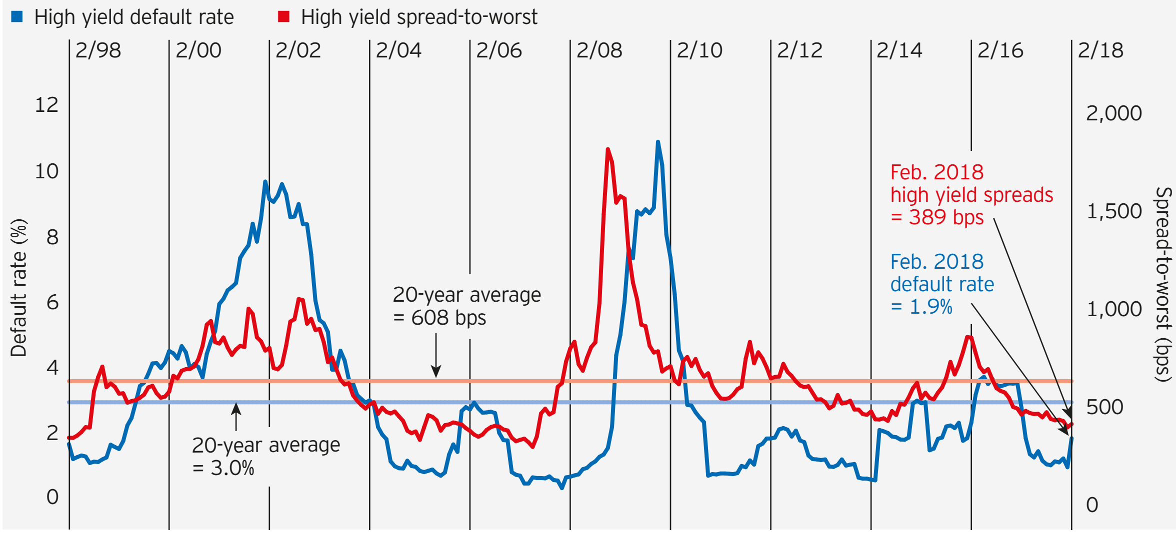
Invesco High Yield

High Yield Snapshot

Monthly high yield bond market update: March 2018

Amid a sell-off in equities, an increase in interest rates, and a significant outflow from the sector, the high yield market struggled in February and delivered a negative return. The highest quality segment suffered the most due to its greater sensitivity to interest rates which rose due to concerns regarding higher inflation and more aggressive central bank tightening. In February, the Bloomberg Barclays US Corporate High Yield 2% Issuer Capped Index returned -0.85% as interest rates rose about 15 basis points (bps) and credit spreads widened about 20 bps. Spreads ended the month at 389 bps, which is 219 bps below the 20-year average. The recent widening of spreads has created some opportunities in the market, both in new issues and in the secondary market. With new issues offering higher yields than just a few months ago, our team is actively selecting new investment ideas that meet our strong credit criteria.

Spreads are below long-term averages



Source: JP Morgan, as of Feb. 28, 2018.

February performance by rating[1]

- BB-rated securities returned -1.11%
- B-rated securities returned -0.71%
- CCC-rated securities returned -0.80%

Earnings trends

Fourth quarter earnings reporting season is behind us. Here are some themes our analysts are following:

- We're hearing of slight upticks in wages in a variety of industries, including restaurants, retail, and healthcare. Special mention was also given to higher freight costs by a number of companies.
- Industrial companies continue to post revenue growth in the mid-single digits, consistent with current GDP growth in the US and Europe.
- Pharmaceutical companies are expected to remain in the headlines as drug pricing pressures will likely persist. We expect companies will try to mitigate these price declines with an aggressive focus on internal cost controls.

High yield performance by sector in February

Source: JP Morgan, as of Feb. 28, 2018.

Fundamentals[2]

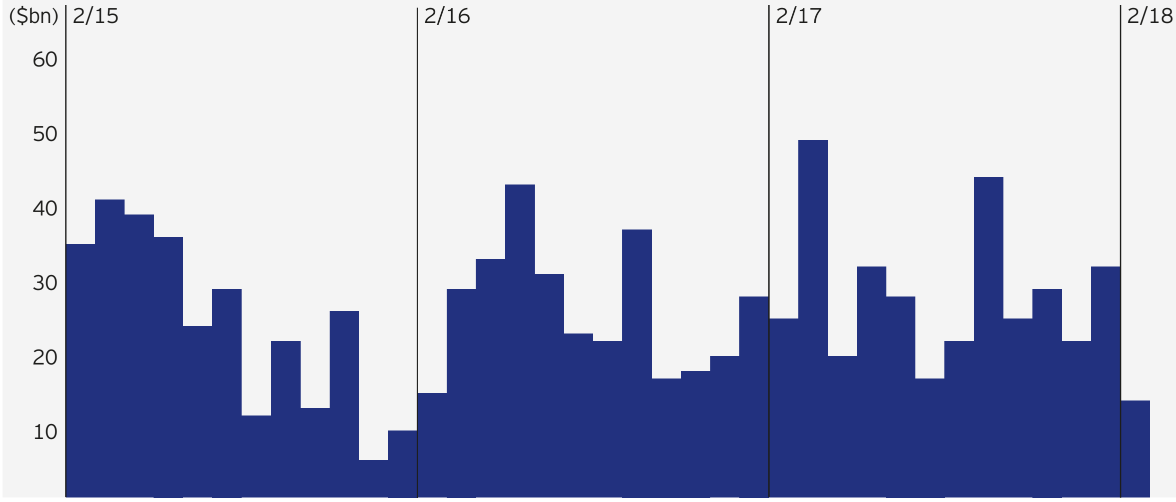
- The Bloomberg Barclays US Corporate High Yield 2% Issuer Capped Index finished the month with a yield-to-worst of 6.14%, a modified duration of 4.04, an option-adjusted spread of 336 bps, and an average price of $99.59.
- There were five defaults in February in the high yield market and as a result, the par-weighted default rate rose to 1.86% from 1.01% in January.
- Credit quality for the overall market is still acceptable.
- Recent leverage statistics continue to improve as companies slowly reduce leverage.

Technicals

- High yield mutual funds reported an outflow of $9.4 billion in February – the fifth consecutive month of outflows and the largest monthly outflow in over two years. In 2017, high yield mutual funds had $20 billion in outflows.
- Issuance for February was $13 billion, a two-year low and a significant decrease from January.
- New issuance was led by refinancing activity, which represented 76% of new deals.

New issuance volume

Monthly high-yield issuance



Source: JP Morgan, as of Feb. 28, 2018.

Relative value

- High yield offers a relatively low duration and a high coupon, which reduces its sensitivity to interest rate movements. However, as spreads tighten the sensitivity to Treasury rates has grown.
- After a strong run over the past two years, we expect the pace of high yield gains to moderate.
- The spread between high yield and investment grade widened in February to 231 bps, which is 143 basis points tighter than the historic average, but continues to provide an opportunity for yield pick-up given a manageable default risk.

Index returns (%)

	10/17	11/17	12/17	1/17	2/18	YTD
Bloomberg Barclays US HY 2% Issuer Cap Index	0.42	-0.25	0.30	0.60	-0.85	-0.26
Bloomberg Barclays US Aggregate Bond Index	0.06	-0.13	0.46	-1.15	-0.95	-2.09
Bloomberg Barclays US Treasury 5-10 Year Index	-0.19	-0.34	0.11	-1.83	-0.67	-2.49
JPM EMBI Global Diversified Index	0.37	0.05	0.73	-0.04	-1.99	-2.03
S&P 500 Index	2.33	3.07	1.11	5.73	-3.69	1.83
S&P/LSTA Leveraged Loan Index	0.56	0.07	0.32	1.07	0.06	1.13

Source: Barclays, JP Morgan and Standard & Poor's, as of Feb. 28, 2018.

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1 Source: Barclays
2 Source: JP Morgan

About risk

Fixed income investments are subject to credit risk of the issuer and the effects of changing interest rates. Interest rate risk refers to the risk that bond prices generally fall as interest rates rise and vice versa. An issuer may be unable to meet interest and/or principal payments, thereby causing its instruments to decrease in value and lowering the issuer's credit rating. Junk bonds involve a greater risk of default or price changes due to changes in the issuer's credit quality. The values of junk bonds fluctuate more than those of high quality bonds and can decline significantly over short time periods.

All data provided by Invesco unless otherwise noted. Data as of Feb. 28, 2018, unless otherwise noted.

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