NCRAM

Monthly Update

June 3, 2024

US High Yield

US high yield returned 1.13% in May, bringing the YTD return to 1.64%, according to the ICE BofA US High Yield Constrained Index (HUC0). The market was supported by a better month of inflation data, with the Core PCE index reported at 0.25%, or 3.0% annualized, compared to readings of 4.0% annualized in the first quarter. This led the market to be a little more optimistic about seeing one to two Fed Funds cuts later this year, and the 5-year and 10-year US Treasury rallied, with yields falling by roughly 20 bps. The high yield market tracked the Treasury market as it moved during the month, and spreads remained relatively stable. Within high yield, the ratings categories performed similarly in May, though the CCC segment is the leader YTD, as it is less sensitive to the rise in Treasury yields. Media, Telecom, Broadcasting, and Cable continued to lag the overall market in May, as secular change and credit events depressed returns. The US high yield market ended the month with a yield of 8.04% and a spread of 320.

Looking forward, progress on reducing inflation will be a key variable on whether the Fed can cut and fixed income can rally, or whether rates need to stay higher for longer. We believe the US economy can continue to show steady growth in the coming year. While higher rates are suppressing some activity, fiscal stimulus, the tech boom, and investment in energy and other innovative sectors are keeping the economy moving forward. Jobs growth in April was slightly weaker than the first quarter, but the overall trend in the US is steady growth in the 2.0-2.5% area for real domestic demand. The large cap US equity markets hit all-time highs in the month, showing the stock market's confidence in growth and earnings, especially in technology. At the same time, smaller stocks are up this year, but not at all-time highs, showing that some sectors are feeling the restrictive effects of higher rates. In an environment of steady growth, we believe the yield and carry in US high yield can drive an attractive total return this year.

European High Yield

The European high yield market returned 0.96% in May and 2.87% YTD(EUR, unhedged), as measured by the ICE BofA European Currency High Yield Constrained Index (HPC0). Rates sold off during the month as fears of sticky inflation persisted, but high yield continued to perform well as technicals remained strong and the growth outlook is improving. Spreads tightened by 17 bps during the month, led by tightening in CCC credits. The Q1 earnings season came to a close during the month, and we continue to see relatively stable fundamentals from the European economy. Manufacturing sectors, such as Chemicals and Packaging, had continued weak results, but showed overall stability sequentially, with the expectation that demand will turn upward going into 2H24. Construction remained somewhat weak, while consumer demand remained resilient, so retail earnings were generally stable. Overall, services remained a bright spot for the economy as consumers continued to pay for experiences such as vacation and travel. In general, fundamentals remain solid in European high yield, and we expect default rates to remain relatively low throughout the rest of 2024.

Emerging Markets

EM hard currency bonds posted positive returns in May, supported by the rally in US Treasury yields and some spread tightening in specific sectors in the corporate segment. EM sovereign bonds, as measured by the JPMorgan Emerging Markets Bond Index Global (EMBIG), gained 1.82% in May and 1.17% YTD, mostly reflecting the US Treasury recovery post April CPI data, as spreads barely moved. Meanwhile, EM corporate bonds, as measured by the JPMorgan Corporate Emerging Market Bond Index Broad Diversified (CEMBI BD) posted a 1.46% return in May (2.89% YTD) with both investment grade credits and high yield bonds performing similarly. The overall CEMBI BD index tightened 4 bps to 217 bps with double-digit spread tightening in the Real Estate, Metals and Mining, and Transportation sectors. Measures announced in China to incentivize the property sector were behind the strong performance in some specific real estate names, while commodity prices were positive for some Metals and Mining credits. Moderate supply net of amortizations and attractive yields compared to other markets continue to be supportive for EM corporates.

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