Invesco

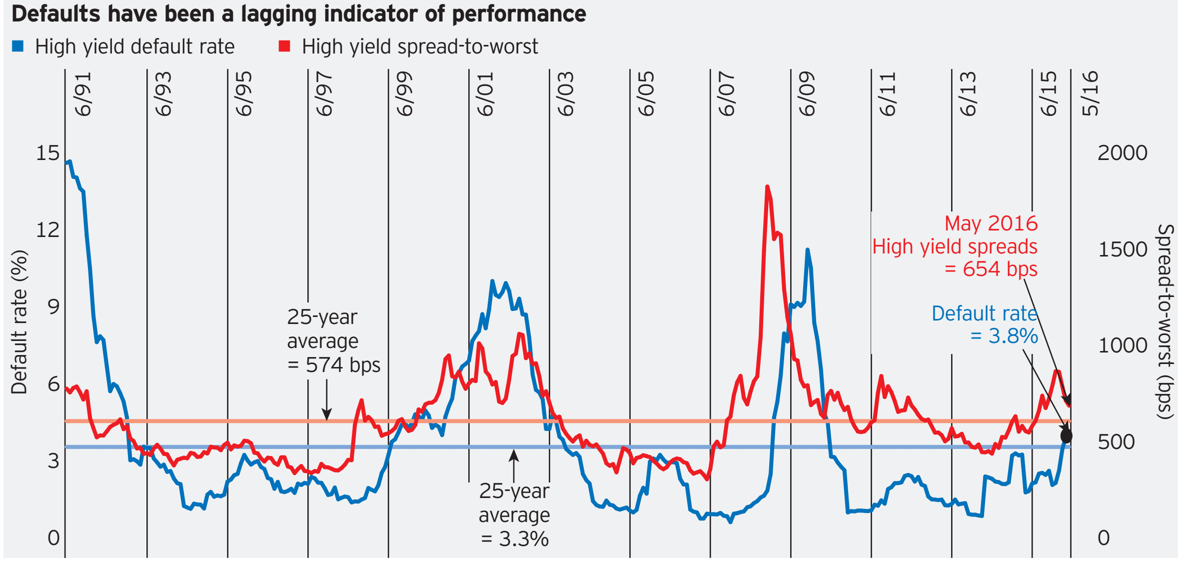
Invesco High Yield

High Yield Snapshot

Monthly high yield bond market update: June 2016

Total returns in the high yield bond market slowed slightly in May, with the Barclays U.S. Corporate High Yield 2% Issuer Capped Index gaining 0.62% during the month. Investors took the strength and stability of global markets as a clear path towards a June rate hike, and as such, underperformance in long duration assets offset some tightening in credit spreads. Investors continued to shrug aside fears of slowing global growth, as CCC and commodity bonds drove spreads tighter. Spreads, as per JP Morgan, ended the month at 654 bps – a level we believe offers value. The five-year and 10-year Treasury yields had relatively little price change at 1.37% and 1.85%, respectively, with each finishing higher than their mid-month lows, as Fed rhetoric turned more hawkish. The market rally continues to suggest that actual defaults will be lower than market estimates, but commodity companies are still burdened with high debt loads and are highly dependent on the outlook of the commodity. Broadly, we believe the asset class still offers attractive compensation for the risks taken.

Defaults have been a lagging indicator of performance



Source: JP Morgan, as of May 31, 2016

Performance by ratings[1]

Within the ratings categories:

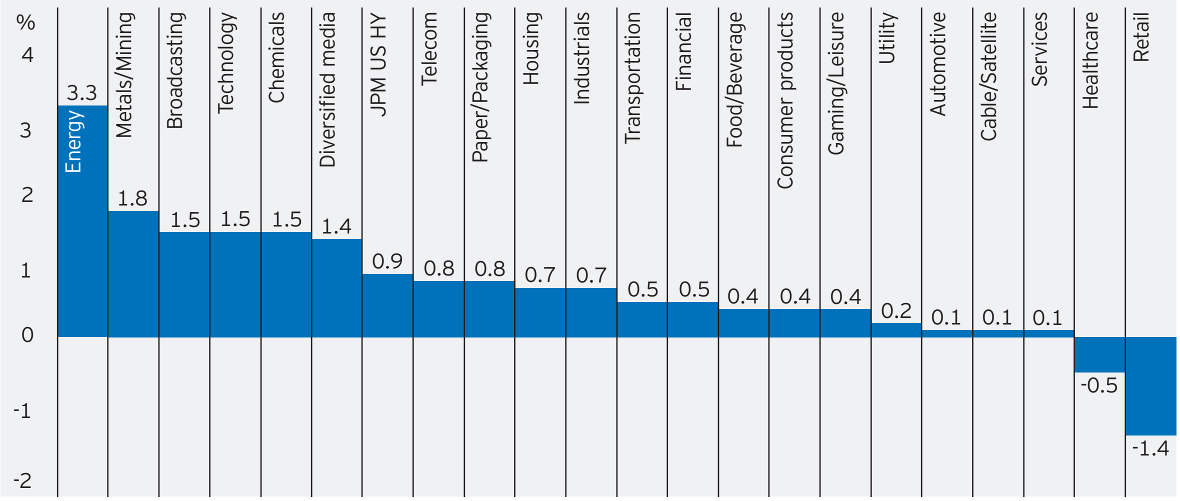
- BB-rated securities returned 0.31%
- B-rated securities generated returns of 0.22%
- CCC-rated securities returned 2.23%

Earnings trends

First quarter earnings season is behind us. As for fundamentals overall, here are several themes we are monitoring:

- We have added to our positions in metals and mining. While we expect challenges to continue for the space, we do see value within some companies. Notably, we've seen credit improvement from companies that have raised new equity or sold assets to bolster liquidity.
- We've noticed some poor earnings from some retail companies. In our view, the US is over-stored. Shifting consumer buying patterns and outdated business models, coupled with high debt loads is a very bad combination, in our opinion. We continue to underweight this industry.
- Energy earnings continue to be quite bad. In particular, energy service companies continue to demonstrate large revenue declines and unsustainable earnings trends. However, with the recent improvement in oil prices, the strongest independent energy credits are on very solid footing. Yet, $50 oil doesn't fix all the problems in this sector and we continue to expect elevated default activity for the industry.

High yield posted strong returns in May



Source: JP Morgan, as of May 31, 2016

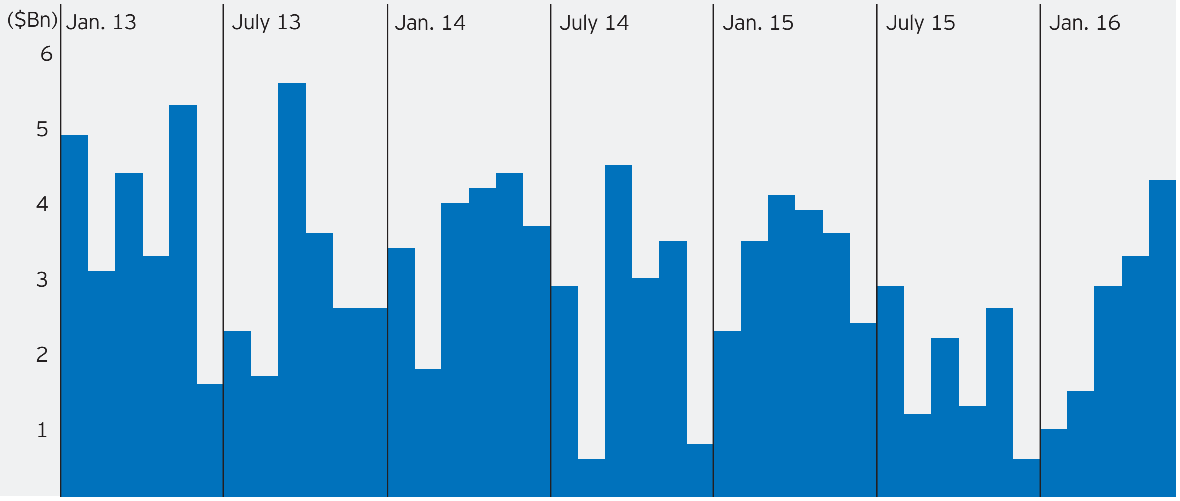
Fundamentals

- The Barclays U.S. Corporate High Yield 2% Issuer Capped Index finished the month with a yield-to-worst of 7.31%, a modified duration of 4.22, an option-adjusted spread of 566 bps, and an average price of 95.12.
- There were five defaults in May in the high yield market which caused the par-weighted default rate to increase to 3.78% from 3.68%. Excluding energy, and metals and mining, the default rate is 0.42%.[2]
- Credit metrics for the overall market continue to reside in a healthy zone, in our opinion.
- Recent leverage statistics continue to increase, driven by poor earnings within the metals and mining, and energy sectors. We don't see this trend reversing in the near-term.

Technicals

- High yield mutual funds reported $2.4 billion of outflows during May, which marks the first time in three months high yield funds have experienced net outflows. In contrast, 2015 saw full-year outflows totaling $16.6 billion, even after a record $23.8 billion of outflows in 2014.
- New issuance for May came in at $42.3 billion, increasing for the fifth consecutive month. Deal volume exceeded $40 billion for the first time since September of 2014. However, overall deal volume remains down year-over-year.
- Year-to-date, new issuance was led by refinancing activity with 61%, followed by 31% being used for general corporate purposes. In 2015, new issuance was led by refinancing activity, accounting for 43% of the total volume, followed by 38% used for acquisition-related purposes. This compares with 54% and 26%, respectively, during 2014.[2]

New issuance volume increased to a 20-month high
Monthly highyield issuance



Source: JP Morgan, as of May 31, 2016

Relative value

- The spread between high yield and investment grade is greater than the historical median, creating an opportunity for yield pick-up given a manageable default risk.
- High yield offers a relatively lower duration and a higher coupon, which reduces its sensitivity to interest rate movements.
- The escalation of risk premiums due to declines in commodity prices and pressure on the energy sector has created value in the overall market.

Index returns (%)

	1/16	2/16	3/16	4/16	5/16	YTD 2016
Barclays U.S. HY 2% Issuer Cap Index	-1.61	0.57	4.44	3.92	0.62	8.06
Barclays U.S. Aggregate Bond Index	1.38	0.71	0.92	0.38	0.03	3.45
Barclays U.S. Treasury 5-10 Year Index	2.85	1.10	0.09	-0.08	-0.14	3.85
JPM EMBI Global Diversified Index	-0.18	1.91	3.27	1.77	-0.18	6.71
S&P 500 Index	-4.96	-0.13	6.60	0.39	1.80	3.57
S&P/LSTA Leveraged Loan Index	-0.65	-0.53	2.64	1.99	0.89	4.49

Source: Morningstar, as of May 31, 2016

1 Barclays
2 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 May 31, 2016, unless otherwise noted.

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