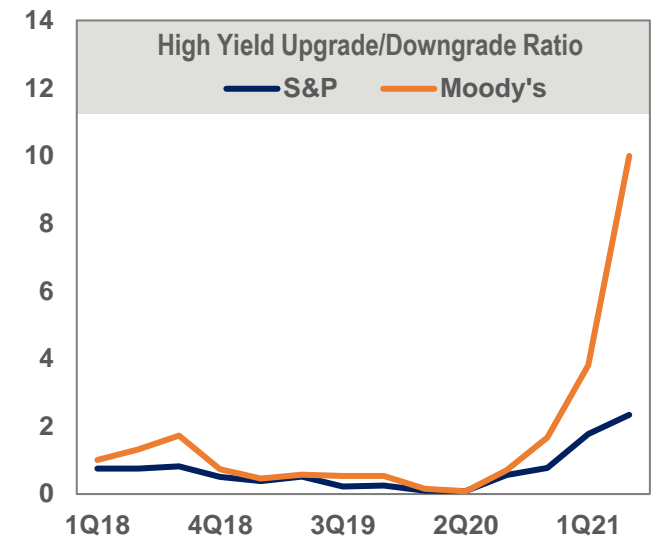
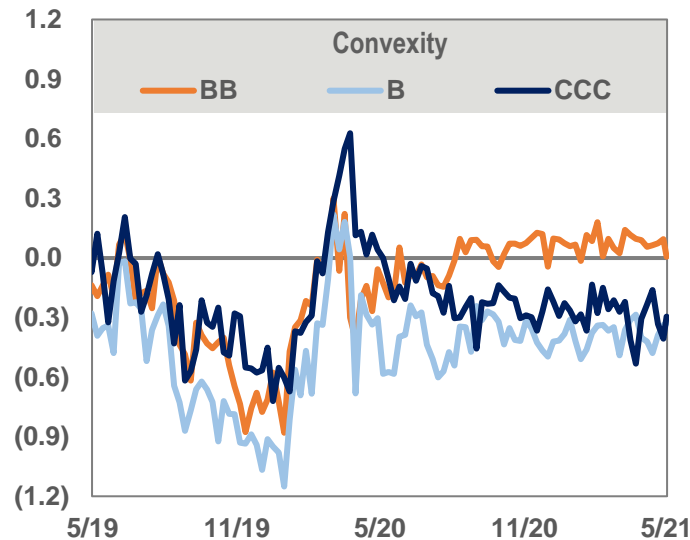
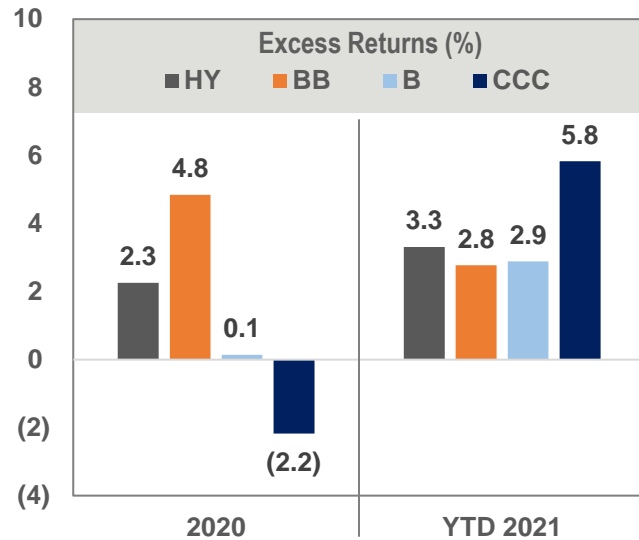


Security Selection within High Yield Increasingly Important



- **There were winners and losers in 2020.** CCC-rated issuers fared the worst amid the March 2020 sell-off, as default rates surged and spreads remained wide. Year-to-date, lower-quality has outperformed, and bond prices are now near recent highs, as COVID-challenged businesses have improved amid the reopening of the economy.
- **The upside price potential is likely capped for most rating cohorts.** Roughly half of the high yield index now trades at a premium to the next call price. This has pushed convexity lower, particularly in B and CCC-rated corporates, constraining any additional price appreciation if rates fall or spreads tighten. BBs have higher convexity due to the addition of fallen angels, which are mostly bullet bonds, and new issuance, which typically has longer call protection for BBs.
- **Fundamentals are improving.** There were a record amount of investment grade issuers downgraded to high yield last year – over \$185 billion. This trend reversed in 2021, with almost \$21 billion of high-yield issuers upgraded to investment-grade (rising stars) versus \$1 billion of fallen angels.
- We remain cautious of adding incremental risk in the current environment given low yields, high dollar prices, and tight spreads. However, we believe that careful security selection should help investors avoid issuers with highly skewed, asymmetric risk profiles. High yield often outperforms in improving economic environments, and carry contributes to returns even with range-bound spreads.

Source: Bloomberg Barclays, Bloomberg as of 5/18/21. High yield index is the Bloomberg Barclays High Yield Index. The views contained in this report are those of IR+M and are based on information obtained by IR+M from sources that are believed to be reliable. This report is for informational purposes only and is not intended to provide specific advice, recommendations, or projected returns for any particular IR+M product. No part of this material may be reproduced in any form, or referred to in any other publication, without express written permission from Income Research + Management. BLOOMBERG® is a trademark and service mark of Bloomberg Finance L.P. and its affiliates (collectively "Bloomberg"). BARCLAYS® is a trademark and service mark of Barclays Bank Plc (collectively with its affiliates, "Barclays"), used under license. Bloomberg or Bloomberg's licensors, including Barclays, own all proprietary rights in the Bloomberg Barclays Indices. Neither Bloomberg nor Barclays approves or endorses this material, or guarantees the accuracy or completeness of any information herein, or makes any warranty, express or implied, as to the results to be obtained therefrom and, to the maximum extent allowed by law, neither shall have any liability or responsibility for injury or damages arising in connection therewith.