



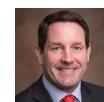
High Yield Bonds—The Grass Roots of the U.S. Economy

U.S. high yield bond market provides attractive opportunities

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KEY INSIGHTS

- The U.S. high yield market represents a cross section of the U.S. economy.
- High yield companies are taking advantage of low borrowing rates and the strong global appetite for yield.
- The U.S. high yield market offers exposure to issuers that blend decent financial fundamentals and attractive income.



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The U.S. is the original high yield fixed income market, with a history stretching back to the 1980s and total outstanding issuance of approximately \$1.3 trillion, largely thanks to the size of the U.S. private-equity market, a major issuer of high yield bonds to finance leveraged buyouts. Although the percentage of private issuers has decreased since 2005, it still represents over half of the opportunity set.¹

Several world regions have developed significant high yield bond markets in the past decade. However, the U.S. market remains the world's largest, and it continues to offer investors attractive opportunities to diversify exposure and find additional income.

The U.S. high yield market offers fixed income exposure to a cross section of domestically focused small- and

mid-cap companies that represent the grass roots of the U.S. economy across sectors including energy, telecoms, industrials, and consumer businesses.

Over the past few years, high yield companies have taken advantage of low borrowing rates and the strong global appetite for yield to refinance their debts on attractive terms—coupons that previously hovered around 8%–9% have been replaced with bonds paying 5%–6%.¹ At the same time, companies are taking the opportunity to borrow for longer periods, reducing the refinancing pressure they previously faced in shorter maturities. Helped by an improving domestic economy, typical U.S. companies that issue high yield bonds are benefiting from stronger cash flows and better business fundamentals. As a result, default rates in the U.S. high yield market are low

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2%

...default rates in the U.S. high yield market are low by historical standards, at around 2%, compared with a historical average of around 4% since 1980.¹

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The U.S. market offers several attractive benefits for high yield investors, notably the opportunity to broaden sources of return by investing in a wide array of companies operating in the world's largest economy. The U.S. high yield universe is large, and average issue sizes tend to be somewhat bigger than in other regions, which helps create a more liquid market.

Going forward, high yield portfolio managers are going to need to adapt their approach for a volatile interest

rate environment as we believe the more than 30-year decline in rates will start to turn and rates will trend higher. We believe default rates are unlikely to fall from today's low levels, so active security selection will be as important as ever to avoid the weak issuers. Furthermore, pricing inefficiencies create attractive relative value opportunities across issuers, due to size (the market is largely composed of small- to mid-cap issuers), credit quality, and geography. The U.S. high yield market offers exposure to issuers that balance decent financial fundamentals with relatively attractive income.

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