rated bonds are at their highest level in over two decades at 54%, while CCC rated-bonds only comprise 11.6% of the index - a level not reached since June 1999 (Fig. 2).

The current rating profile of high yield is the best it has been in over 20 years, unlike other fixed income areas that have seen a downward migration in ratings. 5

Fig- 2 Breakdown of CCC and BB Rated Bonds as % of US High Yield Market

Source: ICE Index Platform, as of 31st August 2021. ICE BofA ML US Cash Pay High Yield Index (J0A0), ICE BofA ML CCC and Lower US Cash Pay High Yield Index (J0A3) and ICE BofA BB US Cash Pay High Yield Index (J0A1). For illustrative purposes only. Chart shows the face value of the J0A1 and J0A3 as a % of the face value of the J0A0, going back monthly for the past 20 years. Shaded areas represent recession periods. Indices selected as best available proxy to measure relative breakdown of rated bonds.

4. JP Morgan, August 2021 US Auto Sales, as of 2nd September 2021
Looking ahead, we believe defaults are likely to remain benign and, with a low percentage of CCCs, the US high yield market is well positioned to participate in the economic recovery.

The economic environment appears robust, central banks remain supportive and public and private markets are open. While rates could rise if the economic recovery extends and the Federal Reserve begins to taper its asset purchase programme, we believe high yield is well positioned to absorb a move since spreads are still well above their 2007 low. US high yield is still poised to potentially perform well over the foreseeable future as it has during in previous expansions where, historically, long-term high yield investors have been rewarded at current spread levels (Fig. 3).

Fig. 3 - US High Yield Historical Spreads

Source: ICE Index Platform, as of 31st August 2001 to 31st August 2021. ICE BofA ML US Cash Pay High Yield Index (J0A0). For illustrative purposes only.

This material is not intended to be relied upon as a forecast, research, or investment advice, and is not a recommendation, offer or solicitation to buy or sell any securities or to adopt any investment strategy. The opinions expressed by Muzinich & Co are as of September 2021 and may change without notice.
Important Information

Muzinich & Co. referenced herein is defined as Muzinich & Co., Inc. and its affiliates. This document has been produced for information purposes only and as such the views contained herein are not to be taken as investment advice. Opinions are as of date of publication and are subject to change without reference or notification to you. Past performance is not a reliable indicator of current or future results. The value of investments and the income from them may fall as well as rise and is not guaranteed and investors may not get back the full amount invested. Rates of exchange may cause the value of investments to rise or fall. Any research in this document has been obtained and may have been acted on by Muzinich for its own purpose. The results of such research are being made available for information purposes and no assurances are made as to their accuracy. Opinions and statements of financial market trends that are based on market conditions constitute our judgment and this judgment may prove to be wrong. This document and the views and opinions expressed should not be construed as an offer to buy or sell or invitation to engage in any investment activity; they are for information purposes only. Opinions and statements of financial market trends that are based on market conditions constitute our judgement as at the date of this document. They are considered to be accurate at the time of writing, but no warranty of accuracy is given and no liability in respect of any error or omission is accepted. This discussion material contains forward-looking statements, which give current expectations of future activities. Further, no person undertakes any duty or obligation to revise such forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events. Muzinich makes no representation or warranty (express or implied) with respect to the information contained herein (including, without limitations, information obtained from third parties) and expressly disclaims any and all liability based on or relating to the information contained in, or errors omissions from, these materials; or based on or relating to the recipient’s use (or the use by any of its affiliates or representatives or any other person) of these materials; or based on any other written or oral communications transmitted to the recipient or any of its affiliates or representatives in the course or its evaluation of Muzinich.

Muzinich & Co., Inc. is a registered investment adviser with the Securities and Exchange Commission (SEC). Muzinich & Co., Inc.’s being a Registered Investment Adviser with the SEC in no way shall imply a certain level of skill or training or any authorization or approval by the SEC. Issued in the European Union by Muzinich & Co. (Dublin) Limited, which is authorized and regulated by the Central Bank of Ireland. Registered in Ireland No. 625717. Registered address: 16 Fitzwilliam Street Upper, Dublin 2, D02Y221, Ireland. Issued in Switzerland by Muzinich & Co. (Switzerland) AG. Registered in Switzerland No. CHE-389.422.108. Registered address: Tödistrasse 5, 8002 Zurich, Switzerland. Issued in Singapore and Hong Kong by Muzinich & Co. (Singapore) Pte. Limited, which is licensed and regulated by the Monetary Authority of Singapore. Registered in Singapore No. 201624477K. Registered address: 6 Battery Road, #26-05, Singapore, 049909. Issued in all other jurisdictions (excluding the U.S.) by Muzinich & Co. Limited. which is authorized and regulated by the Financial Conduct Authority. Registered in England and Wales No. 3852444. Registered address: 8 Hanover Street, London W1S 1YQ, United Kingdom. 2021-07-05-6692