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Azhar has 20 years direct experience of investing in an array of strategies across the global fixed income and leveraged finance arenas. He trained as a chartered accountant with Deloitte before starting his investment career as a high yield credit analyst at Gulf International Bank in London. He subsequently became Head of Corporate Debt responsible for IG & HY absolute and relative return strategies. He left to join Insight as Head of HY & Leveraged Loans before joining RLAM initially as Head of Global High Yield where he has successfully launched strategies across the global credit spectrum. Azhar holds a BA in Economics & Law from SOAS, University of London and obtained a MSc in Behavioural Science from the London School of Economics in 2018.

“ We anticipate a good year ahead for global high yield markets – following the market turbulence in the summer ”

High yield markets: Looking good for 2022 after August reboot

We've been very positive on global high yield since central banks stepped in so promptly to support markets on an unprecedented scale following the initial impact of Covid-19 in March 2020. It was hard to be anything else, particularly once the Federal Reserve (Fed) committed to buying corporate bonds as well as government debt, and that position has served our clients well over most of the period since then.

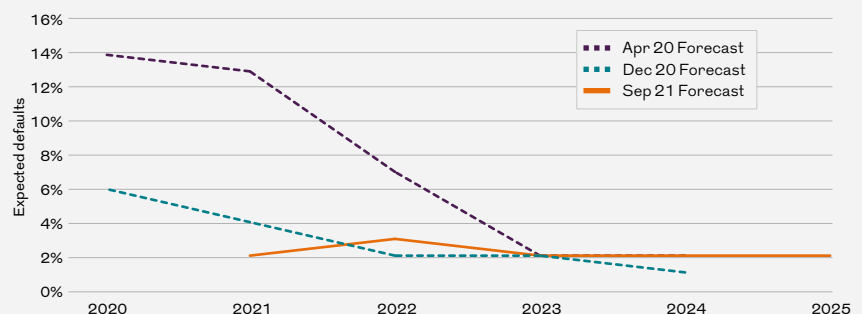
While it may not be a surprise that we remain bullish on global high yield going into 2022, a lot has changed under the surface for us to retain this positive view. I would certainly have given a very different answer if I'd been asked at the beginning of August 2021. At that time, the yield on the global high yield market was down at around 3.8%, having started the year at 4.2% – at that level, it was difficult to see significant upside for the

market as a whole, although particular credits still had potential.

Since then, however, the impact of Evergrande's very public travails in the Chinese real estate sector, and the subsequent broader shift in sentiment on government bond markets, have rebooted global high yield. With the market yield now around 4.8% (a 20% premium to the start of 2021), we see good potential for the year ahead.

Defaults are at the lowest level for over 20 years – at around 0.5% in the US and 1% globally, because of China – and the distress ratio is also very low, so defaults will remain low over the foreseeable future. Issuers have refinanced their debt at record levels (c. \$300-400b in the nine months of 2020 and \$500b in 2021) and half the market has been extended, so the default climate should be more positive.

Market expectations of defaults



Source: S&P Global Ratings Research and S&P Global Market Intelligence's CreditPro as at 30 September 2021.

High yield markets are clearly supported at current levels and there is now a much stronger buffer against higher defaults or a change in approach by the Fed. At the time of writing, the market is discounting three rate hikes in 2022 – we can say with confidence that if interest rates were to rise faster than that, high yield would outperform the fixed income market as a whole; yet, if rates were to increase by less than the anticipated amount, this would also probably be positive for global high yield. This is quite a sweet spot.

While our overall position is clear, it's harder to anticipate which areas of the market will outperform. With less economic stress, sector dispersion is lower than it was 12 months ago – energy has roared back over 2021 as oil prices have risen, and Covid-19 reopening trades have materially played out.

Instead, the dispersion in returns may be driven by regional factors. In particular, I would highlight emerging market debt (EMD) as an area of weakness:

- Dollar strength tends to be negative for EMD.
- The economic slowdown in China is likely to have a greater effect on the region than is currently suggested by consensus – given the sheer scale of the Chinese economy, it will take time to adjust to growth of 3-4%, rather than 7%.

- Contrary to many people's belief, EMD is higher quality with a greater share in the BB rated band, so will be more sensitive to interest rates.

Otherwise, I would have expected European high yield to outperform the US, but the US has pulled back so much since August that I no longer see the scope for European outperformance.

What might we expect from the different strategies?

- Short duration funds: we believe that the front end will remain a relative safe haven, and we believe that we could see potential returns of 3.5-4%.
- Global High Yield: we believe that this has a potential return range of 4-6% – with market defaults low, we expect excess spreads to be more than robust for any expected volatility coming from the interest rate environment. However, the long end is a real puzzle and there will be volatility here if inflation remains sticky. Nonetheless, in my view, spreads are wider than they should be given equity cushions, the amount of debt being used to service interest and the quality of the market (i.e. percentage in BB rated credits).

- The Multi Asset Credit Fund (MAC) is two-thirds invested in floating rates and I believe that this has also has a prospective returns range of 4-6%. In my view, this strategy benefits from its starting yield point and its relative rate immunity should provide some protection for the year ahead if we start to see rate rises.

Interest rates will probably be negative for returns overall, but may not be as bad as some fear.

In summary, we anticipate a good year ahead for global high yield markets – following the market turbulence in the summer, the safety cushion should be big enough to cope with most foreseeable scenarios. Those who are less familiar with global high yield may be less aware of the significant improvement in the quality of the asset class. We've written about this in detail, but the key point is that the high yield market is much higher in quality than it was several years ago and broad analyses over the longer term tend to miss this.

As an aside, I note that at the time of writing, cryptocurrencies have a market capitalisation of c \$2.5tn – which is very similar to global high yield markets. At the current ratings for high yield, I know which one I would rather be in!



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