High Yield Corporate Bonds

Spreads are Nearing Historical Lows

Driven by low net issuance and strong demand, high yield credit spreads continue to tighten towards the lows last seen in 2021.

High yield spreads experienced a brief bout of volatility in early August triggered by concerns over a weakening labor market, but this quickly turned around as buyers found spread levels and all-in yields to be at an attractive re-entry point. Credit fundamentals and rating migration continue to support the view that default rates will remain below average. With credit spreads approaching their historical tights, however, we remain selective.

Sector Commentary

- Spreads on the ICE BofA U.S. High Yield Master II Constrained Index continued to tighten over the quarter, led by lower quality bonds. Earlier this year, higher quality BB-rated and B-rated credit spreads traded tighter than their 2021 lows, indicating that lower quality bond spreads are catching up.
- CCC-rated credit spreads are approaching their 2021 tights of 444 basis points, as the start of the Fed easing cycle and recent strength in economic data continue to drive growing expectations of a soft landing scenario. We are underweight.
- Growth opportunities related to artificial intelligence fueled a rally in CCCs as the market outlook improves for struggling sectors like cable and wireline. The communications sector's rebound follows negative returns in the first half of the year.
- Rating agency upgrades outpaced downgrades for the second consecutive quarter, with 130 upgrades versus 76 downgrades.

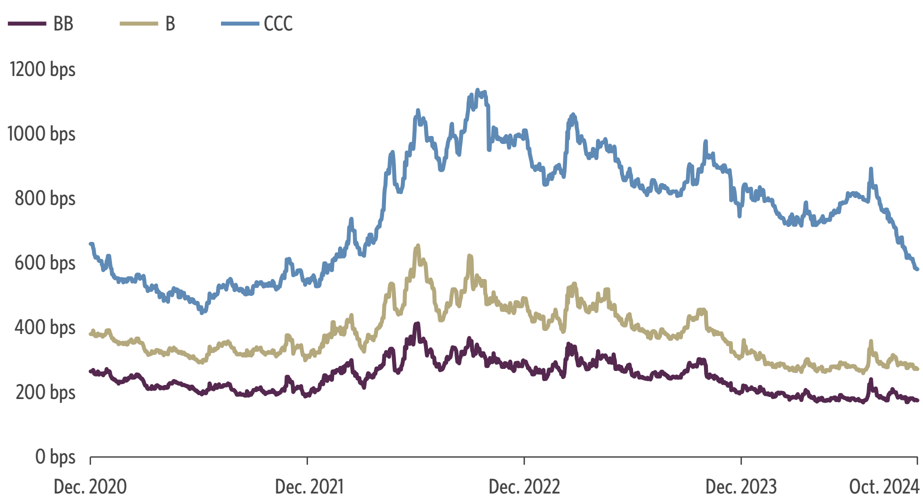
Investment Themes

- Yields averaged 7 percent in mid-October, providing attractive loss-adjusted income given low default expectations. Spreads declined to 287 basis points, nearing their 2021 lows.
- Refinancing has driven 72 percent of this year's primary market activity, a pace of issuance unlikely to continue.
- Issuer net leverage and interest coverage credit ratios were flat in the second quarter, slightly better than long term averages.
- The high yield last-12-month default rate of 1.4 percent declined slightly relative to last quarter and remains well below its long-term average of 4 percent. The distress rate decreased to 5.1 percent from 7.3 percent in June due to the rally in CCCs.
- We prefer higher quality high yield bonds (rated B or above) due to their stronger fundamentals and lower default risk, but careful credit selection remains important.

By Thomas Hauser and Maria Giraldo

CCC-rated credit spreads are approaching their 2021 tights of 444 basis points, as the start of the Fed easing cycle and recent strength in economic data continue to drive growing expectations of a soft landing scenario.

CCC Spreads Are Approaching Their 2021 Low



Source: Guggenheim Investments, Bloomberg. Data as of 10.21.2024. HY BB represented by the Bloomberg Ba U.S. High Yield Average option-adjusted spread (OAS); HY B represented by the Bloomberg B U.S. High Yield Average OAS; and HY CCC represented by the Bloomberg Caa US High Yield Average OAS.