NCRAM

Monthly Update

December 4, 2023

US High Yield

The US high yield market returned 4.57% in November, bringing YTD total return to 9.43%, as measured by the ICE BofA US High Yield Constrained Index (HUC0). In retrospect, the “higher for longer” narrative had gone too far in September and October, and seemed to overlook signs of a slowing economy and disinflation. In November, as both the employment report and CPI provided strong evidence for moderating growth and inflation, the outlook for the Fed flipped from potentially raising rates again in early 2024, to cutting rates steadily, possibly beginning in March. A soft landing, as defined by the return of inflation to the 2% target without experiencing a recession, began to look like a distinct possibility. The capital markets were caught offside, sparking a remarkable rally across both fixed income and equities. The yield on the 10-year US Treasury dropped 60 bps, leading to a strong rally for longer duration assets. At the same time, as a potential soft landing came into focus, spreads tightened as well. Within US high yield, BBs performed the best due to their longer duration. From a technical perspective, BBs were also helped by the Ford upgrade to investment grade, as high yield investors looked for other BBs to replace that exposure. However, spreads actually tightened more in Bs and CCCs, and the best performing sectors in the overall market were higher yielding ones, such as Broadcasting, Publishing, and Retail. The weakest sectors suffered from credit specific concerns, specifically Paper, Entertainment, and Telecom.

The US high yield market ended November with a yield of 8.50% and a spread of 384. Looking forward, we maintain that this yield continues to provide a good starting point for attractive risk-adjusted returns. Inflation looks to be heading the right direction in many areas including goods, energy, wages, and rents. Since the Fed would like to engineer a soft landing if possible, we can easily imagine cuts next year, as the current Fed Funds rate of 5.25% to 5.5% will look very high in real terms if inflation heads towards 2%. While the economy is sluggish today, it remains in slow growth, and we are hopeful a recession can be avoided.

European High Yield

The European high yield market returned 3.07% (EUR, unhedged) for the month of November, resulting in a 9.58% YTD return, as measured by the ICE BofA European Currency High Yield Constrained Index (HPC0). There is a somewhat higher risk of recession in Europe, but similar to US high yield, the European high yield market benefited from hopes for disinflation and rate cuts in 2024, and spreads tightened 61 bps. Q3 earnings were generally good, although the manufacturing recession continues to be a major theme. While there is cautious optimism for a positive turn in 2024, companies have very little visibility over customer destocking activities as well as end market consumer demand. European high yield had increased dispersion during the month as B-rated credits outperformed, followed by BBs, while CCC credits were the worst performing segment of the market. Technicals will continue to support the European high yield market, and we expect the strong bid for high quality paper to continue. The European high yield market ended the month with a yield of 7.35% and spread of 442.

Emerging Markets

Emerging markets hard currency sovereign bonds, as measured by the JPMorgan Emerging Markets Bond Index Global (EMBIG) posted a strong 5.79% gain in November, following three consecutive months of negative returns, which pushed its YTD performance to 5.39%. The turnaround in US yields on Fed expectations, with 10-year Treasuries moving from their 5% peak in October to 4.33% by the end of November, was the main catalyst behind EM sovereign bond performance, given their higher duration relative to other fixed-income markets. EM high yield credits outperformed with a 6.17% return and 60 bps tighter spreads, which benefited our portfolio posture tilted to high yield. Argentina in particular posted a strong +28% return following presidential elections. EM corporate bonds, as measured by the JPMorgan Corporate Emerging Market Bond Index Broad Diversified (CEMBI BD) gained 3.64% in November (5.84% YTD) with both investment grade and high yield names posting similar performance. The index spread tightened almost 20 bps, led by high yield credits, which ended the month with 9.75% average yields. Looking into 2024, technical factors look particularly strong for EM corporates, given expected net negative supply. Our EM corporate and sovereign strategies outperformed their benchmarks (gross of fees) in November.

Multi-Asset Credit

NCRAM's Responsible Multi-Asset Credit strategy posted strong performance in November, outperforming its customized blended reference index by a large margin. Our overweight in investment grade and overall long duration posture were the main drivers of this return. Our tilt to longer duration, which we extended in October into the Treasury sell-off, paid off as the soft landing narrative gained momentum with moderating inflation data and clear signs of deceleration in the US labor market. Looking ahead, we are keeping a long duration posture as we manage credit risk carefully to navigate the possibility of either a soft landing or a mild recession in 2024.

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Disclosures