Insights
Fixed Income

Q3 2024

Global High Yield Quarterly

- Data releases continue to support a US soft-landing narrative where growth has been slowing, but still robust enough to avoid an earnings recession — this is supportive for credit

- The lack of shareholder-friendly excesses and large problem sectors in this cycle, strong corporate earnings, solid fundamentals and improving credit-lending conditions are all supportive for the HY asset class to experience a longer, but shallower defaults cycle.

- Global HY spreads can remain well-anchored at the lower ends of the range, even as the market digests rate cuts in the face of a global economy which is largely doing fine. Yields in the range of 7% are still at reasonably healthy levels, and total return-oriented investors need not position too conservatively.

Performance/ Market Highlights

Global High Yield spreads had a strong Q3 on the back of a larger than expected 50 bps rate cut from the Fed, a global economy that has defied expectations of a severe slowdown (especially in the US), progress made on disinflation and resilient earnings momentum. Risk assets have continued to power ahead throughout this year, supported by optimism that a soft-landing scenario for the global economy is becoming more viable.

Figure 1
Total Returns of High Yield in Recent Periods

Returns	3m (%)	6m (%)	12m (%)	YTD (%)
Global HY ($ Unhedged)	5.84	7.12	16.97	8.70
Global HY ($ Hedged)	4.96	6.48	15.92	8.66
Global HY (€ Hedged)	4.45	5.55	13.85	7.31
Global HY (£ Hedged)	4.79	6.23	15.28	8.34
US HY ($)	5.28	6.42	15.67	8.03
Euro HY (€)	3.48	5.01	12.65	6.72
EM HY ($)	5.20	7.57	18.68	11.77

Source: State Street Global Advisors, BofA. As of 30 September 2024.

Figure 2
Spread Changes by Region

OAS (bps)	Current Level	Δ3m	Δ12m	ΔYTD
Global HY	322	-16	-116	-62
US HY	303	-18	-103	-36
Euro HY	342	-11	-103	-54
EM HY	368	-14	-183	-158

Source: State Street Global Advisors, BofA. As of 30 September 2024.

Figure 3
Return Breakdown of Global High Yield

Returns	3m (%)	6m (%)	12m (%)	YTD (%)
Global HY ($ Hedged)	4.96	6.48	15.92	8.66
Spread Return	1.41	2.18	7.80	4.57
Treasury Return	3.56	4.30	8.12	4.09

Source: State Street Global Advisors, BofA. As of 30 September 2024.

The treasury component dominated total returns, on the back of Q3's sharp bull-steepening in rate markets. Lower quality extended its lead for the year in excess return terms (BB: 3.6%, Single-B: 3.8%, CCC & Lower: 10.8%). All industries are up on the year in excess return terms — with the highest from Real Estate (13.5%), which saw a bounce back from 2023's sharp underperformance, and Healthcare (6.8%).

Gross issuance in Q324 for US HY totaled $73.9bn, and for EUR HY they totaled €25.9bn — a reasonably strong quarter, particularly in September, which saw the strongest monthly issuance YTD. Refinancing activity led use of proceeds though, with net issuance numbers at $26.6bn for US HY and €6.1bn for EUR HY.

The US HY Realized default rate was 1.4% L12M, and in 3Q24 defaults totaled $2.6bn of bonds — lower than last quarter's tally of $4.1 bn. European HY defaults saw the L12M par default rate continue to move above US HY this cycle to 2.8%, with €4.5 bn of defaults coming in over the quarter.

Rising stars have significantly outpaced fallen angels in Q3 (US HY $12.8 bn vs 2.4 bn), a supportive technical for the market, as it has reduced overall net supply, acting as an additive to reasonably healthy flows in US HY (+9.2bn Q3).

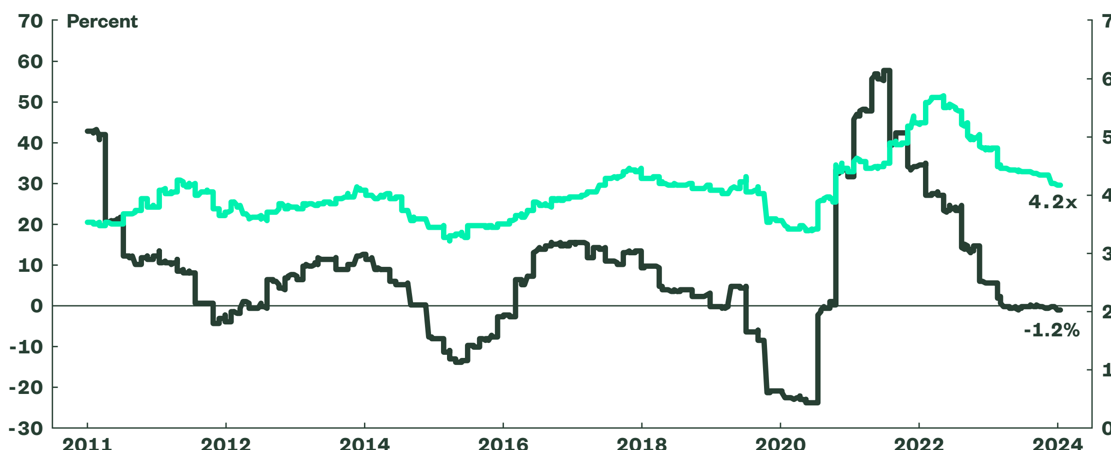
Outlook

The global macro backdrop remains quite supportive for high yield — with a faster starting to the easing cycle, alongside some good data (strong retail sales, low jobless claims), and moderating inflation across most major regions. US growth expectations have held up, with QoQ real GDP growth expected to gradually downshift to 2.0% in Q3 to 1.4% in Q4, with a slight uptick in unemployment to 4.3%, a core PCE moderating to 2.6% and the Fed going ahead with two more cuts in the rest of the year. The outlook for the eurozone is solid as well, with a cyclical upswing in GDP growth supported by robust household savings, steady unemployment and rising dovish expectations for the ECB, with inflation in the eurozone slipping below the 2% policy target.

High yield companies' earnings beat expectations in 2Q23 with 23% of them beating estimates by more than 10%, and in terms of fundamentals, HY balance sheets remain in a strong state, with the pace of deterioration slowing down. L12M EBITDA growth has declined, but still only modestly negative (-1.2%), rather than the typical negative teen numbers seen in a slowdown, and EBITDA margins have been stable. Net leverage is firm at 3.8x, off a record low (3.3x) albeit still below where it stood pre-pandemic, and the long-term average (4.0x). While the interest coverage ratio has declined to 4.2x, coming quickly off 4Q22's record high (5.7x), it is much higher compared to historical levels and has held up better than expected even amidst the sharp rate hiking cycle. Similar trends were seen across European issuers as well, with gross leverage of 3.4x and net leverage at 2.5x near cycle lows. Cash/debt for the median HY issuer reached 29.9%, close to an all-time high. Coverage ratios remain at elevated levels as well, with the EBITDA based ratio at 4.9x, despite growing interest expenses, as they are offset with continued earnings growth. (Source: JPM, Morgan Stanley).

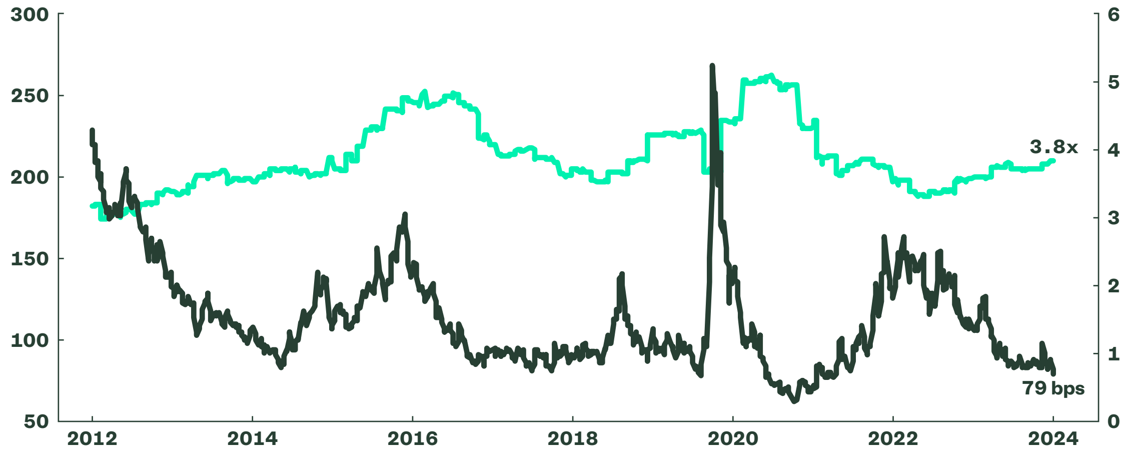
Figure 4a
The Deterioration in Fundamentals From Strong Levels Has Slowed — US HY

EBITDA, L12M % Change
Interest Coverage Ratio (x) (RHS)



Source: State Street Global Advisors, BofA. As of 30 September 2024.

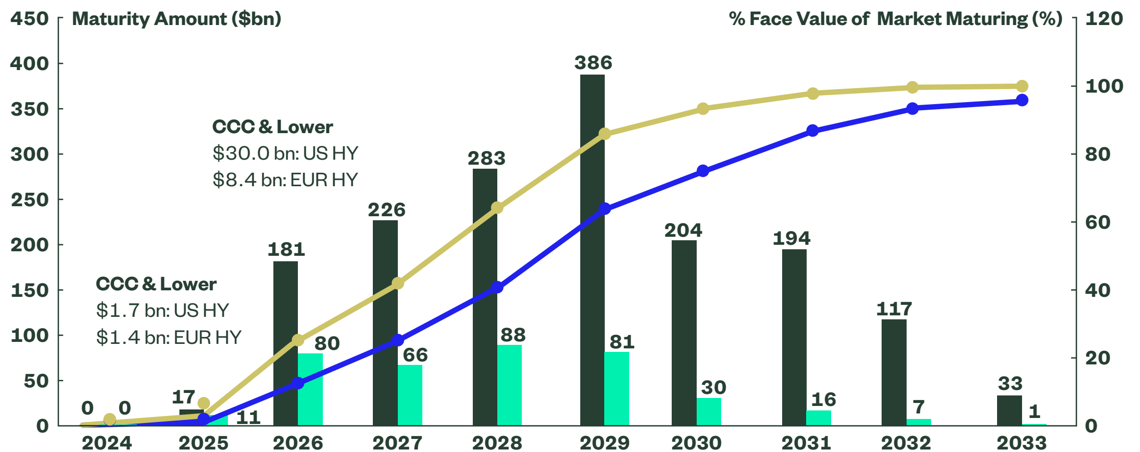
Figure 4b
The Deterioration in Fundamentals From Strong Levels Has Slowed — US HY



Source: State Street Global Advisors, BofA. As of 30 September 2024.

Capital markets saw busy refinancing activity from issuers in 2024, who slowly got to terms with the need to address near-term maturities. Bonds maturing in the years 2025 & 2026 were reduced by more than 50% since end of 2022, with most of the refinancing activity having taken place in the higher-rated segments first, but recently B3 or lower rated issuers have been active as well. This trend is set to continue for the rest of the year now, with rate cuts giving some more breathing space for non-refinancing related issuance as well. The in-place refinancing gap (yield minus current coupon) has come down for both US HY and Euro HY, but the overall market has become sharply bifurcated recently — as both the gap between the widest and tightest cohorts of the market, and dispersion within the distressed segment has grown.

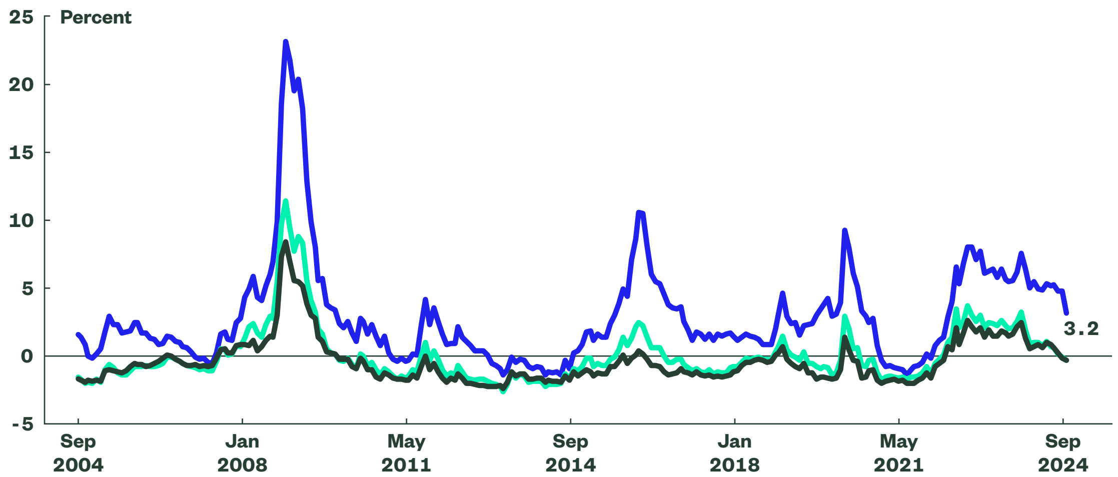
Figure 5a
Issuers were Proactive Towards Addressing the Maturity Wall, Which is a Lot Shallower Now



Source: State Street Global Advisors, BofA. As of 30 September 2024.

Figure 5b
Divergence in Cost to Refinance for Lower Quality Issuers Between US and Europe
Refinancing Gap (% points) — US HY

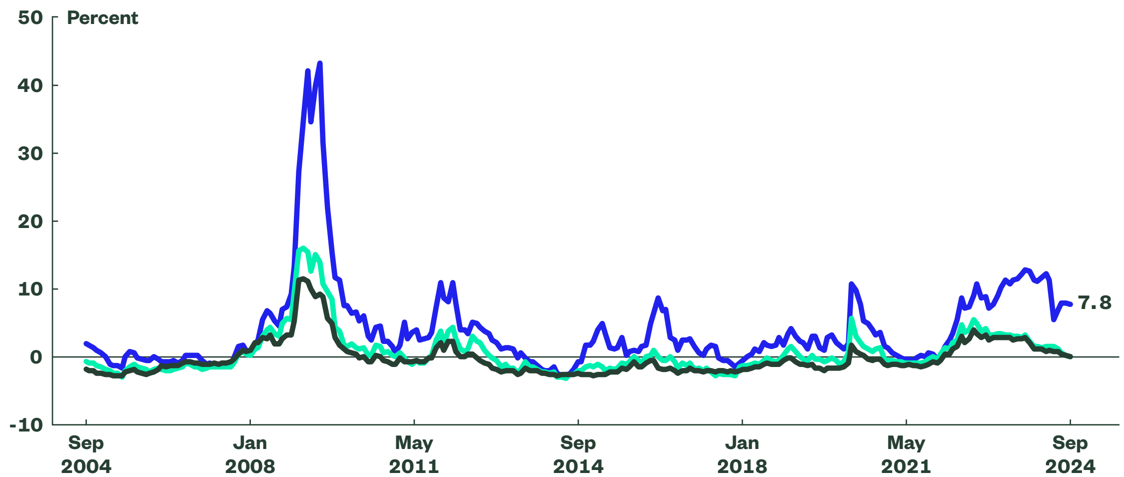
BB
B
CCC



Source: State Street Global Advisors, BofA. As of 30 September 2024.

Figure 5c
Divergence in Cost to Refinance for Lower Quality Issuers Between US and Europe
Refinancing Gap (% Points) — EUR HY

BB
B
CCC

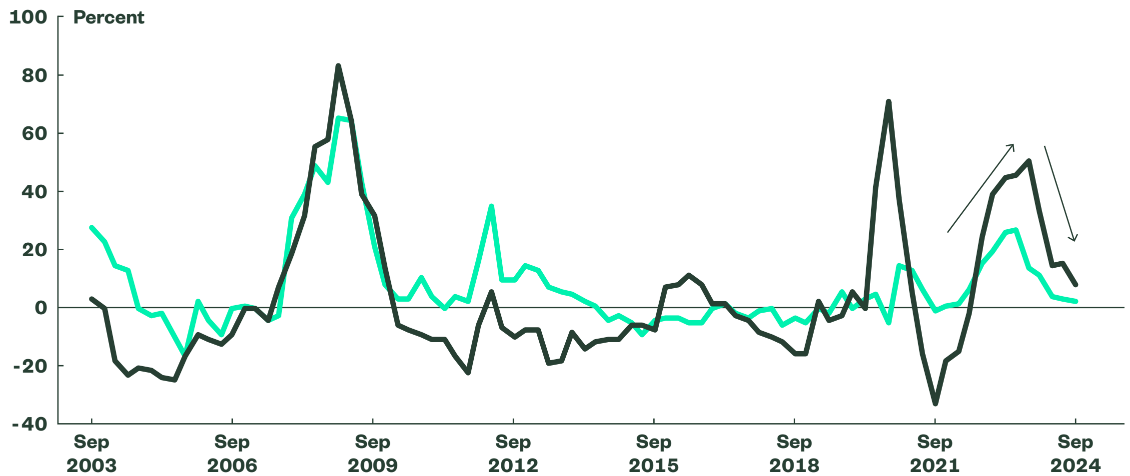


Source: State Street Global Advisors, BofA. As of 30 September 2024.

Without a severe downturn in macroeconomic data, broadening access to capital and easing credit conditions (Fig 6), healthy balance sheets and conservative positioning by investors — we don't see cause for default rates to spike up into the mid-to-high single digits, but believe this cycle will carry a lower peak than previous recessions. The moderate but steady distress levels of around 7–8%, which has persisted even through the recent rally (Fig 7) corroborates our view, and a subjective observation of the default watchlist and the most distressed names — indicates that the next 12M expected defaults in US HY would be in the 2.5% range. Even though EUR HY has been a very low default market in the past decade, the presence of a small number of larger distressed capital structures — as well as a handful of real estate names which face headwinds from elevated energy and construction costs and expensive financing — tells us that the next 12M expected defaults in EUR HY could be in the 3.0% range.

Figure 6
Credit Conditions and Overall Lending Appetite Has Reversed From Being Too Restrictive
% of Banks Tightening Standards for Corporate Loans

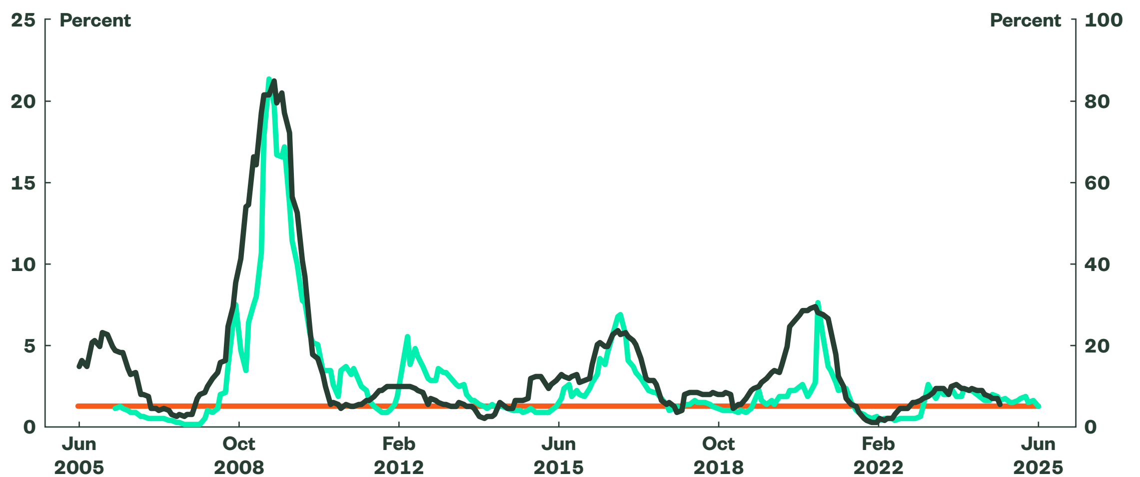
US
Eurozone



Source: Bloomberg. US depicts: Senior Loan Officer Opinion Survey on Bank Lending Practices for Commercial and Industrial Loans for large and medium firms. Eurozone depicts: ECB Bank Lending Survey for change in Credit Standards Lending to Businesses. As of 30 September 2024.

Figure 7a
Prolonged Period of Medium Levels of Distress
US High Yield

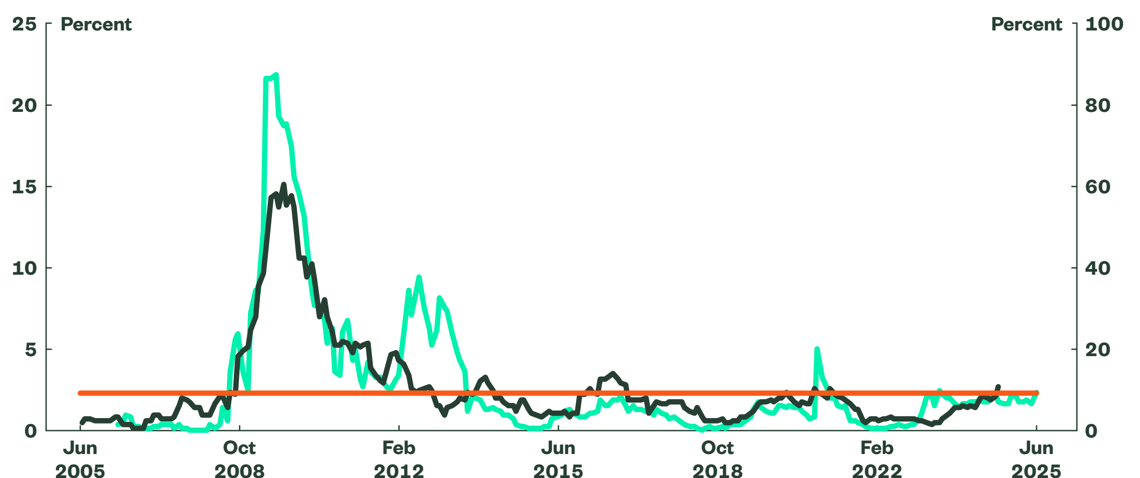
L12M Default Rate
Distress Ratio (RHS, Shifted by 3 Quarters)
Defaults at Current Level of Distress



Source: State Street Global Advisors, BofA. As of 30 September 2024.

Figure 7b
Prolonged Period of Medium Levels of Distress
EUR HY

L12M Default Rate
Distress Ratio (RHS, Shifted by 3 Quarters)
Defaults at Current Level of Distress



Source: State Street Global Advisors, BofA. As of 30 September 2024.

The biggest near-term risk to Global High Yield now is a material slowdown in growth or a sharp pickup in inflation, unwinding the goldilocks outcome for 2024 that markets had priced in, but the probability of that seems to be quite low, given the direction of recent data releases. Global HY spreads of 326bps alone, are close to its richest decile and don't seem to compensate enough for probable bearish outcomes. However, reasonably strong starting points of balance sheets, improved ratings quality of the asset class compared to history, lack of huge volumes of credit-negative transactions — such as new buyouts or dividend recaps this cycle, good retail inflows and all-in yields at around 7% do provide reasons to attract total return-oriented investors.

Conclusion

Global HY is in a balanced territory now, where still reasonably high yields offer a decent amount of carry and rolldown given the index's short duration but there is not a lot of excess risk premium in spreads that would lay the stage for a subsequent outsized spread-return performance. Markets looking forward to positive economic impacts of the upcoming rate cuts, as well as growth which doesn't slow down too much to materially affect earnings estimates, are good for high yield to continue to give coupon-like returns in this environment. Steeper rates curve will be positive for credit demand as well.

Investors may consider moving/allocating to up-in-quality such as BB-B rated segments, or liquidity-screened segments (versus broad market high yield), depending upon their risk aversion, given that lower quality faces much bigger drawdown risks for a given level of potential gains, since we have seen markets rapidly extrapolating every data release, and repricing levels accordingly.

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* Pensions & Investments Research Center, as of December 31, 2023.
† This figure is presented as of June 30, 2024 and includes ETF AUM of $1,393.92 billion USD of which approximately $69.35 billion USD is in gold assets with respect to SPDR products for which State Street Global Advisors Funds Distributors, LLC (SSGA FD) acts solely as the marketing agent. SSGA FD and State Street Global Advisors are affiliated. Please note all AUM is unaudited.

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