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Markit Commentary

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Riskiest end of US HY market powers bond returns

US high yield bonds have now outperformed investment grade bond returns in 2016, propelled by spread compression among the lowest rated credits.

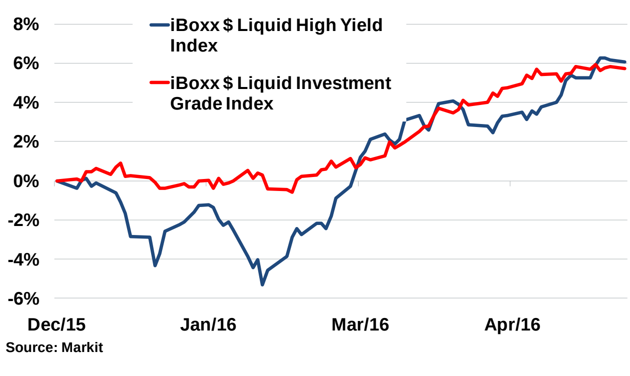
- After gaining 2.65% so far this month, US HY bond returns have now outperformed IG counterparts for 2016
- Markit iBoxx USD Liquid High Yield CCC Index has returned 7% so far this month
- Chesapeake Energy Corp and California Resources Corp have led the spread compression among CCC names

US high yield (HY) bond returns have continued to power ahead this month, driven by risky Oil & Gas names such as Chesapeake Energy Corp and California Resources Corp. As a result, HY bond returns have now outperformed their investment grade (IG) counterparts in 2016 to date, having previously trailed by as much as 5.6% in February.

US HY bonds stride ahead

After returning 3.6% in March, US HY bonds, as represented by the Markit iBoxx $ Liquid High Yield Index, have continued to gain traction with returns totalling 2.65% so far this month. US HY bonds have now returned 6.05% in 2016, an 11.4% upswing after hitting a low of -5.3% during February.

US corporate bonds total return ytd



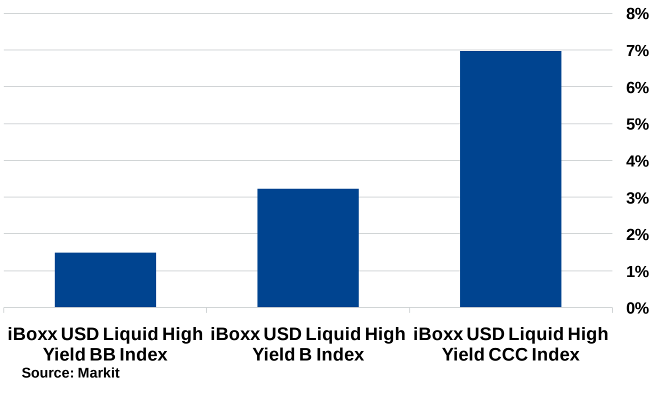
Source: Markit

The last few weeks in particular have seen a surge in returns; totalling over 2% since April 11th. This has been principally led by improved sentiment in the riskiest end of the US HY market. US HY bonds have now surpassed US IG bond returns so far this year, after trailed for the majority of 2016.

Riskiest bonds lead the way

The riskiest end of the US HY bond market, companies rated CCC, has seen the bulk of returns, which has been principally led by a compression in spreads (interest premium over US treasuries). The Markit iBoxx USD Liquid High Yield CCC Index has returned 7% so far this month, over twice as much as bonds rated a notch above, and beating those two notches above by fourfold.

US HY bonds total return in April



Source: Markit

Spread compression (a sign of risk falling) has been the key component of total returns, with average CCC bonds tightening to 1,231bps, from 1,417bps at the start of the month.

With fears of further downside risk in oil prices dissipating over the past month, it comes as no surprise that oil-related names have outperformed. The Oil & Gas sector remains prominent among CCC rated names, representing 19% of the Markit iBoxx USD Liquid High Yield CCC Index, and the largest sector by weight.

Chesapeake Energy Corp and California Resources Corp were the stand out CCC rated names in terms of spread compression.

Earlier this month, weak natural gas price affected Chesapeake announced its credit lines were robust, dispelling fears around liquidity and providing the company time to restructure its balance sheet. Bonds reacted positively to the news, with Chesapeake's' 6.5% bond maturing in 2017 seeing its spread tighten to 2,570bps, from 4,156bps at the end of March. Likewise California Resources Corp, a fellow natural gas producer, saw its 5.5% bond maturing in 2021 spread fall to 3,480bps, from 4,757bps at the end of March.

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