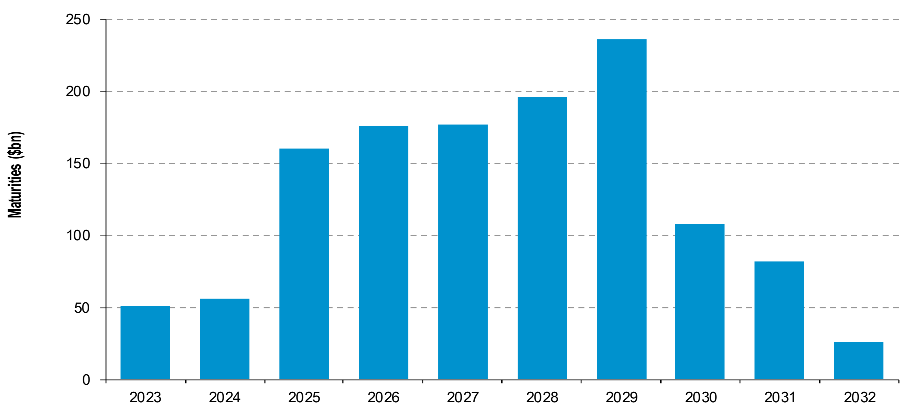
May 2022 High Yield Market Insights

- Bond refinancing needs of high yield issuers are minimal until 2025 and beyond
- Recent bond issuance has not been of the speculative sort
- Loan issuance has been more speculative

Inflation has proven persistent. The Fed will continue to tighten. Policy rates could be raised by more than is currently expected. Higher rates often result in larger high yield risk premiums, the spreads between high yield interest rates and treasury rates. This can put pressure on issuers if they need to refinance.

There is good news. Maturities, which dictate the need to refinance, are light until 2025. The Fed could be easing by then.

Figure 1: HY Maturity Schedule



Source: BAML

In some cycles, issuance can make companies riskier. Bonds used to finance leveraged buyouts or to pay dividends to equity holders leave companies more levered than before their issuance. Prior to the global financial crisis (GFC), up to 35% of high yield bonds were issued for these purposes. Post GFC, the LBO/Dividend proportion of high yield bond issuance range has been much lower, approximately 5-10%.

Riskier issuance has been more pronounced in the loan market since the GFC. The rise in prominence of private lending might account for this change. Private lending firms often work hand-in-glove with private equity (PE) shops. Often, they are private equity shops. We suspect this allows for more control by the PE complex in the event of distress, but that is irrelevant for our purposes. For our purposes, it leaves the high yield bond market a bit less risky. We are OK with that.

Figure 2: Bonds Issued for LBOs and Dividends

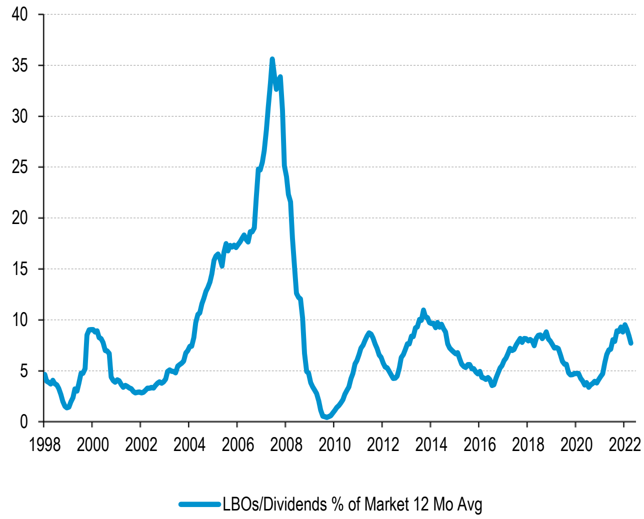
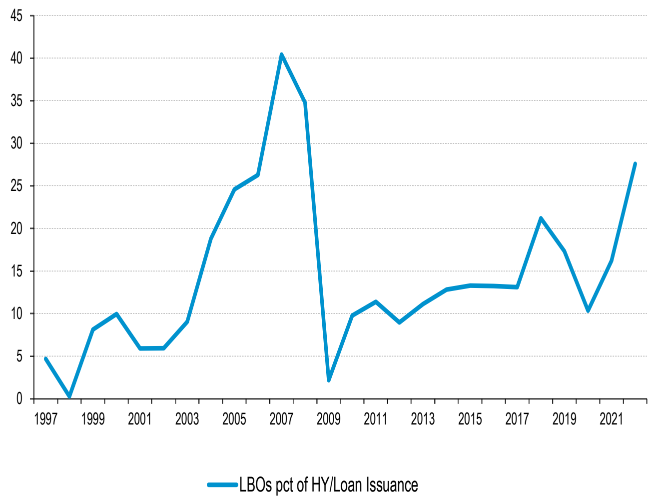


Figure 3: Loans Issued for LBOs



Loans have been growing as a proportion of the high yield market in recent years. We do wonder whether higher rates will cause that trend to reverse. Loans sport floating rates. That was great in the low rate environment of the last decade or so. Floating rate obligations might not be what firms want in a rising rate environment.

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