

High-Yield Corporate Bonds Turning the Corner



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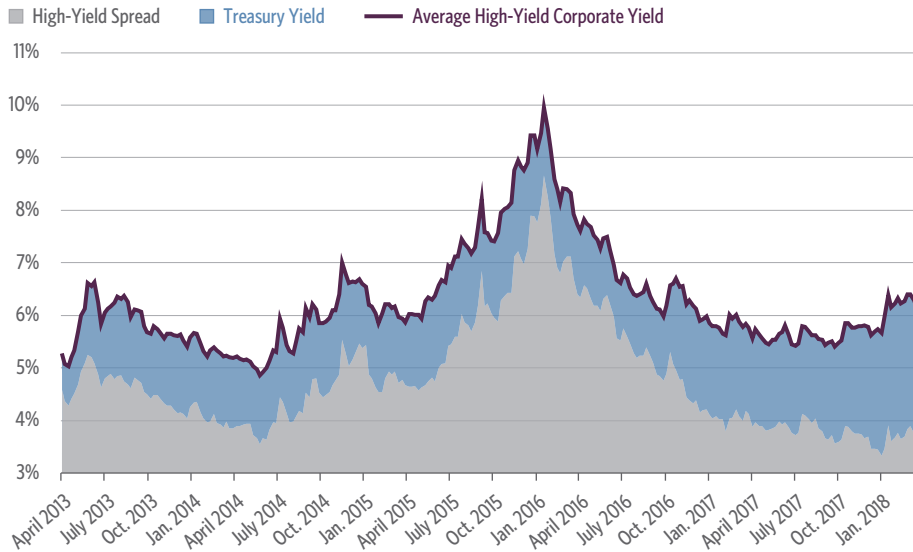
Demand for high-yield corporate bonds waned in the first quarter as Treasuries sold off, but signs of a turnaround are visible.

High-yield corporate bonds are trading at yields above 6 percent for the first time since December 2016, mostly due to the backup in benchmark Treasury rates (see chart, top right). While five-year Treasury yields rose 61 basis points year to date through April, spreads are 26 basis points tighter, continuously retesting cycle lows as higher yields attract income seekers back into the market.

Although we saw a pickup in volatility in the first quarter, we believe higher yields against a relatively benign credit backdrop will stem a mass exodus from the high-yield market. The ICE Bank of America Merrill Lynch High-Yield index posted a 0.9 percent loss on a total return basis, as higher-duration BB-rated bonds delivered their worst performance since the third quarter of 2015 with a 1.7 percent loss, compared to a 0.4 percent loss for B-rated bonds and a 0.5 percent gain for CCC-rated bonds. Since 10-year Treasury yields began to move higher in early September 2017, BB-rated bonds have returned -0.8 percent, the only rating category in leveraged credit to record a loss over this period.

The selloff in Treasuries caused some trepidation among leveraged credit investors as higher-duration BBs experienced negative price returns. Between January and March, high-yield mutual funds and exchange-traded funds experienced net outflows totaling \$15.5 billion, but we expect a turnaround in demand. Funds saw a net inflow of \$920 million in one week during April followed by the largest inflow in over a year of \$3 billion (see chart, bottom right). We also note that primary dealer inventories of high-yield bonds have plunged, falling from approximately \$5 billion at year-end 2017 to only \$1 billion in mid-April, according to New York Federal Reserve Bank data. The last time dealer inventories fell to similar levels was in March 2016, when a swift pickup in demand caught dealers by surprise. To the extent investors are looking for opportunities in high yield as volatility levels off, we view B-rated credits relatively favorably in the current environment as they balance credit and duration risks and offer wider spreads compared to their own history than other rating categories.

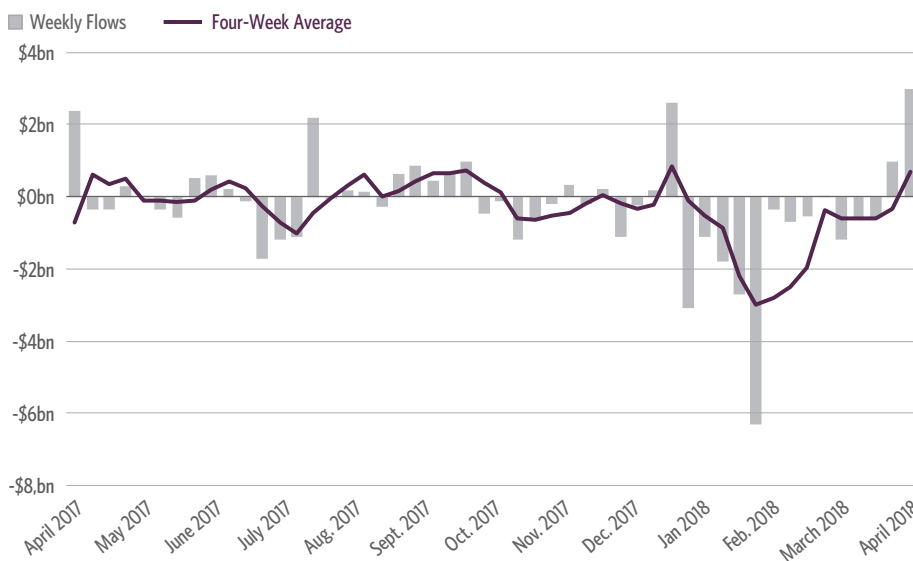
High-Yield Corporate Bond Yields Top 6 Percent



Source: ICE Bank of America Merrill Lynch, Guggenheim Investments. Data as of 4.24.2018.

While five-year Treasury yields rose 61 basis points year to date through April, spreads are 26 basis points tighter, continuously retesting cycle lows as higher yields drive investor demand. Although we saw a pickup in volatility in the first quarter, we believe higher yields against a relatively benign credit backdrop will stem a mass exodus from the high-yield market.

High-Yield Mutual Fund and ETF Flows Turn Positive



Source: Lipper, Guggenheim Investments. Data as of 4.18.2018.

Between January and March, high-yield mutual funds and exchange-traded funds experienced net outflows totaling \$15.5 billion, but we expect a turnaround in demand. Funds saw a net inflow of \$920 million in one week during April followed by the largest inflow in over a year of \$3 billion.

Investing involves risk. In general, the value of fixed-income securities fall when interest rates rise. High-yield securities present more liquidity and credit risk than investment grade bonds and may be subject to greater volatility. Asset-backed securities, including mortgage-backed securities, may have structures that make their reaction to interest rates and other factors difficult to predict, making their prices volatile and they are subject to liquidity risk. Investments in floating rate senior secured syndicated bank loans and other floating rate securities involve special types of risks, including credit risk, interest rate risk, liquidity risk and prepayment risk. Guggenheim Investments represents the following affiliated investment management businesses of Guggenheim Partners, LLC: Guggenheim Partners Investment Management, LLC, Security Investors, LLC, Guggenheim Funds Investment Advisors, LLC, Guggenheim Funds Distributors, LLC, Guggenheim Real Estate, LLC, GS GAMMA Advisors, LLC, Guggenheim Partners Europe Limited and Guggenheim Partners India Management. ©2018, Guggenheim Partners, LLC. No part of this article may be reproduced in any form, or referred to in any other publication, without express written permission of Guggenheim Partners, LLC.