High yield remains resilient despite recent volatility.

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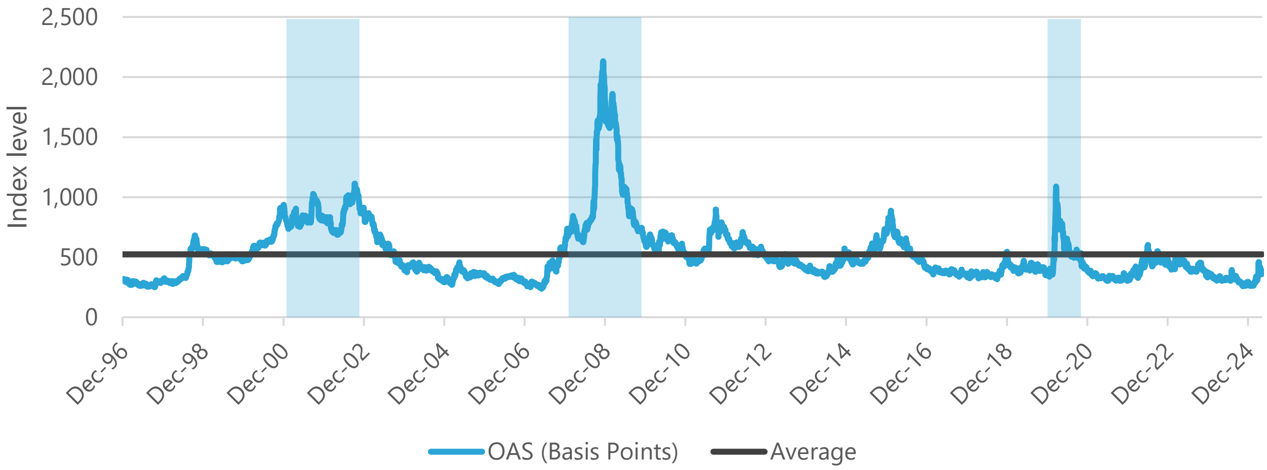
It has been an eventful start to 2025, with tariffs, inflation, and the prospect of a recession all hot button topics. On April 2, President Trump's Liberation Day, new tariffs were announced to address what the administration considered to be unfair trade practices.

Prior to the announcement, the option adjusted spread (OAS), of the high yield market (as measured by the ICE BofA US High Yield Constrained Index) was 342 basis points while the year-to-date low was 259 basis points on January 22.

Following the announcement, financial markets sold off dramatically and high yield spreads widened notably, peaking at 461 basis points on April 7 which was the highest level since June 2023. On April 9, there was an announcement of a 90-day suspension of additional tariffs which offered relief to the markets evidenced by OAS tightening over the course of the next month ending at 316 basis points on May 16.

While the size of the move was eye catching, the nearly thirty-year average high yield spread is roughly 525 basis points, so the market was below that threshold at the April 7 peak and well below it at the time of this writing (mid-May). The recent spread widening, which was the most extreme of the past two years, doesn't compare to recent stressful periods of 2001-02, 2008-09, and 2020 in which the high yield market OAS exceeded 1,000 basis points as displayed in Exhibit 1 below.

Exhibit 1: ICE BofA US High Yield Constrained Index (OAS)

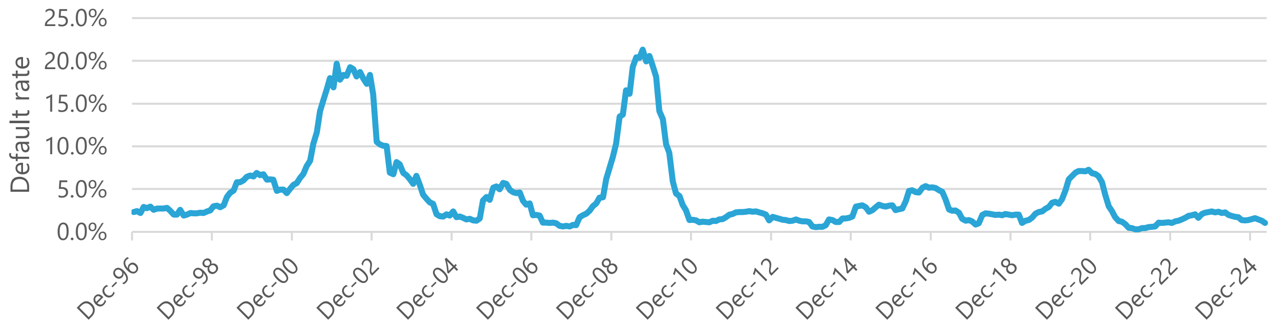


Source: ICE Index Platform

The high yield market's yield-to-worst (YTW), which represents the lowest possible yield excluding a default scenario, followed a similar path. Peaking at 8.65% on April 7, the market yield is now less than 8% whereas the long-term average is approximately 8.4%.

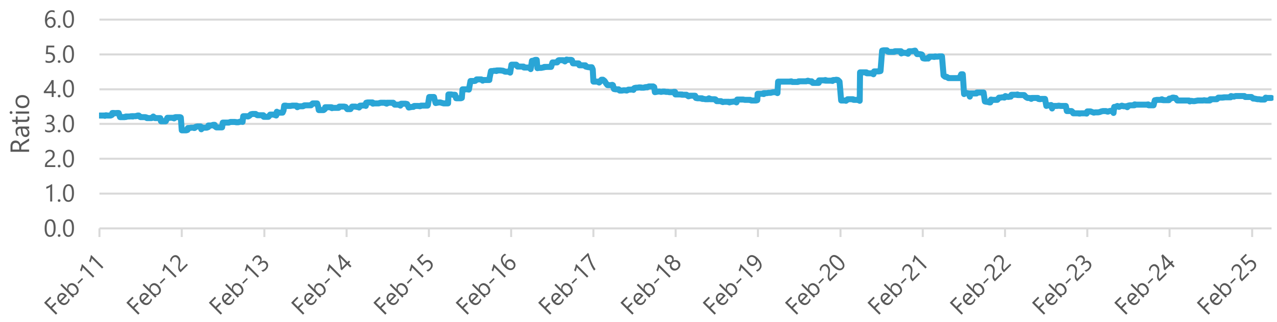
As the high yield spread approached its pre-Liberation Day level, corporate fundamentals remained healthy as evidenced by low default rates and reasonable net leverage and interest coverage (shown in Exhibits 2 through 4). While these are historical statistics, the high yield market is not currently pricing a deterioration in corporate fundamentals and that has been supported by the previously mentioned OAS level. Historically, OAS levels surpassing 600 basis points would be an early signal of market distress or the possibility of recession.

Exhibit 2: U.S. High Yield Par-Weighted Default Rate



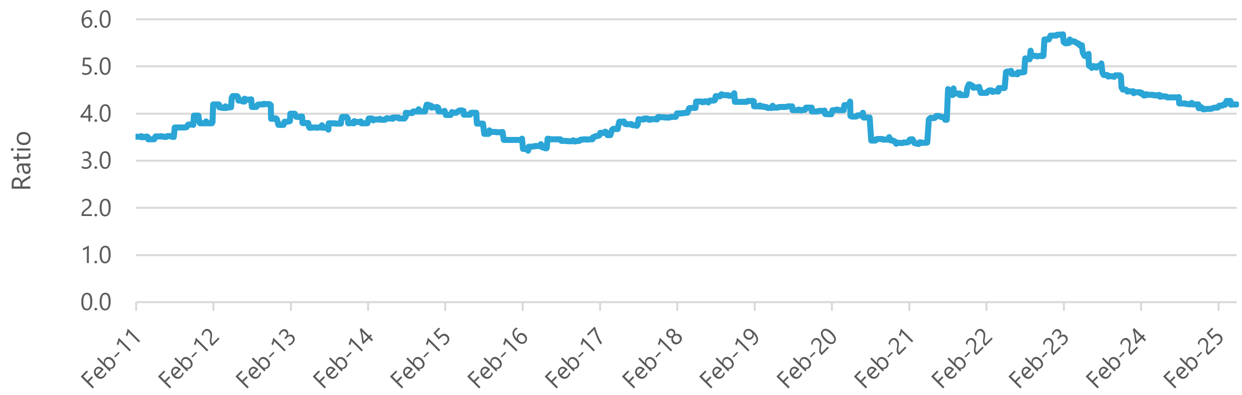
Source: BofA Global Research

Exhibit 3: Net Leverage Ratio



Source: BofA Global Research

Exhibit 4: Interest Coverage Ratio

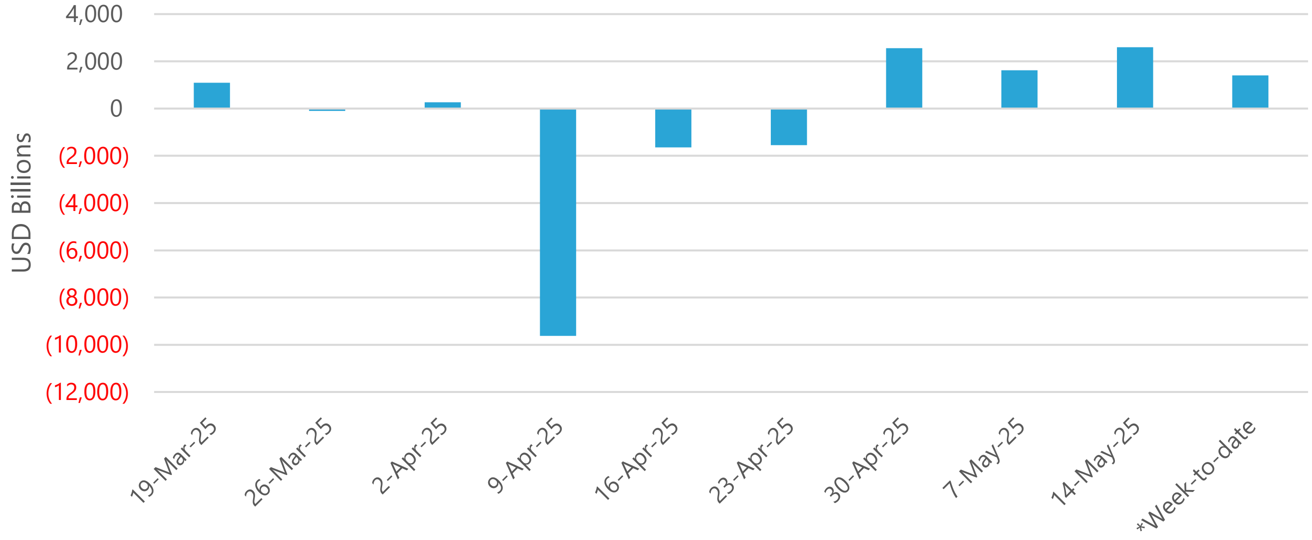


Source: BofA Global Research

Another gauge for general market health is fund flow data which is a reading of inflows and outflows (shareholder/investor activity) for the respective asset class. This includes, but isn't limited to, mutual funds and exchange-traded funds (ETFs). In the case of the high yield market, inflows are generally a sign of strength and confidence in the asset class, whereas outflows can be a sign of concern. As the high yield market spread widened, investors redeemed from high yield mutual funds (see Exhibit 5) in April as nearly $13 billion left the asset class.

However, as spreads began to tighten, the high yield market experienced three consecutive weeks of inflows in excess of $6 billion. We wouldn't be surprised to see inflows continue into the asset class should OAS remain near their current level or if they tighten further.

Exhibit 5: High Yield Weekly Fund Flows



Source: J.P. Morgan (WTD 05/16/25)

Volatile markets can be favorable for active management as they offer attractive buying opportunities and skilled managers may avoid credit mistakes. Active management can prove beneficial as managers are not required to buy the entire market unlike the passive alternative. Recently, managers added some risk in high conviction positions, but positions were relatively small. Should recessionary fears come to the forefront, then OAS would most likely exceed 600 basis points, providing active managers with additional attractive opportunities.

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