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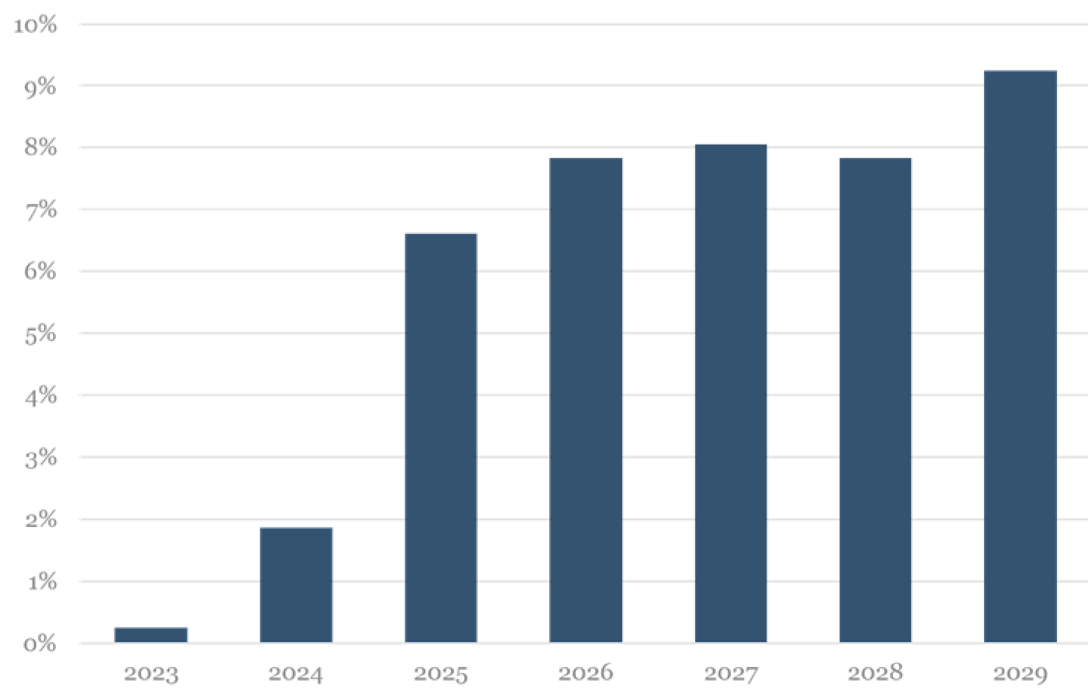
WEEKLY UPDATE
August 29, 2022

MARKET COMMENTARY

Fig. 1: US High Yield bonds rated single B or lower maturities (% of High Yield universe)



Source: ICE Bank of America US High Yield Index, Mill Creek.

It's hard to believe that summer is winding down, and the annual post-Labor Day rush of deal activity is just around the corner. New bond issuance tends to slow in June through August as market participants enjoy an extended vacation, but 2022 is shaping up to be one of the quietest years on record. Investment grade and high yield corporate bond issuance were only $353 billion in 1H22, down 53% year-over-year. This starkly contrasts with 2021 when low yields combined with robust capital market conditions led to a wave of refinancings. Last year's heavy refinancing activity is the primary driver behind low default expectations moving forward despite potentially souring economic conditions. Just 2.11% of high yield bonds rated single B or lower (i.e., low creditworthy companies most vulnerable to default) mature before 2025.

Anemic net supply and positive fundamentals have helped push investment grade and high yield bond spreads meaningfully lower over the past two months, resulting in quarter-to-date returns of 1.5% and 5.5%, respectively. However, the path forward remains challenged and it's uncertain if the recent rally has legs. As the fourth quarter draws near, we are paying attention to one particular corner of the credit market to help gauge market sentiment: hung debt. This relates to debt commitments made by investment banks to fund announced mergers and leveraged buyouts. Banks agree to take on the risk of backing a deal now with the intent to syndicate (sell-off) commitments in the future in exchange for earning transaction fees of 2.0% - 2.5%. Securing debt financing is key to the M&A process and runs smoothly under normal market conditions. However, it becomes more challenging in volatile periods like we are currently experiencing. Deals signed in 4Q21/1Q22, before the market downturn, now face a much different pricing dynamic. Banks are 'hung' with large debt commitments that will likely need to be sold at steep discounts to reflect the current interest rate environment. High-profile deals include Citrix and Tenneco. How well these transactions are received by the market and the magnitude of discounts taken by banks will be another factor shaping our view on the current state of affairs.

QUICK LINKS

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- How Will Investors Face Q2 Valuations?
- Earnings Rise Albeit at a Slower Pace Than Prior Quarters
- August Update: Recession?

This week's contributor: *Nora Pickens, CAIA*

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