NCRAM

Monthly Update

November 1, 2023

US High Yield

The US high yield market returned -1.25% in October, as measured by the ICE BofA US High Yield Constrained Index (HUC0), lowering YTD total return to 4.66%. Treasury volatility continued as the market braced for increased supply and a "higher for longer" Fed Funds rate, driven by robust growth data and inflation running slightly hotter than expectations. The 10-year US Treasury yield briefly topped 5% before retreating, ending October up 36 bps at 4.93%. Spiking interest rates impacted high yield spreads, which had remained largely impervious to Treasury volatility in the first nine months of the year. The spread on the HUC0 index increased 39 bps in October to 445 bps, but remains 38 bps lower YTD.

Third quarter earnings season has kicked off with relatively solid results in the US thus far. More high yield companies have surprised to the upside than the downside, and forward earnings guidance has skewed modestly positive. Shortly after agreeing to resolve its labor dispute with the United Auto Workers, Ford was upgraded to investment grade by S&P. This will result in roughly $40bn of debt transitioning out of the high yield market. Higher quality issuers outperformed in October, as spread widening triggered sharp CCC underperformance. Defensive sectors like food and utilities topped the broader index, while technology bonds lagged with the NASDAQ, and lower quality healthcare issuers also trailed the market.

Looking forward, NCRAM maintains a constructive outlook for the high yield market. The HUC0 index' 9.5% yield to worst offers an attractive entry point relative to post-GFC history. Early results portend resilient third quarter US high yield earnings. Market technicals remain supportive, with light new issuance this year and more than $115bn of rising stars (including Ford) leaving the high yield investment universe. While the US economy powered through the third quarter (real GDP rose 4.9% and nominal GDP was up a whopping 8.5%), softer indicators like the Beige Book and regional Fed business surveys suggest current growth could be weaker than some hard data implies. NCRAM expects the economy to slow into 2024. Declining growth and cooler inflation should enable the Fed to ease monetary policy as needed, creating a more favorable interest rate environment next year.

European High Yield

The European high yield market, as measured by the ICE BofA European Currency High Yield Constrained Index (HPC0), returned -0.26% in October (EUR, unhedged), resulting in a 6.32% YTD return. Spreads widened about 33 bps during the month. Spread widening was driven by rates, with the yield on the 5-year Bund decreasing 20 bps, and also by a poor start to the European third quarter earnings season, as companies in certain industries have experienced weak demand trends and inventory destocking. This backdrop has resulted in the B and CCC ratings cohorts underperforming in October, while we continue to see solid demand for higher quality paper. Technicals remain strong, and Ford's upgrade to investment grade should further improve demand for BB bonds in the market.

Emerging Markets

Emerging markets (EM) hard currency sovereign bonds, as measured by the JPMorgan Emerging Markets Bond Index Global (EMBIG), declined -1.45% in October, with the drawdown mostly explained by weaker US Treasuries. Investment grade credits underperformed with a -2.0% decline, while high yield credits declined only -0.6%, supported by the bonds' yield cushion. The overall EMBIG spread widened marginally (+4 bps) to 366 bps, while the index yield increased to 8.69% (6.4% in EM investment grade credits and 12.4% in EM high yield).

EM corporate bonds, as measured by the JPMorgan Corporate Emerging Market Bond Index Broad Diversified (CEMBI BD), posted a -1.22% decline in October, with investment grade and high yield names generating similar results. The index spread widened 15 bps on the month to 316 bps, taking the index yield to 8.15%. Year to date, EM USD corporates have delivered a positive total return (+2.12% through October), despite higher US yields.

Multi-Asset Credit

NCRAM's Responsible Multi-Asset Credit Strategy posted a loss in October, underperforming its customized blended reference index. We increased risk and extended duration further in October to take advantage of the sell-off driven by the conflict in Israel and concerns regarding the Fed's higher for longer narrative. Our base case sees a continued corrective phase with a mild recession coming as the effects of aggressive tightening gain momentum. Accordingly, we continue to overweight investment grade risk and duration in this strategy.

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