

HIGH YIELD BONDS: THE USEFUL SIDE OF SUPPLY CONSTRAINTS

Fixed income portfolio managers Seth Meyer and Tom Ross note how low primary supply (new issuance) in the high yield bond market is providing some support for high yield bonds at a time when the asset class is being pressured by inflation and growth concerns.



Seth Meyer, CFA
Portfolio Manager



Tom Ross, CFA
Portfolio Manager

Faced with a wait of several months for a new car? You are not alone. Unless you are prepared to snap up the model in the dealer's showroom, the wait time for even the more basic models can run into months. Order backlogs have been amplified by production delays as COVID lockdowns and the conflict in Ukraine impacts the supply of critical parts. But supply constraints are not just restricted to the physical economy, we notice them in the financial world too – and one area of fixed income with limited supply recently has been high yield bonds.

Death of supply

Primary issuance in high yield has been particularly weak. In the US, the first four months has been the slowest start for more than a decade and expectations are that the total for the year could be similarly weak.

Figure 1: 2022 shaping up to be a slow primary year for US high yield



Source: Citi Research, S&P/LCD, 2012 to 2022, at 30 April 2022. Expected remaining is based on issuance for rest of the year following the post-crisis average. Expected levels are Citi estimates and are not guaranteed.

The lack of supply is just as stark in Europe where just one deal worth €465m was issued in April. In the first four months of 2022 just €13 billion of non-financial high yield bonds have been issued, marking a 73% fall on the same period in 2021 and the weakest pace of European high yield issuance since 2016.¹

Feast to famine may be a little strong but issuance was always likely to slow – what has caught the market by surprise is the extent of the slowdown. Lest we forget 2020 and 2021 were decent years for growth in the size of the high yield market. This reflected a number of factors:

(*) Esta columna solo refleja la opinión del autor, y no necesariamente la opinión de CFA Society Chile, ni la del comité editorial, ni tampoco la opinión de CFA Institute.

- Existing issuers needing to borrow to cover revenue shortfalls caused by lockdowns
- Investment grade companies being downgraded into the high yield universe
- First time issuers coming to the market, typically at the intermediate stage of growth where more meaningful debt capital was required to finance expansion.

This contributed to a rise in the overall size of the high yield market, with both total face value and the number of bonds in issue growing.

Figure 2: High yield market expansion and contraction



Source: Bloomberg, total face value and number of bond issues within the ICE BofA Global High Yield Bond Index, 30 April 2012 to 30 April 2022.

Recent months have seen something of a reverse. Partly, this is something to celebrate. Several large high yield issuers have become ‘rising stars’, progressing up to investment grade status. Familiar names making this move in recent months include Kraft Heinz, the food group, and Freeport-McMoRan, the miner.

Corporate borrowers are opportunistic. In many cases, there is simply no need to borrow more when they did all the financing they needed to do during and in the aftermath of the COVID crisis. After all, it made financial sense to issue bonds last year when rates were low. Cash balances today are relatively high and without pressing expansion projects we should expect companies to be patient.

Added to that has been a recent slowdown in merger and acquisition (M&A) activity, which usually needs financing. This is actually a welcome development from our perspective as we were beginning to worry that corporates were starting to exhibit bondholder-unfriendly behaviour, with more issues linked to leveraged buyouts and takeovers. Judging how the recent volatility in equity markets will play out for credit

is challenging as it can both decrease enthusiasm for M&A by encouraging boards to preserve cash or increase it as lower equity prices can spur opportunistic takeover bids and share buybacks.

Figure 3: M&A transactions are starting to slow (12-month rolling total)



Source: Bloomberg, total M&A transaction value (12-month rolling total), USD, 30 April 2001 to 30 April 2022.

Should we be concerned by weak issuance?

There is a danger that corporate borrowers backload more of their borrowing for the latter part of the year. For example, as Figure 1 demonstrated earlier, 2016 started off slowly but an acceleration later in the year led to a pick-up in issuance, although the annual total was still below average. This would require surprise borrowing, however, as the maturity profile of existing bonds means there is no pressing refinancing need that would suggest a wall of issuance near term. Central bank policy tightening and concerns about a possible slowdown in the economy are also unlikely to encourage companies to take on unnecessary borrowing.

Low primary issuance can be frustrating for investors as it is often a fruitful way to gain access to a borrower’s bonds. To encourage take-up, new issues typically come at a small price discount (or yield premium) to an issuer’s existing bonds in the secondary market so fewer new issues lessens the opportunity to potentially benefit from this. That being said, a new issue yield premium alone is not reason enough to invest in a bond so investors still need to do their homework on the fundamental strengths of the issuer and the bond’s valuation. A more valuable role for new issuance is that of diversification. A pipeline of new issues helps ensure the asset class does not become stale. We want to be able to hold securities across a range of companies to diversify risk so over time it is healthy to have companies using the bond market to raise capital.

The other key advantage of new issuance is it both acts as a sign of confidence and provides useful price signalling or discovery. Regular supply of new issues can help market participants gauge whether the pricing in secondary markets is fair. Fewer new issues mean fewer opportunities to benchmark existing bond prices against what the market is prepared to pay for new issues, which in turn can lower confidence in prices and contribute to higher volatility.

On the plus side, lower supply does mean there is less technical pressure that could drive credit spreads wider as demand and supply are more likely to be in equilibrium.

It takes two to tango

The other side of the ledger is demand. Borrowers are more inclined to issue if they can do so at low cost (i.e. low yields) when there is strong investor demand. Recently, that demand has been weaker. Greater risk aversion from investors has seen outflows from high yield funds, particularly among exchange traded funds (ETFs). Concern about inflation has also meant loans (an alternative way of raising debt capital) have been popular with investors given they typically have floating rates where the coupon or interest paid on them rises as interest rates rise.

Added to this, several central banks are moving away from quantitative easing towards quantitative

tightening. This is going to remove large price insensitive buyers from corporate bond and sovereign bond markets. As part of their asset purchase schemes, central banks have been active in the investment grade corporate bond markets, particularly in the UK and Europe; although high yield bonds have not typically featured in these schemes there is potential for pass through of spread widening if the withdrawal of central bank support diminishes risk appetite. This is potentially less of a direct concern in the US where asset purchases have been directed principally at sovereign bond and mortgage-backed securities, although there could still be spillover effects. How central banks engage in quantitative tightening – either passively by allowing bonds to mature and not reinvesting or actively by selling securities to accelerate their balance sheet shrinkage – will have a bearing on how credit markets react.

We recognise that there may be some tricky months ahead for high yield bond markets, but with yields higher across the board and supply technicals favourable, this could help mitigate some of the widening pressure on spreads arising from concerns about the economic growth outlook. We might moan about the weak supply but right now it is proving timely in helping to offset some of the softening in demand.

1Source: Morgan Stanley, European Credit Strategy, 3 May 2022

Los puntos de vista que aquí figuran corresponden a la fecha de publicación. Se ofrecen exclusivamente con fines informativos y no deben considerarse ni utilizarse como asesoramiento de inversión, jurídico o fiscal ni como oferta de venta, solicitud de una oferta de compra o recomendación para comprar, vender o mantener ningún valor, estrategia de inversión o sector de mercado. Nada de lo incluido en el presente material debe considerarse una prestación directa o indirecta de servicios de gestión de inversión específicos para los requisitos de ningún cliente. Las opiniones y los ejemplos se ofrecen a efectos ilustrativos de temas más generales, no son indicativos de ninguna intención de operar, pueden variar y podrían no reflejar los puntos de vista de otros miembros de la organización. No se pretende indicar o dar a entender que cualquier ilustración/ejemplo mencionado forma parte o formó parte en algún momento de ninguna cartera. Las previsiones no pueden garantizarse y no es seguro que la información proporcionada sea completa o puntual, ni hay garantía con respecto a los resultados que se obtengan de su uso. A no ser que se indique lo contrario, Janus Henderson Investors es la fuente de los datos y confía razonablemente en la información y los datos facilitados por terceros. La rentabilidad histórica no predice las rentabilidades futuras. La inversión conlleva riesgo, incluida la posible pérdida de capital y la fluctuación del valor.

No todos los productos o servicios están disponibles en todas las jurisdicciones. El presente material o la información contenida en él podrían estar restringidos por ley y no podrán reproducirse ni mencionarse sin autorización expresa por escrito, ni utilizarse en ninguna jurisdicción o en circunstancias en que su uso resulte ilícito. Janus Henderson no es responsable de cualquier distribución ilícita del presente material a terceros, en parte o su totalidad. El contenido de este material no ha sido aprobado ni respaldado por ningún organismo regulador.

Janus Henderson Investors es el nombre bajo el cual las entidades que se indican ofrecen productos y servicios de inversión en las siguientes jurisdicciones: (a) En Europa, Janus Capital International Limited (n.º de registro 3594615), Henderson Global Investors Limited (n.º de registro 906355), Henderson Investment Funds Limited (n.º de registro 2678531), Henderson Equity Partners Limited (n.º de registro 2606646), (cada una de ellas registrada en Inglaterra y Gales en 201 Bishopsgate, Londres EC2M 3AE y regulada por la Autoridad de Conducta Financiera) y Henderson Management S.A. (n.º de registro B22848, en 2 Rue de Bitbourg, L-1273, Luxemburgo y regulada por la Commission de Surveillance du Secteur Financier) ofrecen productos y servicios de inversión; (b) En EE. UU., los asesores de inversión registrados ante la SEC filiales de Janus Henderson Group plc; (c) En Canadá, a través de Janus Henderson Investors US LLC, solo para inversores institucionales de determinadas jurisdicciones; (d) En Singapur, Janus Henderson Investors (Singapore) Limited (número de registro de la sociedad: 199700782N). Este anuncio o publicación no ha sido revisado por la Autoridad Monetaria de Singapur; (e) En Hong Kong, Janus Henderson Investors Hong Kong Limited. Este material no ha sido revisado por la Comisión de Valores y Futuros de Hong Kong («SFC»); (f) En Taiwán (República de China), Janus Henderson Investors Taiwan Limited (con funcionamiento independiente), Suite 45 A-1, Taipei 101 Tower, No. 7, Sec. 5, Xin Yi Road, Taipéi (110). Tel.: (02) 8101-1001. Número de licencia SICE autorizada 023, emitida en 2018 por la Comisión de Supervisión Financiera; (g) En Corea del Sur, Janus Henderson Investors Limited (Singapur), exclusivamente para Inversores profesionales cualificados (según se definen en la Ley de servicios de inversión financiera y mercados de capitales y sus subreglamentos); (h) En Japón, Janus Henderson Investors (Japan) Limited, regulada por la Agencia de Servicios Financieros y registrada como Entidad de servicios financieros que realiza actividades de gestión de inversión, asesoramiento de inversión y actividad de agencia y actividades de instrumentos financieros de tipo II;

(i) En Australia y Nueva Zelanda, por Janus Henderson Investors (Australia) Limited ABN 47 124 279 518 y sus entidades relacionadas, incluida Janus Henderson Investors (Australia) Institutional Funds Management Limited (ABN 16 165 119 531, AFSL 444266) y Janus Henderson Investors (Australia) Funds Management Limited (ABN 43 164 177 244, AFSL 444268); (j) En Oriente Medio, Janus Capital International Limited, regulada por la Autoridad de Servicios Financieros de Dubái como Oficina de representación. No se realizarán transacciones en Oriente Medio y cualquier consulta deberá dirigirse a Janus Henderson. Las llamadas telefónicas podrán ser grabadas para nuestra mutua protección, para mejorar el servicio al cliente y a efectos de mantenimiento de registros reglamentario. Fuera de EE. UU: Para uso exclusivo de inversores institucionales, profesionales, cualificados y sofisticados, distribuidores cualificados, inversores y clientes comerciales, según se definen en la jurisdicción aplicable. Prohibida su visualización o distribución al público. Comunicación Publicitaria. Janus Henderson, Knowledge Shared y Knowledge Labs son marcas comerciales de Janus Henderson Group plc o una de sus filiales. © Janus Henderson Group plc.