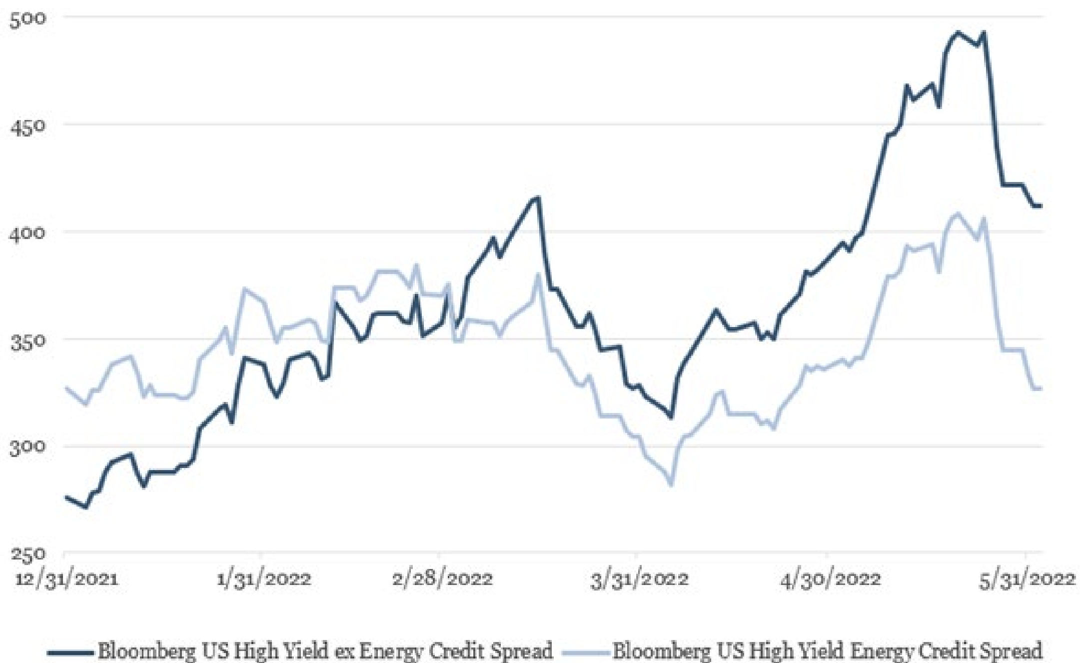
MARKET COMMENTARY

Fig. 1: YTD US High Yield Credit Spreads



Source: Bloomberg, Mill Creek. Data is as of 6/1/22.

Non-investment grade bond yields have steadily increased this year and reached a 2022 high of 7.82% in mid-May. Although they have since receded, this is just the fifth time since the Great Financial Crisis that the market has reached this level. Market yield is a useful indicator of future returns, but it should be paired with credit spreads to paint a more informative picture of risk and value.

Credit spreads are simply the yield premium (i.e., compensation for risk) demanded by the market over risk-free Treasuries. Macro and micro factors shape the market's overall view of risk, pushing spreads wider during times of uncertainty and tighter when conditions are steady. For example, when oil prices approached record lows at the year-end of 2015, credit spreads on energy bonds rose from 426 basis points to 839 basis points over the course of eight months. Investors demanded higher compensation to account for an increased probability of default and principal loss. This year, US high yield corporate credit spreads have increased 125-175 basis points across most sectors as questions around the durability of profits, inflation, and monetary conditions increased perceived risk. Still, the market's current level of 400 basis points remains modestly below its 20-year average of 430 basis points, indicating that investors remain constructive on fundamentals. And, unlike in 2015, the energy sector has outperformed due to spiking oil prices and ongoing supply constraints. The Bloomberg US High Yield Energy Index has returned -4.22% year to date compared to the Bloomberg US High Yield ex-Energy Index at -8.61%.

We believe the strength of issuer balance sheets and favorable liquidity profiles will keep default rates low; however, credit spreads remain at risk of widening due to increasingly volatile macro conditions. We continue to monitor the space closely as yields move higher and plan to discuss our views on allocating to the space in more detail in our third quarter market commentary set for release in early July.

QUICK LINKS

- June Update: Cracks in the Foundation
- Global Small-Cap Stocks Present Attractive Opportunity for Investors
- Behind the Curve
- Earnings Yields Better-Than-Expected Results

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