CONCISE CAPITAL

June 2022 High Yield Market Insights

- Growth stocks and long duration assets have been at the center of the boom and now, the bust
- Credit has not been the focus of this bear market
- High yield bond spreads have risen but are not signaling stress

In financial markets, we care about diversification. The less related assets are, the better it is to combine them in your portfolio. In a perfect world, we would own a group of assets where some zig when others zag.

Correlations measure relatedness. Correlations range from negative one or inversely related, to zero or unrelated, to one or perfectly related. Unfortunately, in bear markets correlations go to one. Everything falls. The baby is thrown out with the bathwater.

Figure 1: High Yield Correlations to Selected Stock Market Sectors, July 2011 – May 2022*

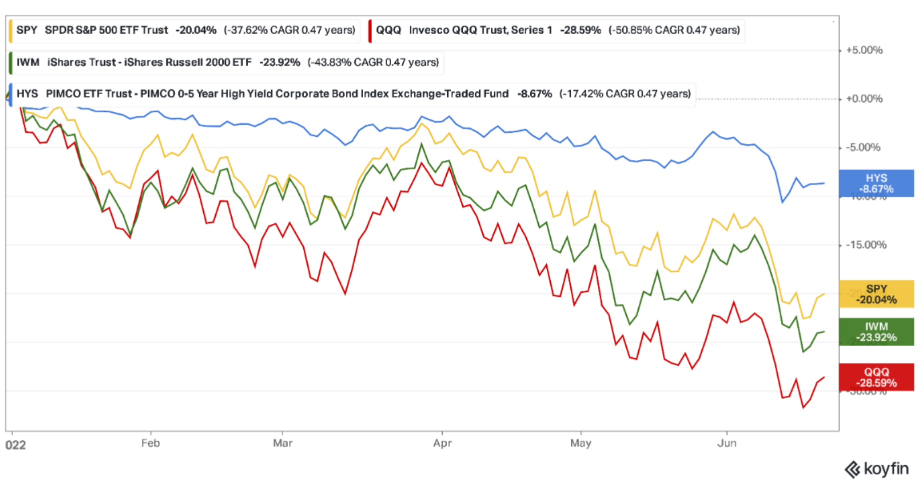
Name	Ticker	HYS
PIMCO 0-5 Year High Yield Corp Bd ETF	HYS	1.00
iShares Russell 2000 ETF	IWM	0.78
SPDR S&P 500 ETF Trust	SPY	0.77
Invesco QQQ Trust	QQQ	0.63

Short term high yield (HYS) has a lower correlation to tech (QQQ) and a higher correlation to small cap stocks (IWM).
*Calculated from monthly data.

Inflation has induced a rise in Treasury yields and a fall in bond prices. The rise in yields has helped cause a bear market centered on overvalued tech stocks. Tech stocks are bets on the future. Such companies might have great prospects but few profits and meager current cash flow. Rising discount rates hurt the value of their distant future profits. Now they are crashing hard.

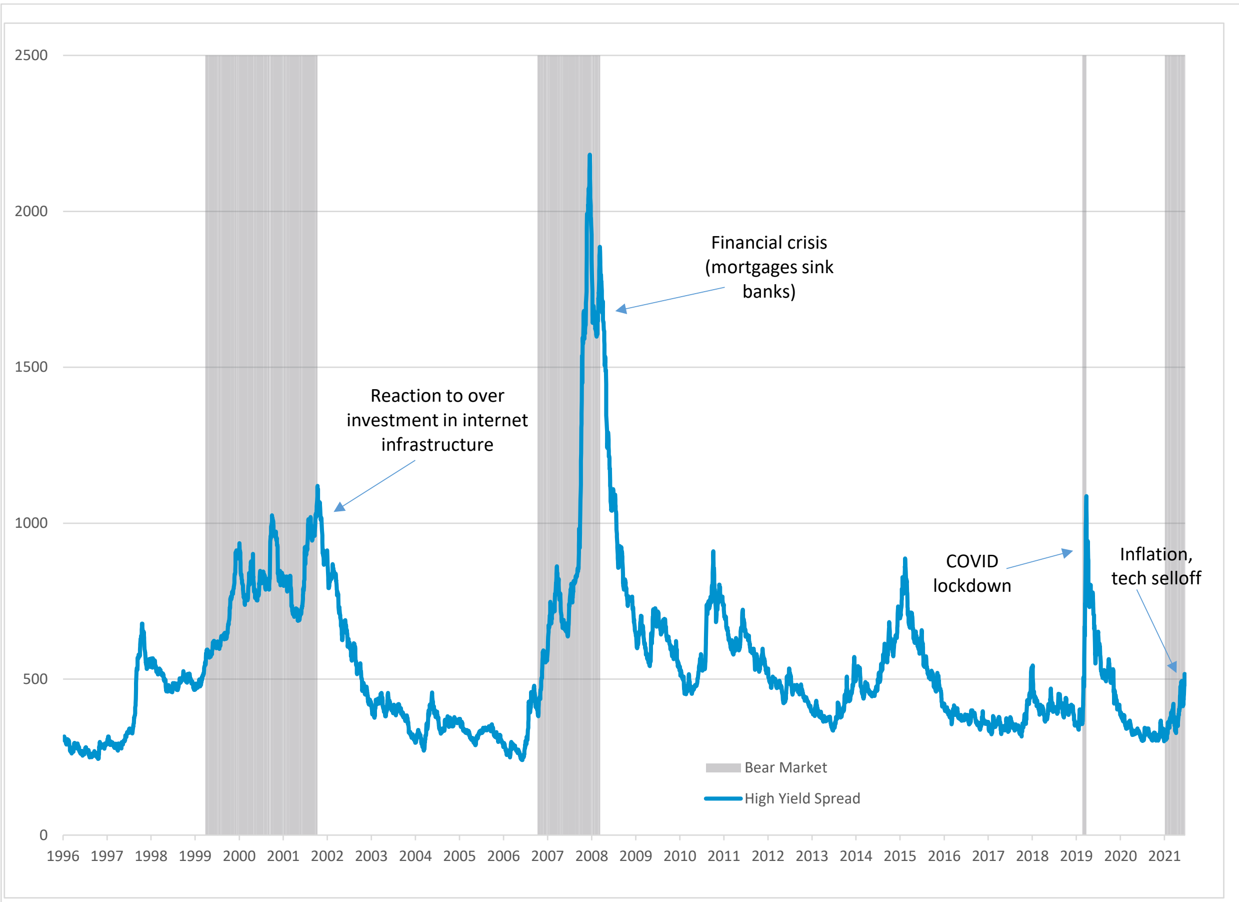
High yield bonds have components related to both the rise in rates and the fall in the equity market. They have fixed coupons, and no fixed coupon bond can resist a rise in treasury yields. These bonds are also the debts of riskier firms, hence the pull of the stock market.

Figure 2: HYS and Stock Returns, Year to 6/22/2022



The high yield spread to treasuries, a measure of the risk of the asset class, has not moved nearly as high in this bear market as it did in the prior three. Perhaps it is early, but there seems to be a significant difference between how this bear market is affecting high yield and the effects of the three previous ones.

Figure 3: HY Spread During Equity Bear Markets



(Gray bars indicate bear markets in the S&P 500) Source: BAML, Concise Capital

This equity bear market looks like the 2000-2002 tech rout, but it likely has fewer implications than that earlier selloff for high yield. High yield debt suffered in the 2000s due to high issuance aimed at funding investment in telecoms and cable to build out the internet. There is neither an investment boom funded by high yield bonds nor any threat to the financial system as in 2007-2009 or a sudden stop in economic activity brought about by COVID in 2020.

When you are thinking about how to allocate today, you are thinking about what might do well down the road. Typically, the assets that were the focus of the last boom do poorly for years after the bubble bursts. The assets that merely suffered collateral damage, like high yield bonds in this tech focused bear market, tend to do well once the bear market is over. While high yield could continue to suffer along with the stock market, if history is any guide, it has a good chance of performing well in the recovery.

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