AXA Investment Managers

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May 2020

Why now for US High Yield Bonds?

Strategy update

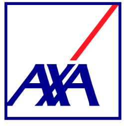
The volatility of recent months pushed credit spreads well wide of historic norms, peaking around mid-March at levels last seen during the 2008/ 2009 Credit Crisis. In the face of this market turmoil, the broad US high yield market has returned -9.8% for the year-to-date (as at April 30), while AXA IM's US Core High Yield strategy has held up relatively well, capturing only around 66% of the market loss (net of fees)[1]. We believe the strategy remains well-positioned to weather future volatility and there remain plenty of reasons for optimism.

Reasons for optimism

1 Security selection pays off	Security selection has been key in this volatile environment. Within credit markets, the energy sector – especially oil - has been one of the worst hit sectors due to coronavirus-related demand destruction coupled with a supply glut. Our strategy's underweight to energy broadly (focusing instead on the less commodity-price-dependent pipeline sector) has provided good protection from the downside.
2 Avoiding defaults	Our strategy has a long term track record of avoid defaults and has only had 5 defaults, in comparison to over 600 defaults in the ICE BoA US High Yield index since the inception of the strategy.[2]
3 A well-resourced trading team	During periods of volatility, trades often take longer to execute than under normal conditions. Our dedicated US High Yield trading is larger than most in the industry and provide us with the resources to obtain the best pricing.

(1) *Source: AXA IM, Bloomberg as of 30-April-2020. Please note that the performance data is not intended to represent actual past or simulated past performance of AXA IM's US Core High Yield strategy. The data is based on a representative account that follows AXA IM's US Core High Yield strategy (AXA WF US High Yield fund, I USD, net of fees). Past performance is not a reliable indicator of future results.*

(2) *Sources: AXA Investment Managers. ICE BofA ML US High Yield index is shown for illustrative purposes only. J.P. Morgan Default Monitor as of May 1, 2020. Data is from composite strategy inception date of September 30, 2001 through April 30, 2020.*



4
Attractive valuations

The average yield -to-worst in the portfolio is 8% and the average spread 750 bps[3], offering a more attractive entry point into US high yield than we've seen in years.

5
Lower-volatility substitute for equities

We have long been of the view that high yield can be used as a substitute for equities, particularly in the late stage of a cycle. We are witnessing that in today's market, where the drawdown in high yield during March was much lower than in equities. High yield outperformed equities in the recovery phase post-2008 and we expect it could do so again this time. This is because high yield does not need earnings growth and multiple expansion to perform, it simply needs a stable economic environment.

6
Higher upside capture rate

Having protected from much of the downside during the peak of volatility in March, we are now focused on capturing as much of the upside as possible on the way back up. The long-term historical upside market capture of the strategy has been 84% while the downside market capture ratio has been only 69%.[3] This low participation in down-markets and attractive up-market capture provides a favourable comparison versus the broad US high yield market.

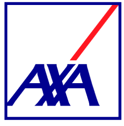
7
Shape of the market

One factor that particularly bolsters our current confidence on the outlook for US high yield is the shape of the maturity profile of the market. Unlike the credit crisis of 2008/09, the wall of maturities no longer exists. This means high yield companies should not have significant refinancing needs during this difficult liquidity window.

8
USD/EUR currency hedging costs continue to fall

After reaching a historical high of almost 3.5% in late 2018, as of the end of April these hedging costs are near 70 bp4, a low not seen since 2015. This change, along with the significantly higher yields should help generate significant interest to return to high yield

(3) *Source: AXA IM, FactSet, as of April 30, 2020, since the strategy's inception on 30 September 2001.* ***Past performance is not a reliable indicator of future results.*** *[4]These include 3 month FX forwards, annualized.*



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