July 2022 High Yield Market Insights

- Equity selloffs induce high yield selloffs
- Systemic bear markets, like 2008-2009 and 2020, are deeper and returns in their aftermath tend to be extremely strong
- Returns post non-systemic bear markets and near-bear markets have been positive, but vary depending upon the causes of the selloff

There have been three equity bear markets and three near misses in the US this past quarter century. HY bonds have followed stocks down during each selloff. High yield follows equity because it depends on individual company performance, the overall performance of similar firms and interest rates, much as stocks do. Performance after bear markets has been strong, particularly after the global financial crisis and the Covid panic. Apart from the systemic crises, post selloff returns for high yield have depended upon whether high yield itself was at the epicenter of the crisis, as it was during the 2000 tech wreck.

Figure 1: High Yield Bond Performance During S&P 500 Bear Markets

Bears						
Start	Finish	S&P 500 Decline	HY Return	BB return	B Return	CCC Return
3/24/2000	10/9/2002	-49.1%	-8.8%	4.5%	-11.6%	-32.9%
10/9/2007	3/9/2009	-56.8%	-30.6%	-18.4%	-31.8%	-50.6%
2/19/2020	3/23/2020	-33.9%	-21.4%	-19.0%	-22.4%	-28.6%
1/3/2022	6/16/2022	-21.5%	-13.0%	-13.0%	-12.2%	-15.0%

*2022 bear market finish is unknown as yet.

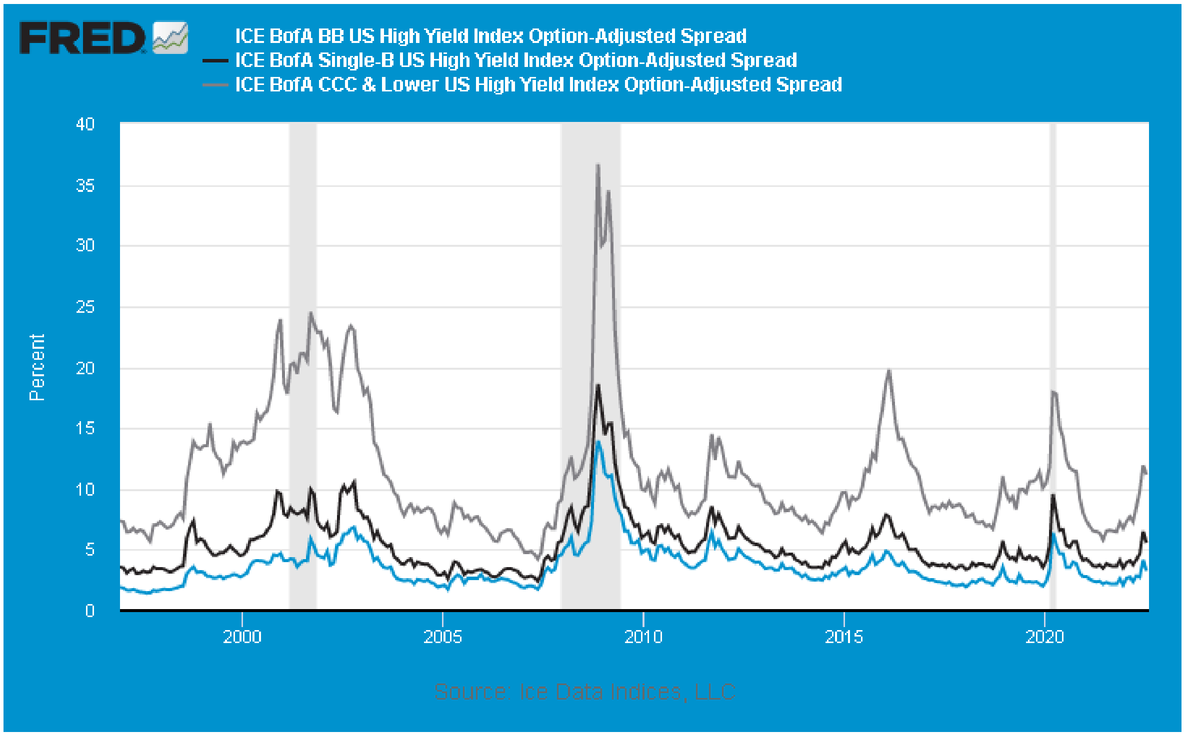
Falls in HY have not been of the same magnitude as equities, though they typically have been severe when equity drops a lot and less severe when equity selloffs have approached bear market territory but have not crossed the -20% line.

Figure 2: S&P 500 Bear Market Close Calls

Close Calls						
Start	Finish	S&P 500 Decline	HY Return	BB return	B Return	CCC Return
7/17/1998	8/31/1998	-19.3%	-5.0%	-2.1%	-6.1%	-11.2%
4/29/2011	10/3/2011	-19.4%	-7.4%	-4.7%	-7.1%	-15.8%
9/20/2018	12/24/2018	-19.8%	-4.9%	-3.2%	-5.2%	-10.5%

The two systemic crises, the global financial crisis of 2008-09 and the COVID bear market stand out for their depth, the fiscal and monetary response, and the ensuing strong recoveries. The “tech wreck” at the turn of the century had the mildest effect on high yield bonds. BB, the best rated tier of HY, actually rose 4.5% in that episode while CCC debt fell almost 33%. The latter makes sense, as CCC spreads rose comparatively higher and stayed elevated longer than BB spreads in that episode.

Figure 3: BB, B and CCC Spreads



Source: BAML, Concise Capital

The current selloff just scraped into bear market territory at -21.5% in mid-June, yet HY returns are twice as bad as they were in the three close calls since 1998. A close call just misses the -20% definition of a bear market; the three incidents in Figure 2 fall between -19% and -20%. The unique characteristic of the current decline is much of it is due to the rise in treasury rates. Spreads have widened but not to the extent seen in previous selloffs. High yield debt's decline seems to be as much collateral damage as it is fundamental.

Figure 4: S&P 500 and HY Returns Following Bear Markets

S&P 500				High Yield			
End of Bear	3 Months Later	6 Months Later	12 Months Later	End of Bear	3 Months Later	6 Months Later	12 Months Later
10/9/2002	19.4%	11.5%	33.7%	10/9/2002	9.8%	17.2%	27.8%
3/9/2009	39.3%	52.8%	68.6%	3/9/2009	26.0%	35.5%	48.1%
3/23/2020	40.0%	44.7%	74.8%	3/23/2020	18.8%	22.1%	27.8%

Failing a rally in treasury yields, it looks like the recovery from the current selloff will resemble the close calls more than it will the strong bear market recoveries. We are reasoning by analogy, comparing this case to similar ones in recent history. Should market concern turn to credit quality, the potential for a further selloff and a subsequent stronger rebound could come into play.

Figure 5: S&P 500 and HY Returns Following Close Calls

S&P 500				High Yield			
End of Close Call	3 Months Later	6 Months Later	12 Months Later	End of Close Call	3 Months Later	6 Months Later	12 Months Later
8/31/1998	21.4%	29.1%	37.9%	8/31/1998	2.7%	3.8%	4.3%
10/3/2011	16.2%	28.6%	32.0%	10/3/2011	6.6%	11.2%	18.4%
12/24/2018	19.0%	25.3%	37.1%	12/24/2018	7.5%	9.2%	12.4%