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Monthly Update

December 2, 2024

US High Yield

US high yield returned 1.15% in November, bringing the YTD return to 8.67%, according to the ICE BofA US High Yield Constrained Index (HUC0). The election of Donald Trump was the key driver of market activity in November. While there are uncertainties about what the new administration will propose and what will pass Congress, the market has viewed the election as positive for risk, and the S&P 500 ended November at an all-time high. In particular, the administration is expected to favor lower taxes and deregulation. While this direction for policy could further increase budget deficits and inflation, the new administration is also putting attention on shrinking and simplifying the role of government through an unofficial "Department of Government Efficiency," which could potentially offset tax cuts with spending reductions. Beyond this, Trump is clearly enamored with using tariffs as a threat to both incentivize production in the US as well as achieve geopolitical goals, and depending on the details, tariffs could become a risk factor to lower growth and increase inflation. While Treasuries initially sold off after the election due to the prospect of fiscal expansion, they rallied in the second half of November thanks to the prospect of spending cuts, the fear of tariffs, and a market-friendly nominee pick for Treasury Secretary in Scott Bessent. In an overall risk-on environment, US High Yield rallied, CCCs led among the ratings tiers, and spreads tightened. Cable TV, Energy and Financials were among the best performing sectors, while Technology, Utilities and Food Retailers lagged. US High Yield ended the month with a yield of 7.16% and spread of 274.

Looking forward, the new administration is pro-growth, but also has a large "anti-establishment" influence and a fairly large appetite for change. Their overall thinking is relatively suspicious of America's largest corporations, including technology, pharmaceutical, food, media and defense companies. That said, most substantive policy changes will require Congressional support, and the degree of support in Congress will be tested in the year ahead. Republicans control the Senate by a margin of 53-47 and the House by a margin of 220-215, so there is relatively little cushion to pass legislation if certain Republicans oppose a given idea and Democrats remain opposed. On the other hand, some of the ideas may find bipartisan appeal, contributing to the unknowns about what regulatory changes are coming. At this time, we expect some industries may benefit from lighter regulation and tariffs including financial services, industrials, and transportation. We believe that Energy companies could benefit from lower regulatory costs, but prices may come under pressure on increased supply. At the same time, consumer goods companies that rely on imports would be negatively impacted by higher tariffs. Sector and industry losers may include businesses that benefited from Biden administration priorities including green energy and healthcare.

The Fed has indicated that they will remain focused on the real economy and avoid speculating about future policy changes. The Fed still views policy as relatively restrictive and accordingly has a modest easing bias, and thus the market is pricing in three further cuts by the end of 2025, which if consummated would reduce overnight rates from 4 ½%- 4 ¾% today to 3 ¾% to 4% at the end of 2025. The Fed may make one cut in December, but this is not assured. Overall, NCRAM is optimistic that the election is generally supportive for growth and high yield issuers' fundamentals, the Fed continues to cut rates over the next year, and the 7.16% yield on US high yield can help provide an attractive risk adjusted return.

European High Yield

The European High Yield market, as measured by the ICE BofA European Currency High Yield Constrained Index, returned 0.68% (EUR, unhedged) in November, and 8.64% for the YTD period. The impact of the US election in Europe was mixed, as risk assets were led higher by US equities, but the outlook for the European economy was more uncertain. The looming potential for tariffs impacted the already muddy outlook for European autos, while a potential for resolution to the Ukraine conflict was viewed as a positive (despite subsequent provocations in the region). The prospect of monetary policy divergence increased as it is expected the ECB will continue to cut steadily, while the Fed may need to entertain the impact of tariffs and fiscal stimulus. Ultimately, Europe still faces a tough structural backdrop with political and fiscal uncertainty in both Germany and France that should linger into 2025. Spreads widened during the month as 10-year Bund yields declined from 2.40% to about 2.10%, but demand remained strong and the cash market continued to rally. We expect that with continued strong technicals, the performance of the market should continue to be strong going into the end of 2024.

Emerging Markets

Emerging markets hard currency bonds delivered positive returns in November after a pause in October. EM Corporates, as measured by the JPMorgan Corporate Emerging Market Broad Diversified Index (CEMBI BD), gained 0.60% in November (8.22% YTD), with both high-yield and investment-grade buckets posting similar returns. Metals & Mining and Oil & Gas credits were the best performing sectors within the index. Spreads remained flat in EM investment-grade credits and widened only marginally in high-yield credits. Meanwhile, EM Sovereign bonds as measured by the JPMorgan Emerging Markets Bond Index Global (EMBIG) posted a 1.19% return in November (7.34% YTD), with EM high-yield credits gaining 1.96% and investment-grade lagging with a 0.61% gain, an outperformance of HY seen during most of this year. Our flagship EM strategies remained skewed towards high-yield credits during the month.

David Crall, CFA
NCRAM CEO and CIO

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