December 2021 High Yield Market Insights

- Rule 144 HY bonds historically suffered from a lack of liquidity and restrictive holding requirements
- Rule 144A reduced restrictions and improved liquidity, attracting more investors
- Liquidity premiums tied to 144A HY bonds have narrowed yet still offer attractive opportunities

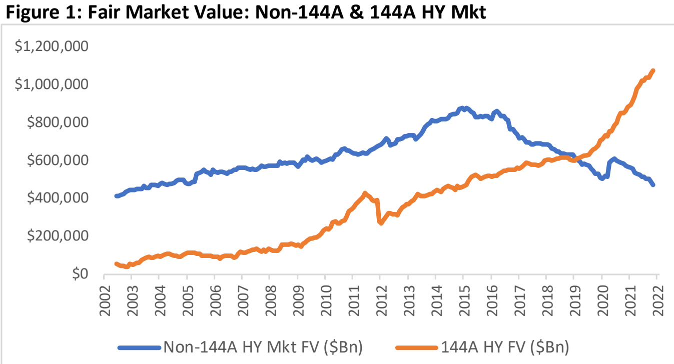
All offers and sales of securities must be registered under the Securities Act of 1933 unless an exemption from the registration requirement is available. In 1990, the SEC adopted Rule 144A and Regulation S. Rule 144A provides an exemption for offers and sales of unregistered securities to large "qualified institutional buyers" in the United States, while Regulation S exempts offers and sales of securities that occur outside of the United States.

In 2012 Rule 144A was amended under the Jumpstart Our Business Startups (JOBS) Act. In short, the amendment reduced informational requirements and shortened the holding period from two years to six months for the purchase and sale of private placement securities. This changed the environment for private security issuance and trading, particularly in the high yield market.

Prior to 2012, many investors avoided Rule 144A high yield bonds over concerns surrounding future liquidity, due in large part to a two-year holding period requirement. Consequently, investors required higher interest rates over similar high yield bonds registered at issuance. Rule 144A securities also traded at wider spreads in the secondary market. Because of such impediments, they represented only 10% of the broad high yield market in mid-2002.

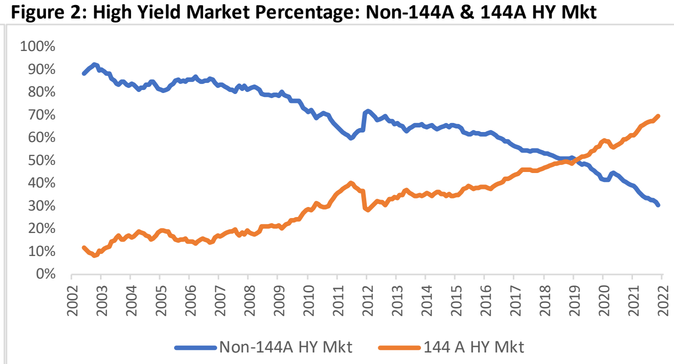
Since 2012, the number of new 144A issues has ballooned and transformed the high yield market. During 2012, 144A securities made up on average 31% of the U.S. high yield market by face value ($321 Bn). Driven by the dramatic ramp-up in 144A new issuance since then, 144A securities now account for 64% of new deals and 69.6% of the HY market by face value ($1.073 Tn). See Figures 1 and 2.

Figure 1: Fair Market Value: Non-144A & 144A HY Mkt



Source: Bloomberg, ICE BofA Indicies, Concise Capital

Figure 2: High Yield Market Percentage: Non-144A & 144A HY Mkt



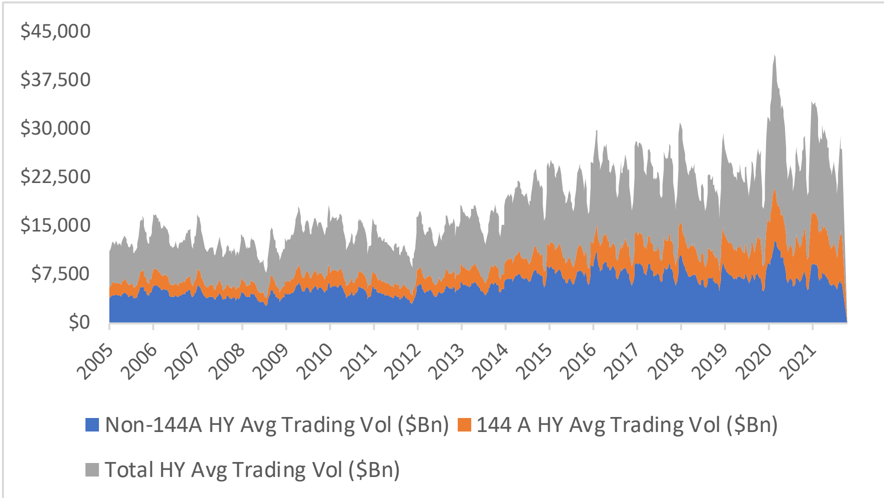
Source: Bloomberg, ICE BofA Indicies, Concise Capital

Private placement 144A debt issues are typically smaller in size, shorter in maturity, and have lower credit ratings than public debt issues. Since 144A securities tend to bear a lower credit rating than registered high yield bonds, the increasing proportion of 144A issues has affected the overall credit rating of the high yield market. The current average quality of 144A HY bonds is just shy of B+ while registered issues have an average rating of nearly BB.

To offset the perceived lower credit quality and lower liquidity, investors have traditionally required a higher yield on 144A issues, although the premium has declined over time. After adjusting for the rating differential, in 2012 the premium for 144A bonds was around 100bp. Currently, the premium ranges between 20bp to 25bp.

The increase in issuance has dramatically changed 144A liquidity. Between 2005 and 2012 the daily trading volumes of 144A issues stayed in a narrow range. Since 2012, volumes have increased significantly. At the start of 2012, 144A securities represented 30.6% ($1.7Bn) of the average daily trading volume of HY bonds. By October 2021, they represented 54.7% ($7.4Bn) - see Figure 3. The 4.3x increase compares to the 2.6x increase for the total high yield market.

Figure 3: Trace High Yield Market Average Trading Volumes



Source: Bloomberg, Trace, Concise Capital

The 144A market now represents a large pool of attractive issues. While the overall liquidity premium has declined over the years, many opportunities remain to be monetized, thereby providing a potential alpha source to a high yield portfolio.

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