NCRAM

Monthly Update

September 4, 2024

US High Yield

US high yield returned 1.59% in August, bringing the YTD return to 6.29%, according to the ICE BofA US High Yield Constrained Index (HUC0). During the month, an outlook for an economic "soft landing" continued to drive markets. The labor market has softened, as seen by numerous surveys, and the Fed is planning to cut rates beginning in September. During his Jackson Hole speech in August, Fed Chair Powell noted "the time has come" to pivot to easing, and the market is now pricing more than four 25 bps reductions by year-end, and more than eight within 12 months. Thanks to this outlook for Fed cuts, US Treasuries continued to rally, with yields on shorter maturity Treasuries falling more. At the same time, US Q2 GDP expanded 3.0%, showing inherent economic momentum. While somewhat lower growth should be expected for the next few quarters, the market is betting slow growth can continue until looser Fed policy helps to stimulate the economy in 2025. This sentiment helped equities perform well, with the average stock outperforming the mega-cap tech stocks, which started to falter, and within US high yield, CCC-rated bonds performed the best. Among sectors in the overall high yield market, Technology and Telecom outperformed, while Automotive and Leisure lagged. The US high yield market ended the month with a yield of 7.34% and spread of 317.

While the returns in August were positive overall, early August saw a brief but sharp sell-off in risk markets as growth concerns after soft payroll figures were exacerbated by deleveraging connected to a Yen rally and VIX index spike. During this period, US high yield dropped roughly 1%. While the panic passed quickly, it illustrated the potential for volatility in an environment with a slowing labor market. The US election upcoming on November 5th could also be a source of volatility, especially if the election is too close to call, though a clear winner and a divided government is a fairly high likelihood, in our view. In general, NCRAM believes that expected slower but positive economic growth is supportive for credit markets' forward returns. While heightened interest rate and spread volatility going forward is certainly possible, we believe that mid-7% yields position the high yield market to deliver attractive total returns over the balance of 2024 and into next year.

European High Yield

The European high yield market returned 1.17% (EUR, unhedged) in August, and 6.14% YTD, as measured by the ICE BofA European Currency High Yield Constrained Index (HPC0). Like US high yield, European high yield experienced a short bout of market volatility triggered by the weak non-farm payrolls data in US and the surprise interest rate hike by the Bank of Japan, but subsequently the market recovered strongly and rallied into the end of summer. Technicals were extremely favorable for the month, as new issue activity was seasonally low, while demand for the asset class remained robust with increased expectations for rate cuts in the US and Europe. In addition, the Q2 earnings season showed that, while earnings growth is slowing, the market environment remains stable, consistent with our soft landing outlook. These factors resulted in a strong backdrop for risk, and lower quality credits outperformed during the month. Looking forward into September, we do expect new issue to pick up in the second half of September and into October as issuers look to extend maturities into a constructive interest rate and spread environment.

Emerging Markets

Emerging markets hard currency bonds had another month of positive returns in August, mostly driven by stronger US Treasuries and some marginal spread tightening. EM sovereign bonds, as measured by the JPMorgan Emerging Markets Bond Index Global (EMBIG) gained 2.33% during the month, with investment grade credits outperforming (up 2.47%). Meanwhile, EM corporates, as measured by the JPMorgan Corporate Emerging Markets Bond Index Broad Diversified (CEMBI BD) gained 1.69% in August, with similar performance among investment grade and high yield credits. Notably, EM spreads managed to reverse the initial spread widening seen at the beginning of the month, when weaker-than-expected US payrolls tested market consensus of a soft landing and led to a spike in market volatility.

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