NCRAM

# Monthly Update

October 2, 2024

## US High Yield

US high yield returned 1.63% in September, bringing the YTD return to 8.03%, according to the ICE BofA US High Yield Constrained Index (HUC0). September culminated a very strong Q3, during which US high yield returned 5.28%. The prospect of a "soft landing" is an optimal environment for high yield and has been the primary driver of the strong market rally. A keystone of the soft landing outlook is the deceleration of inflation. The August reading for Core PCE was 0.13% month-over-month, bringing the 3-month annualized rate down to roughly 2.0%. In addition, oil prices, which have outsized importance for the inflation that consumers feel, fell from $81 WTI to $70 WTI during the quarter.

The deceleration of inflation has allowed the Fed to focus on the rise in unemployment, which has increased from 3.7% to 4.2% this year. While some rebalancing of the labor market was necessary for inflation to fall, the Fed clearly wants to avoid a self-reinforcing deterioration in jobs, consumer confidence, and the economy overall. With that in mind, the FOMC opted to cut the Fed Funds rate by 50 bps in September, and furthermore signaled that supporting employment had become their primary goal, the polar opposite of their focus on inflation 12 to 24 months ago. The market currently expects an extended Fed cutting cycle, with Fed Funds rates falling to roughly 4% at year-end 2024 and roughly 3% at year-end 2025. Meanwhile, Real GDP growth remains stable around 2.0% to 2.5%, and the Fed cutting cycle will help keep it in that range. China stimulus during the month provided an incremental positive for the global growth outlook. With growth stable, inflation falling, and the Fed cutting, US high yield was able to enjoy both a Treasury rally and spread tightening during both the month and the quarter. For Q3 overall, the 5-year Treasury yield dropped by 82 bps and US high yield spreads tightened by 18 bps. US high yield ended September with a yield to worst of 6.98% and an option-adjusted spread of 303. In a bull market, CCCs have performed the best, up a remarkable 5.2% in the month and 10.3% for the quarter. A large contributor to that return has been the Cable sector, up 7% in the month, while other leading sectors in September included Broadcasting and Telecom. In general, the market took a much rosier view of the stressed sectors, including those issuers going through distressed exchanges, as the soft landing outlook and equity market rally increased risk appetites. Lagging sectors in the month included Leisure and Financials.

Looking forward, we embrace the outlook for a soft landing, which seems likely. The US election and possible tax or tariff policy changes in 2025 have the potential to cause volatility, though most likely the actual policy changes will be less dramatic than campaign rhetoric, especially if the control of the government is divided. We believe the demand for high yield is very strong, partially due to other credit strategies like private debt seeking to deploy capital in high yield. Spreads may not tighten further, but high yield still offers a roughly 7% yield in an environment of falling rates.

## European High Yield

The European high yield market returned 1.20% (EUR, unhedged) in September and 7.42% YTD, as measured by the ICE BofA European Currency High Yield Constrained Index (HPC0). European high yield rallied into the Fed's initial rate cut and also the 25 bps cut by the ECB. Lower rated securities continued to outperform as default rates should continue to be moderate, with a stable economic environment and robust new issue market, in which issuers are coming to market to refinance maturities due in 2025 through 2027. In addition, technical factors remain supportive as the all-in yields in the market continue to be attractive on a historical basis.

As we look forward into the Q3 earnings season, we will scrutinize outlooks for our companies given the pockets of weakness in economic data, particularly in Germany and France. Issuers in the Automotive sector are already broadly reducing their earnings expectations for the rest of this year. Looking into October, we continue to believe that the backdrop for the market is positive, and while new issuance should continue at a steady pace, we believe that the market is well-equipped to digest any net new supply.

## Emerging Markets

Emerging markets hard currency bonds extended gains in September, as the Fed delivered its first interest rate cut, China unexpectedly unveiled policy measures to stimulate domestic demand, and some inflows returned into the asset class. EM sovereign bonds, as measured by the JPMorgan Emerging Markets Bond Index Global (EMBIG) gained 1.79% in September (6.07% in 3Q24) with high yield credits outperforming with a 6.78% return and spreads tightening 58 bps. EM corporates gained 1.23% in September (4.48% in 3Q24) according to the JPMorgan Corporate Emerging Markets Bond Index Broad Diversified (CEMBI BD), with high yield credits in the CCC and B credit buckets performing the best. The performance of EM hard currency bonds in the month was remarkable considering that heavier seasonal supply usually tends to weigh on returns in September.

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