GLOBAL HIGH YIELD

HIGHLIGHTS

EUROPE OFFERS BETTER RELATIVE VALUE: In our view, European senior secured loans and high yield bonds currently offer better value relative to the U.S., particularly at the single-B level. While corporate fundamentals remain stable on both sides of the Atlantic, technical factors in Europe—such as macro volatility and increased levels of private equity-led M&A—have caused spreads to widen beyond what fundamentals would suggest. This widening, coupled with the expectation that defaults will remain low, suggests that investors may benefit from increasing their exposure to European high yield bonds and loans. To illustrate the impact of this technical trend, the chart shows the percentage of new issue deals that have widened in investors' favor over recent months in the European senior secured loan market.

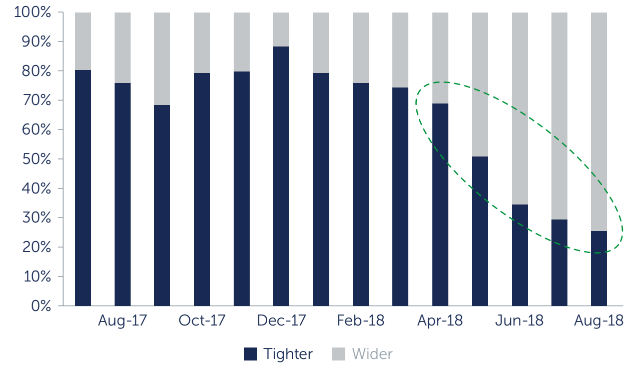
FUNDAMENTALS REMAIN STRONG: Corporate fundamentals appear stable. Recent reports from J.P. Morgan[1] and Barclays[2] confirm what we are seeing in our portfolios—corporate high yield issuers continue to grow revenue and EBITDA[3], and credit metrics remain at reasonable levels. With the exception of the retail sector, where we believe there are significant secular challenges related to disintermediation from online shopping, we are not seeing any significant stress in the high yield corporate universe. The energy sector, which was a source of significant volatility in 2015 and 2016, remains stable-to-improving. In addition, the number of companies trading at distressed levels is low, suggesting defaults may remain low into 2019.

DECENT DEAL FLOW: Stronger Demand: After a brief slowdown in August, deal flow in both the global senior secured loan and global high yield bond markets accelerated in early September, with several multi-billion dollar new deals easily clearing the market (Thomson Reuters Financial & Risk Business, AkzoNobel Specialty Chemicals, Envision Healthcare). Looking forward, we expect a more muted new issue pipeline, which, given the firm technical backdrop, could lead to an increase in repricing and refinancing transactions.

OUTLOOK

- While the current economic expansion is the second-longest on record, we do not expect it to end any time soon. Companies continue to report solid revenue and earnings growth, and we expect reports of stable-to-improving fundamentals among high yield issuers to persist in the near to medium-term.
- As corporate fundamentals remain solid, we expect defaults in both global senior secured loans and global high yield to remain low.
- We expect the opportunity in European senior secured loans and high yield bonds to persist. Even if the supply/demand imbalance corrects, the wider spread levels in Europe provide more potential for tightening, and we are positioning portfolios to take advantage of this opportunity.

European New Issue Loan Spreads Have Widened During Syndication



SOURCE: S&P LCD. As of August 31, 2018.

MARTIN HORNE
Head of Global High Yield Investments

DAVID MIHALICK
Head of U.S. High Yield Investments

1. As of September 25, 2018.
2. As of September 14, 2018.
3. Earnings before Interest, Taxes, Depreciation and Amortization.