Invesco High Yield

High Yield
Snapshot

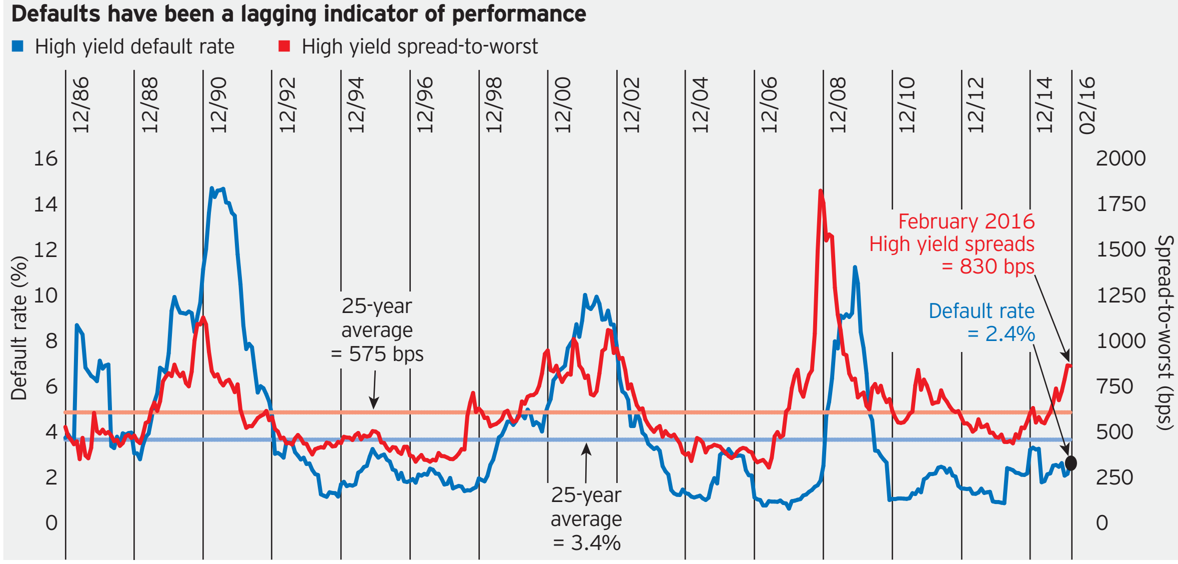
Monthly high yield bond market update: March 2016

Total returns in the high yield bond market were positive in February, with the Barclays U.S. Corporate High Yield 2% Issuer Capped Index gaining 0.57% during the month. We witnessed two very different markets during the month. First, the markets experienced weakness in risk assets earlier in the month that was remedied by a swift change in sentiment as investors changed their global growth views. The last two weeks of the month featured a massive rally that brought many buyers into the market as evidenced by cash inflows into the asset class. Spreads, as per JP Morgan, ended the month at 844 basis points (bps) – a level that is attractive to us. The five- and 10-year Treasury yields decreased to 1.21% and 1.73%, respectively, as investors rotated into perceived "safer" assets.

Defaults

We believe default rates will be in the range of 5% to 6% this year, as commodity-related companies will likely seek to restructure their balance sheets. We would remind investors that default rates are a lagging indicator and offer little predictive value. With this in mind, we believe there is value in today's high yield market. However, careful credit and sector selection remains critical to performance.

Defaults have been a lagging indicator of performance



Source: JP Morgan, as of Feb. 29, 2016

Performance by ratings[1]

Within the ratings categories:

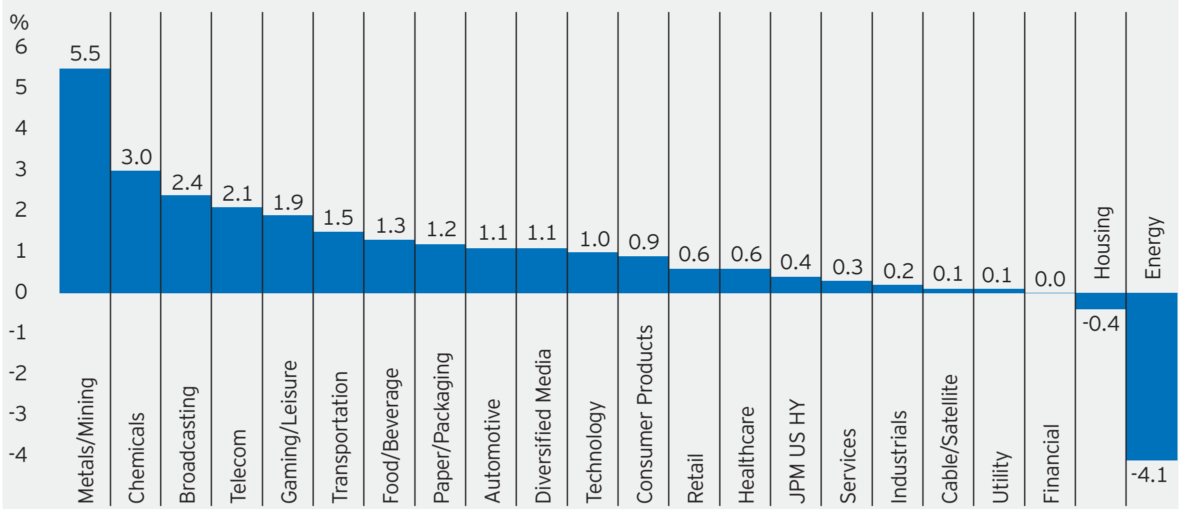
- BB-rated securities returned 1.31%
- B-rated securities generated returns of 0.47%
- CCC-rated securities returned –1.29%

Earnings trends

Fourth-quarter earnings reports, for the most part, are completed. As for fundamentals overall, here are several themes we are monitoring:

- We remain underweight metals and mining. While we have added to selective positions in this sector, we remain cautious about overall weak fundamentals.
- Building products and home builders continue to display improved results. Recent industry data on activity supports our bullish posture.
- While we are underweight to the energy sector overall, we did add to some positions as oil prices move from recent lows. Our preference for owning the stronger companies has not changed. We recognize a large number of defaults will occur in this space and it's too soon to get overly bullish.

Bifurcated performance between the metals/mining and energy sectors



Source: JP Morgan, as of March 1, 2016

Fundamentals

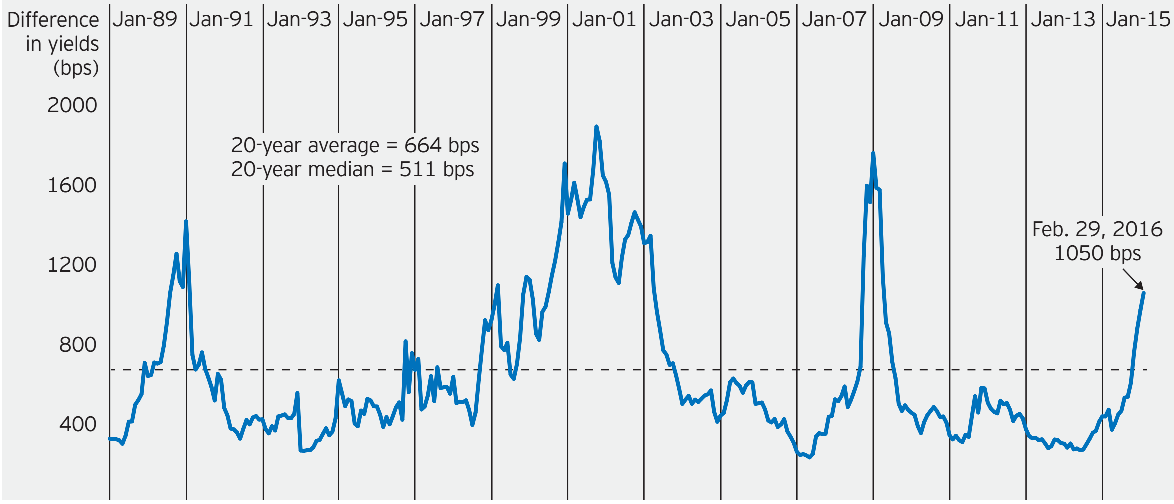
- The Barclays U.S. Corporate High Yield 2% Issuer Capped Index finished the month with a yield-to-worst of 9.02%, a modified duration of 4.22, an option-adjusted spread of 727 bps, and an average price of 87.16.
- There were eight defaults in February, increasing the par-weighted default rate to 2.4% from 1.9%.[2] This is the highest number of defaults since the summer of 2009.
- Credit metrics for the overall market continue to reside in a healthy zone, in our opinion.
- Most sectors had positive performance this month, including metals and mining, which was the top performing sector. Contrary to last year, there is bifurcated performance between metals/mining and energy year-to-date.

Technicals

- High yield mutual funds reported $1.7 billion of inflows during February (with only weekly reporting funds included), as investors returned to risk. Ten of the prior 11 months had outflows netting $33 billion.
- New issuance was only $14 billion this month and year-to-date issuance is down 58% year-over-year.
- Year-to-date, new issuance is being led by acquisitions/leveraged buyouts (LBO), with 41% being used for these purposes. Last year, 38% of new issuance was used for acquisition/LBO purposes, which was the most since 2007 and 2008. Refinancing is at 19% after the first two months of the year, which is significantly lower than historical volumes.

Weakness in lower-rated credits

Spreads between bonds rated B and CCC



Source: JP Morgan, as of March 1, 2016

Relative value

- The spread between B- and CCC-rated bonds has widened significantly to levels not seen since the financial crisis. Given the greater uncertainty in the market, the lower-rated credit tier of the market has continued to underperform. Weakening US growth estimates have created fears of slower earnings for companies, which has impacted those with higher leverage.
- 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 market overall.

Index returns (%)

	11/15	12/15	2015	1/16	2/16	YTD
Barclays U.S. HY 2% Issuer Cap Index	-2.21	-2.52	-4.43	-1.61	0.57	-1.04
Barclays U.S. Aggregate Bond Index	-0.26	-0.32	0.55	1.38	0.71	2.10
Barclays U.S. Treasury 5-10 Year Index	-0.42	-0.29	1.84	2.85	1.10	3.99
JPM EMBI Global Diversified Index	-0.06	-1.39	1.18	-0.18	1.91	1.72
S&P 500 Index	0.30	-1.58	1.38	-4.96	-0.13	-5.09
S&P/LSTA Leveraged Loan Index	-0.88	-1.05	-0.69	-0.65	-0.53	-1.18

Source: Morningstar, as of Feb. 29, 2016

1 Barclays
2 JP Morgan

About risk

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