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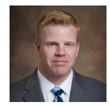
ASSET ALLOCATION INSIGHTS

The Case for High Yield Bonds

November 2020



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KEY INSIGHTS

- Investment-grade bond yields are likely to remain exceptionally low for the foreseeable future, a challenge for investors seeking income.
- We believe that high yield bonds may offer a compelling alternative, but rigorous security selection is essential given their additional credit risk.

Investment-grade bond yields are likely to remain exceptionally low for the foreseeable future, presenting a significant challenge to investors seeking current income from their bond portfolios.

Although high yield bonds offer considerably more yield, the credit risk associated with these bonds—given the economic headwinds many companies face today—is a valid source of concern for many investors. While we agree that caution is warranted, we believe that there are reasons to be optimistic about the outlook for high yield bonds.

First, liquidity could be supportive. It is typically difficult for high yield companies to issue new bonds amid an economic crisis, but this has not been the case in 2020 due to a combination of Fed support and increased investor appetite for higher yields. Even among industries most affected by social distancing and stay-at-home orders, such as energy and gaming, issuance has been strong.

Second, credit markets are signaling that the worst may potentially be behind us. The chart below shows that the distressed ratio,[1] a useful indicator of the current level of credit stress, is below its long-term average. Further, the spike in ratings downgrades this year has resulted in a record number of "fallen angels"—bonds that have lost their investment-grade rating and are now part of the high yield market—which has increased overall credit quality within the sector.

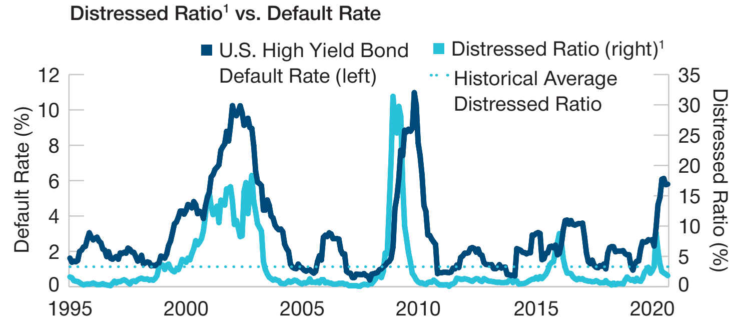
In our view, a higher-than-normal exposure to the high yield market may benefit many investors, particularly when combined with thoughtful security selection from a high-quality active manager.

Searching for Yield

Opportunities in High Yield Bonds

Bloomberg Barclays U.S. Aggregate Index—Yield to Maturity

Distressed Ratio[1] vs. Default Rate



Past performance is not a reliable indicator of future performance.

20 years ended 10/16/2020 (left chart). January 1995 through September 2020 (right chart).

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[1] Distressed Ratio is defined as the percentage of the U.S. High Yield market trading below 50% of par.

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