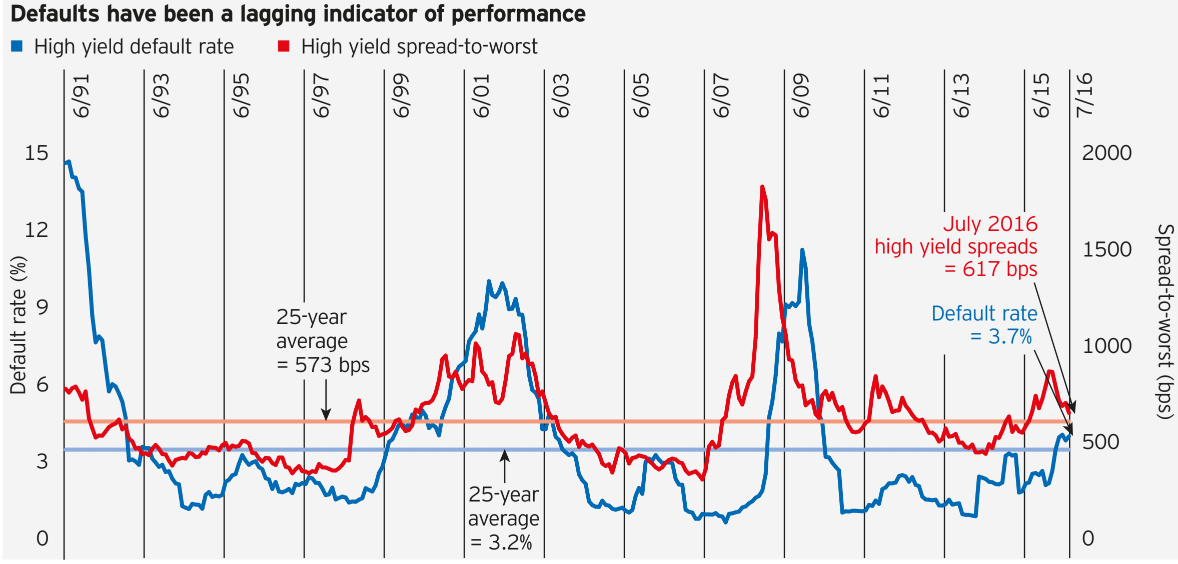
High Yield
Snapshot

Monthly high yield bond market update: August 2016

The high yield market was very strong in July, with the Barclays US Corporate High Yield 2% Issuer Capped Index gaining 2.70%. Gains in the early part of the month were assisted by light new issue supply and inflows into the asset class. We note investors did exhibit caution as the month progressed as the sell-off in oil, coupled with weaker macro data and heavy new issue supply, brought sellers into the market. Per JP Morgan, spreads ended the month at 617 bps, which in our opinion is an attractive level. The five-year and 10-year Treasury bonds steepened slightly when compared to June, with the five-year relatively flat at 1.02%, compared to 1.01% the month prior, and the 10-year at 1.45%, compared to 1.37% the month prior. Overall, considering the uncertain global macro picture and low yield levels worldwide, we believe select sectors of the high yield market offer attractive return potential.

Defaults have been a lagging indicator of performance



Source: JP Morgan, as of July 31, 2016

Performance by ratings[1]

Within the ratings categories:

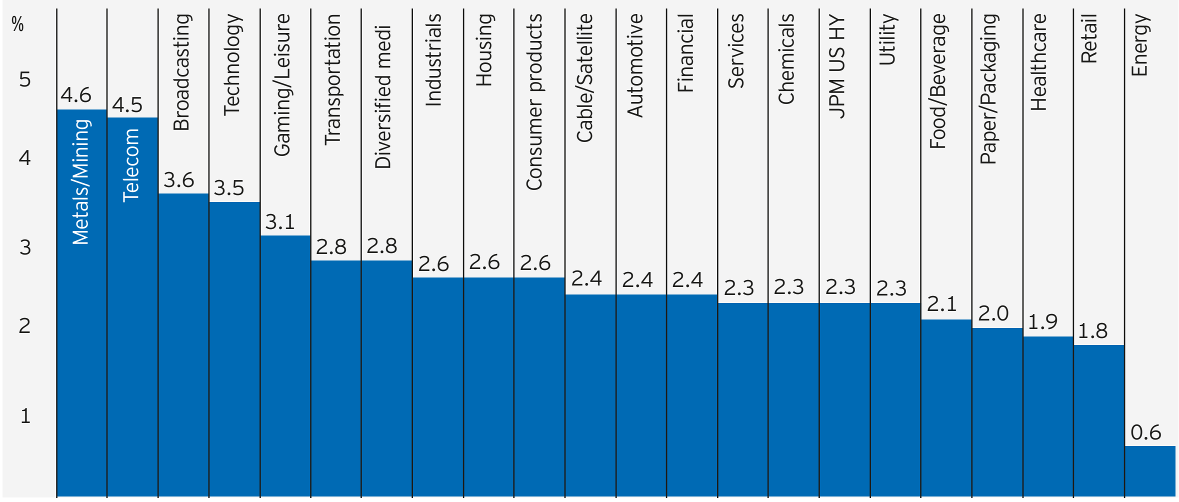
- BB-rated securities returned 2.27%
- B-rated securities generated returns of 2.30%
- CCC-rated securities returned 2.56%

Earnings trends

Second quarter earnings season is underway. As for fundamentals overall, here are several themes we are monitoring:

- We continue to selectively add to positions in metals and mining. While we expect challenges to continue for the space, we do see some improvements. We note a number of companies continue to improve their balance sheets with asset sales and new issuance of equity.
- Retail continues to be a challenging sector. 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 Shifting consumer buying patterns and outdated business models coupled with high debt loads is a very bad combination. We continue to underweight this industry.
- Energy earnings continue to be poor. We note a recent increase in the active rig count has some questioning if this will keep a lid on oil prices. In our opinion, US production will continue to decline as the small number of rig additions is insufficient to stem the high decline rates of shale wells. Having said that, we are entering a seasonally weak period for oil prices coupled with very high levels of inventory remaining. This storage overhang needs to be worked through before oil has any real chance of marching higher. In terms of positioning, we continue to own the higher-quality independent E&P companies and are very underweight oil field services.

High yield produced positive returns in July



Source: JP Morgan US High Yield Bond Index, as of July 31, 2016

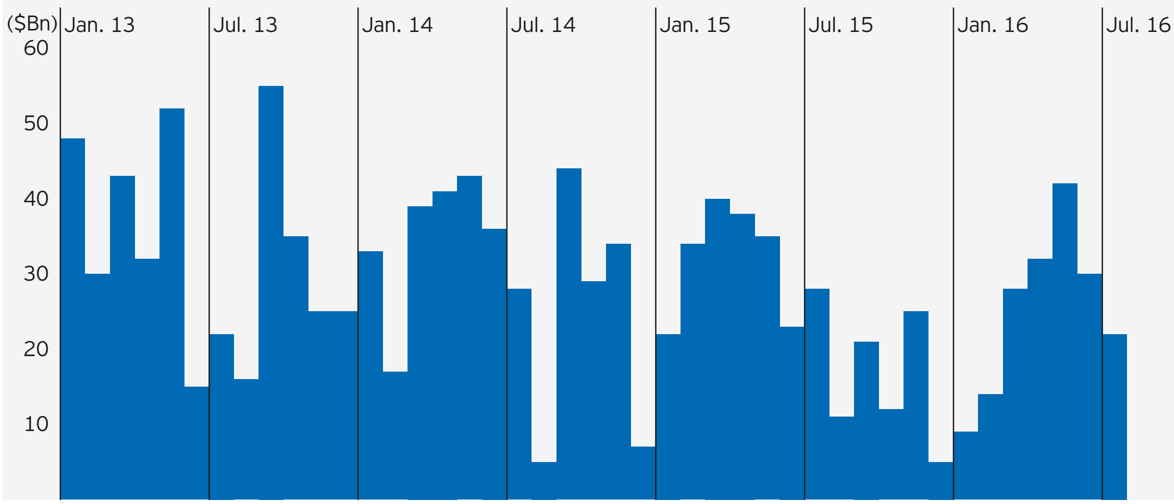
Fundamentals

- The Barclays US Corporate High Yield 2% Issuer Capped Index finished the month with a yield-to-worst of 6.71%, a modified duration of 4.10, an option-adjusted spread of 540 bps, and an average price of 97.54.
- There were four defaults in July in the high yield market which caused the par-weighted default rate to rise to 3.72% from 3.56% in June. Excluding energy, and metals and mining, the default rate is only 0.56%.
- Credit metrics for the overall market continue to reside in a healthy zone, in our opinion.
- Recent leverage statistics continue to increase, being driven by poor earnings within energy, and metals and mining. We don't see this trend reversing in the near-term.

Technicals[2]

- High yield mutual funds reported $5.8 billion of inflows during July, which marks a reversal from May and June. Year-to-date, inflows have totaled $9.4 billion, compared to 2015 when outflows totaled $16.6 billion.
- New issuance for July came in at $22.0 billion, the second drop in five months. Year-to-date, there has been $177 billion in new issuance, compared to $219 billion in the first seven months of 2015.
- New issuance was led by refinancing activity, which represented 48% of new deals followed by 38% for general corporate purposes. Year-to-date, new issuance has been led by refinancing activity, accounting for 53% of the total volume, followed by general corporate purposes, which represented 25% of the total.

New issuance volume fell in June and July



Source: JP Morgan, as of July 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 (%)

	3/16	4/16	5/16	6/16	7/16	YTD 2016
Barclays US HY 2% Is suer Cap Index	4.44	3.92	0.62	0.92	2.70	12.01
Barclays US Aggregate Bond Index	0.92	0.38	0.03	1.80	0.63	5.98
Barclays US Treasury 5-10 Year Index	0.09	-0.08	-0.14	2.52	0.21	6.69
JPM EMBI Global Diversified Index	3.27	1.77	-0.18	3.37	1.80	12.30
S&P 500 Index	6.60	0.39	1.80	0.26	3.69	7.66
S&P/LSTA Leveraged Loan Index	2.64	1.99	0.89	-0.15	1.64	7.09

Source: Barclays, JP Morgan and Standard & Poor's, as of July 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 July 31, 2016, unless otherwise noted.

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