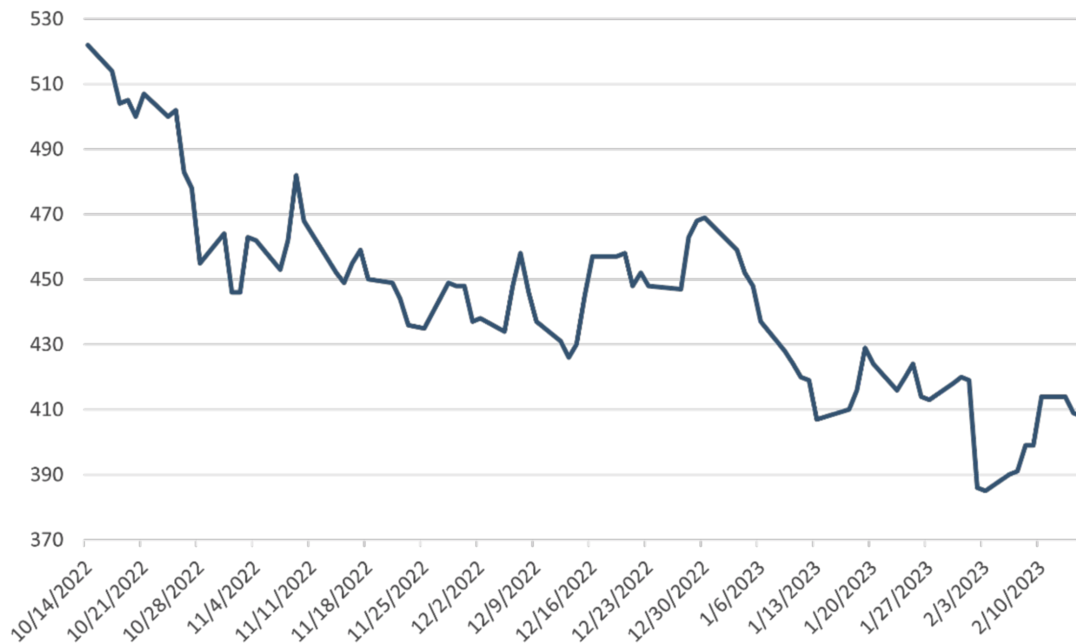
MARKET COMMENTARY

Fig. 1: US Corporate High Yield Bond Spread



Source: Bloomberg, Mill Creek.

In October 2022, we expressed a belief that high yield bonds offered a good risk-reward opportunity. At the time we expected the opportunity to persist for 12-18 months as the economy worked through a Fed-engineered growth slowdown.

Since then, growing hopes for a soft economic landing combined with steady fund inflows have pushed yields lower and fixed income has experienced very strong performance. The taxable and tax-exempt bond markets have returned 4.6% and 3.9%, respectively, since mid-October. Further, high yield corporate credit spreads (a measure of the yield compensation received for accepting high yield risk) have dropped significantly, down -1.14% to 4.08% over the past few months, generating a 6.8% total return for high yield bonds.

Accordingly, we no longer see a particularly attractive opportunity in high yield bonds for two reasons:

- Recent economic data has increased the likelihood of a higher Fed terminal rate versus what is currently priced into the market. As investors come to terms with a “higher for longer” interest rate environment, we anticipate lower-rated bonds will face a rocky

path given their greater sensitivity to late-cycle dynamics. Maintaining a higher quality portfolio helps guard against downside volatility.

- Credit spreads at 400 basis points above Treasuries – roughly 100 basis points below the long-term historical average - offer poor value considering the heightened uncertainty around monetary policy moving forward. We would consider high yield bonds relatively attractive if spreads move higher again, closer to 600 bps.

QUICK LINKS

- House View Summary
- Reacceleration
- February Update: Is the 60/40 Portfolio Dead?
- The Labor Market Remains Very Tight

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