NCRAM

Monthly Update

March 1, 2024

US High Yield

The US high yield market returned 0.30% in February, as measured by the ICE BofA US High Yield Constrained Index (HUC0). February was the second consecutive flattish month for high yield, bringing the YTD total return to a modest 0.32%.

Hotter-than-expected CPI and PPI inflation data caused investors to reassess the outlook for Fed interest rate cuts. The Fed Funds Futures market is now pricing in three or four cuts starting in June or July, versus early February expectations of five or six moves lower commencing in May. This higher for longer shift lifted interest rates across the curve, and the 10-year US Treasury yield rose nearly 35 bps to 4.25%.

High yield managed to generate positive returns despite the sharp increase in rates on the month, as spreads served as an effective shock absorber. HUC0's option-adjusted spread (OAS) tightened by 30 bps to 329 bps, while the index' yield to worst rose only 6 bps to 7.90%.

Generally stronger-than-expected fourth quarter earnings helped high yield weather the more difficult macroeconomic backdrop in February. High yield's spread rally drove lower quality, less interest rate-sensitive issuers to outperform. CCCs fared best on the month, while BB-rated bonds posted negative returns. At the sector level, higher spread categories like retail and telecom outperformed. Tepid earnings announcements weighed on media and broadcasting, and utilities sold off with Treasuries.

Going forward, interest rate declines may not support high yield with the stiff tailwind that had been expected this year. However, softer retail sales, industrial production, and durable goods data released in February suggest the easier monetary policy thesis still holds, even if the cuts occur later in the year, and at a lower quantum. High yield companies' operating earnings remain resilient, and a surprising $60bn of bond issuance YTD (85% for refinancing) has allowed issuers to further chip away at near-term debt maturities. Nearly two thirds of leveraged finance borrowers have no upcoming maturities prior to 2027, and less than $25bn of high yield debt comes due this year. While OAS inside of 350 bps provides limited room for further spread tightening, NCRAM believes that high yield's average dollar price in the low 90s creates capital gain opportunities, and the market's nearly 8% yield offers an attractive entry point for investors.

European High Yield

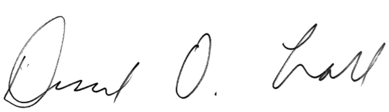
The European high yield market returned 0.36% (EUR, unhedged) in February, with YTD returns totaling 1.46%, as measured by the ICE BofA European Currency High Yield Constrained Index (HPC0). Spreads tightened 40 bps in February and 57 bps YTD. The market's positive performance was driven mainly by positive technicals, as the asset class continued to experience strong inflows, while net supply remained low. Corporate earnings have mostly met expectations, which has supported the spread tightening environment. As a result, both the B and CCC ratings buckets outperformed. While spreads have tightened meaningfully so far in 2024, we continue to believe that fundamentals and technicals remain strong in the European high yield market.

Emerging Markets

EM sovereign and corporate bonds both delivered positive returns in February, supported by attractive valuations, idiosyncratic developments, and positive technical factors. Emerging markets hard currency sovereign bonds, as measured by the JP Morgan Emerging Markets Bond Index Global (EMBIG), gained 0.69% in February. The market was led by a 2.48% return from high yield sovereigns, which saw spreads tighten by 67 bps. Investment grade sovereign credits returned -0.56%, selling off with US Treasuries. The broad JP Morgan Corporate Emerging Market Bond Index Broad Diversified (CEMBI BD) gained 0.71% in February. Similar to the EM sovereign index, high yield corporates outperformed with a 1.64% return (45 bps tighter spread), compared to a substantially flat return in investment grade EM corporates.

Multi-Asset Credit

NCRAM's Multi-Asset Credit strategy posted a small gain in February, similar to its customized blended reference index. Security selection was a positive contributor, while long duration and a modest overweight to investment grade dragged down performance. A soft landing is our base case for 2024 with a potential "growth phase" coming later, supported by expectations for an easing cycle, softer inflation, and a resilient economy. In February, we commenced the shift toward a "growth phase" portfolio, reducing investment grade exposure and adding higher yielding credit. The portfolio remains longer duration in anticipation of declining rates and as a hedge against disappointing economic growth.



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