2020 High Yield Market Outlook

Dear Investor,

Last year turned out far better for high yield than almost anyone expected. A return to monetary stimulus, strong corporate earnings, and the easing of geopolitical risks drove bullish sentiment for risky assets.

Looking forward to 2020, we expect the longest economic expansion on record to continue, albeit at a slower pace. The lowering of interest rates in the US and monetary stimulus elsewhere should sustain the global economy, despite a lack of political will for accommodative fiscal policy. Trade tensions between the US and China should ease through the US presidential election in November to bolster the narrative of a stronger economy. Offsetting these positive developments, despite the removal of trade headwinds, the Chinese economy should continue to decelerate and dampen global growth.

Monetary easing propelled the gains in equity and high yield during 2019. While the specter of a growth slowdown should prevent the Fed from raising interest rates anytime soon, we believe the expansive monetary policy that has persisted for years has mostly run its course. The yield curve should steepen, increasing the profit margins of banks and ensuring an adequate source of liquidity for consumers and corporations.

For 2020 we see stable, but low interest rates that will continue to support the “hunt for yield”. We believe the high yield market is overbought, with spreads at record lows and anticipate a healthy pullback later this year, leading to modest returns. We expect a mild pickup in default rates towards their historical average, as corporate profits come under pressure from higher wage costs and lower economic growth. Volatility should increase from the historic lows today, driven by geopolitical and electoral catalysts.

Unlike most of high yield, the underfollowed issues in our portfolio did not participate in the tightening of credit spreads that larger issues experienced. We believe that our niche still offers value and the potential for excess returns. We have marginally increased the hedge on our portfolios and are considering increasing it further early this year. During the second half of 2019 we took a more conservative stance by focusing on higher quality issues in the 7%-10% yield range. Many of these bonds have been called or redeemed, decreasing our portfolio’s duration and its exposure to interest rate risk.

While we underperformed more liquid, longer duration high yield in 2019, our performance improved through year-end. We believe this trend of relative outperformance of smaller issues should continue into 2020, given the value and yields that are still available in our universe and the absence of value in the broader high yield market.

Sincerely,

The Concise Team

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To receive a compliant presentation and/or the firm's list of composite descriptions, please contact Yves Soyfer at ysoyfer@concisecapital.com.