High Yield Corporate Bonds

Selectively Constructive on High Yield

High yield bonds remain compelling despite tight spreads.

Despite election volatility starting to impact rate and equity markets, high yield spreads had stayed within a narrow range until the recent selloff induced by the nonfarm payroll miss and broader worries about economic trajectory. Looking forward, limited net supply will likely continue to support the broader market but economic uncertainty could increase dispersion across sectors and issuers. Our focus remains on higher quality credits that can weather high rates through cash flow stability and healthy margins.

Sector Commentary

- High yield bond yields averaged near 8 percent in the second quarter, continuing to offer a compelling entry point despite tight spreads.
- Following some recent volatility in early August that led to spreads retracing to December levels, we have seen some recovery with BBs in the 18th percentile of historical levels and Bs in the 14th percentile. CCCs remain comparatively wider to their own history, in the 56th percentile, as markets remain concerned about some of the recent weakness in labor market data.
- Primary market activity is on pace to reach pre-COVID averages, with a total of $166 billion so far. Over 75 percent of issuance continues to be for refinancing, resulting in modest new paper entering the index.

Investment Themes

- The risk of defaults in lower rated credits requires a selective approach. The CCC-rated par-weighted default rate over the last 12 months has been 12 percent, according to BofA Merrill Lynch Research, compared to no defaults and a 0.3 percent default rate for BB-rated and B-rated corporates, respectively.
- Rate cuts potentially beginning in September could boost returns for the sector and improve the outlook for credits with scheduled maturities in the next two years (only 8 percent of the market).
- We prefer higher quality high yield bonds (rated B or above) due to their stronger fundamentals and lower default risk. These bonds offer a balance of attractive yields and relative safety.
- Given elevated refinancing costs, closely monitoring issuers' balance sheets and their ability to service debt is crucial. We favor companies with strong cash flows and manageable debt levels.

By Thomas Hauser and Maria Giraldo

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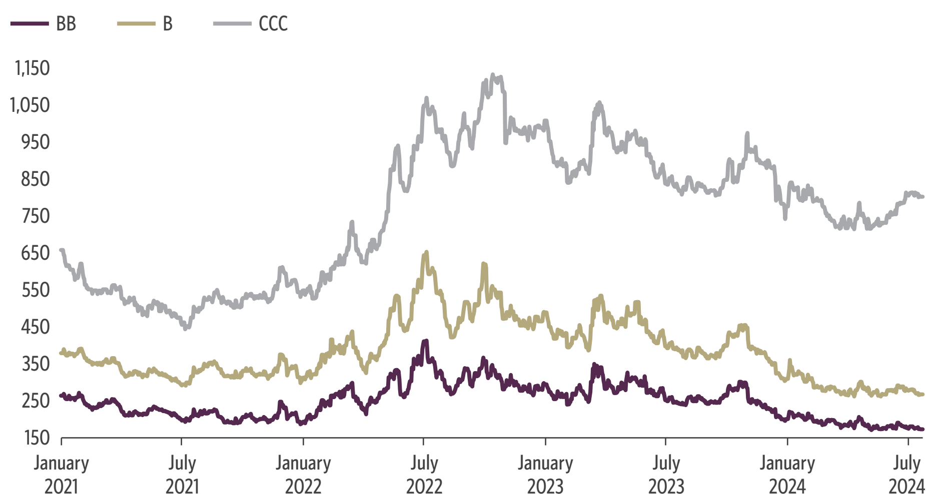
As BB and B Spreads Approach Three-Year Tights, CCC Spreads Hit Resistance



Source: Guggenheim Investments, Bloomberg. Data as of 7.19.2024.

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Investing involves risk, including the possible loss of principal. In general, the value of a fixed-income security falls when interest rates rise and rises when interest rates fall. Longer term bonds are more sensitive to interest rate changes and subject to greater volatility than those with shorter maturities. During periods of declining rates, the interest rates on floating rate securities generally reset downward and their value is unlikely to rise to the same extent as comparable fixed rate securities. High yield and unrated debt securities are at a greater risk of default than investment grade bonds and may be less liquid, which may increase volatility. Investors in asset-backed securities, including mortgage-backed securities and collateralized loan obligations ("CLOs"), generally receive payments that are part interest and part return of principal. These payments may vary based on the rate loans are repaid. Some asset-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 and valuation risk. CLOs bear similar risks to investing in loans directly, such as credit, interest rate, counterparty, prepayment, liquidity, and valuation risks. Loans are often below investment grade, may be unrated, and typically offer a fixed or floating interest rate.

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