High-Yield Corporate Bonds

Ongoing Shift Toward Lower Quality

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The lowest quality corporate bonds gain as investors stretch for yield.

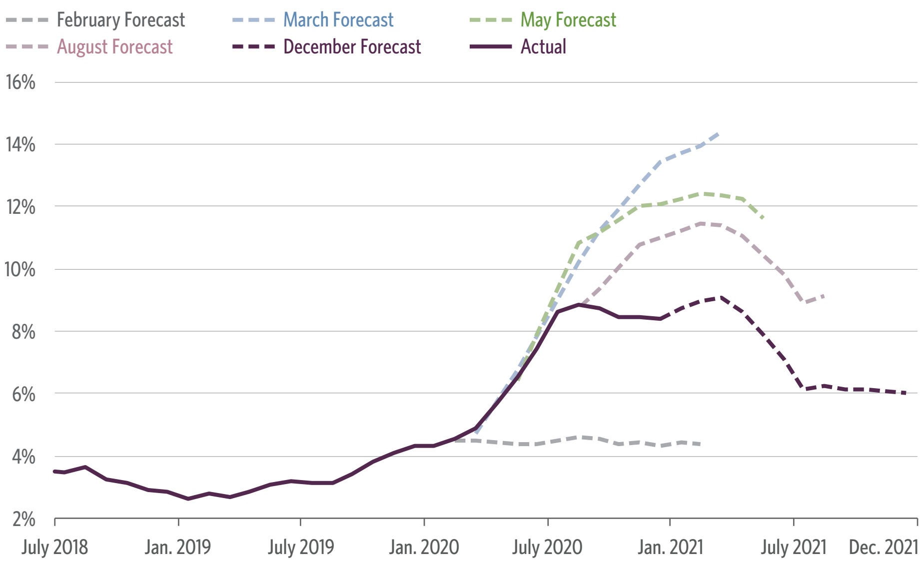
High-yield corporate bond spreads continued to tighten as investors gained confidence that the economy will eventually make a full recovery. The ICE BofA High Yield index yield fell to historical low of 3.9 percent during the first quarter of 2021 before rising back above 4.0 percent. It was previously thought that the floor on high-yield corporate bond index yields was 5 percent. In each of the last four cycles, bonds have pierced through the previous cycle's lowest yield, and this cycle is proving to be no different, even if the record low has arrived much sooner than normal. This is owing to the vast amount of policy support that continues to buttress financial conditions and, in turn, has decreased default projections.

Moody's now expects the speculative-grade default rate to fall to 6.0 percent in 2021 compared to 8.4 percent in 2020 (see chart, top right). We expect Moody's will continue to downgrade its default rate forecast as the U.S. economy grows well above potential, and as access to capital remains easy. In the first month of 2021, the high-yield corporate bond market saw $52 billion in debt issuance, a 36 percent increase from last January's total and the third largest monthly issuance volume dating back to January 2005. The makeup of January issuance also reflects a continued move toward lower quality, with 16 percent of high-yield corporate bond issuance rated CCC or below. This is a significant shift from 2020, when CCC or below issuance represented only 5.8 percent of the primary market.

We also see investors continuing to move decisively toward lower quality in the secondary market as they reach for higher total return potential. In the fourth quarter of 2020, CCC-rated bonds delivered more than twice the total return of the higher-rated BB and B-rated categories, with a return of 12.2 percent in a single quarter, leaving CCC-rated corporates yielding an average of only 8.7 percent, the lowest on record (see chart, bottom right). We think some of the rally in CCC looks overextended and would look for better value in the single B rated or higher space, where fewer deeply distressed situations exist. Broadly speaking, we continue to view selloffs as an opportunity to add to risk.

Accommodative Policies Support a Decline in Default Expectations

Moody's 12-Month Speculative-Grade Default Rate Forecasts



Source: Guggenheim Investments, Moody's. Data as of 12.31.2020.

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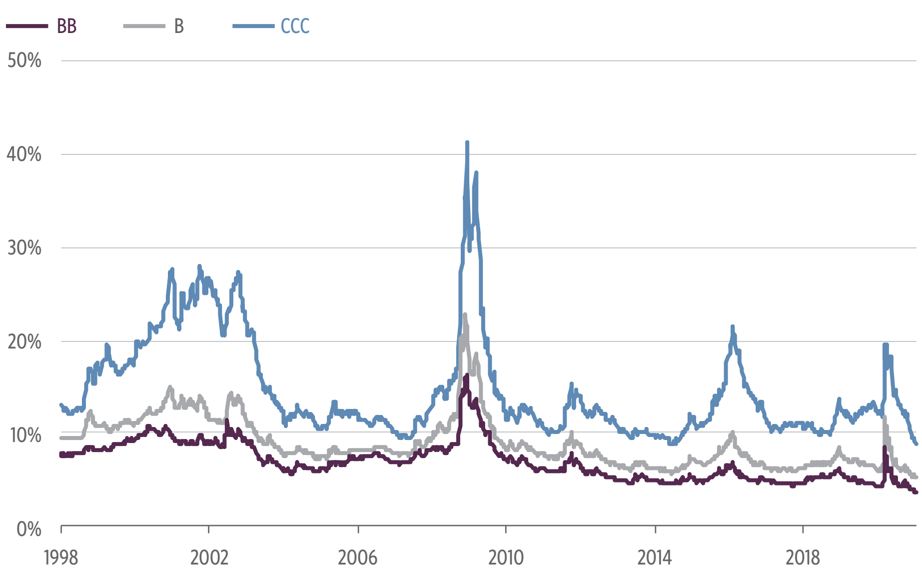
CCC-Rated High-Yield Corporate Bond Yields Hit Record Lows

Index Yields by Rating



Source: Guggenheim Investments, ICE Index Services. Data as of 1.22.2021.

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