NCRAM

Monthly Update

May 1, 2024

US High Yield

The ICE BofA US High Yield Constrained Index (HUC0) lost -1.0% in April, reducing the 2024 total return to 0.5%. During the month, markets recognized that progress on inflation has stalled in the US in early 2024. Last year, the US experienced disinflation, and the Core PCE index fell from roughly 4% annualized in the first half of 2023 to roughly 2% annualized in the second half. In Q1 2024, the rate has been roughly 4% again, as inflation is still percolating and prices for goods and services are updated periodically. While some ups and downs can be expected, the Fed is clearly discouraged by the set-back and unwilling to cut rates until inflation comes down, leading the markets to price in "higher for longer." At the same time, the labor market does not appear to be overheating, and the Fed is unlikely to raise rates again from the current level. Nevertheless, the 10-year Treasury sold off and yields increased 48 bps on the month, bringing the increase to 80 bps on the year, and this weighed on returns for many asset classes including high yield. During the month, CCCs underperformed, and Cable TV was the worst performing sector in the overall market due to issuer specific activity, followed by Telecom and Media, while Healthcare and the economically sensitive sectors like Energy and Chemicals performed best.

Thankfully, the US economy continues to be in a phase of steady growth. While Q1 real GDP growth was reported at 1.6%, inventories detracted, and real final sales to domestic purchasers increased at a 2.8% annualized rate. Therefore, the market feels that the real growth in the US remains in a 2% to 3% trend, and a solid economic outlook has kept high yield spreads in check. US high yield ended the month with a yield to worst of 8.20% and spread of 318. Yields are up approx. 50 bps in 2024 to date, while spreads are down about 20 bps. Looking forward, NCRAM feels the yield and carry will drive an attractive total return for high yield this year, while progress on inflation will be a key driver of Fed policy and Treasury yields.

European High Yield

The European high yield market returned -0.02% in April, and 1.89% for the YTD period (EUR unhedged), as measured by the ICE BofA European Currency High Yield Constrained Index (HPC0). During the month, spreads tightened by roughly 10 bps, led by BB bonds, as Bund yields increased during the month while cash high yield bonds remained relatively steady. Bs and CCCs underperformed as some investors sold riskier credits that had rallied significantly year to date. In addition, there continued to be volatility around certain idiosyncratic distressed issuers such as Altice France and Ardagh Packaging. The European economy looks to be recovering from a period of negative growth over the last several months, and while inflation continues to be sticky, the trend is expected to allow the ECB to cut at their June meeting. Technicals continued to be constructive in European high yield as new issue activity remained modest and there has been plenty of cash to absorb any new supply, most of which has been used for refinancing. New issues picked up at the end of April as issuers pushed forward their plans to refinance their 2025 and 2026 maturities given the healthy capital markets.

Emerging Markets

Emerging market hard currency bonds gave up some of their previous gains due to higher US Treasury yields in April on the back of persistently elevated inflation in the US. EM sovereign bonds returned -2.01% in April, pulled down by investment grade sovereigns which dropped -2.77%, as measured by the JPMorgan Emerging Markets Bond Index Global (EMBIG). Meanwhile, EM corporate bonds posted a -0.88% negative return, while spreads remained relatively resilient, as measured by the JPMorgan Corporate Emerging Markets Bond Index Broad Diversified (CEMBI BD). The lower average duration of EM corporate bonds relative to EM sovereigns allowed them to outperform. A common theme for both corporates and sovereign EM bonds was the continuing outperformance of the high yield segments relative to investment grade credits.

Multi-Asset Credit

NCRAM's Responsible Multi-Asset Credit Strategy posted a loss in April, underperforming its customized blended reference index. Our long duration and modest overweight to investment grade issuers were negative contributors. We have increased duration further in April as the 10-year Treasury sold off, and we see long-term value in Treasury sensitive assets with the 10-year Treasury real yield above 2%. The portfolio continues to adopt a barbell strategy of holding higher risk assets like high yield, loans, and EM debt, which benefit from growth, alongside investment grade and long duration assets, as a hedge against an economic slowdown.

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