GIA PARTNERS

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Global High Yield: Crash or Correction

For some time we have been talking about record new issuance in the credit markets and the risk associated with large money flows into the high yield market as investors reached for yield. Last month, as demand peaked, yields hit historic lows dipping below 5%[1]. However, the yield was consistent with low U.S. treasury yields and an expectation treasury yields would remain low for some time.

Factors leading to the downward spiral in anticipation of today's (June 6) Non-Farm Payroll number

- Interest rates moved sharply higher in May as a result of the Fed's comments that were interpreted to mean they were thinking of stopping their purchases of mortgages and treasuries sooner than expected.
- The rise in interest rates prompted high yield investors to start selling, and they took funds out of ETFs and mutual funds out of fear rates would rise further.
- In emerging markets many investors are absolute return players and May's sharp move higher in interest rates led holders of EM credit to sell.
- Credit markets experienced record issuance during the first 5 months of 2013. Some of this paper was purchased by investors on a short term basis or held by the underwriters. The excess supply created a glut of securities as rates began to move higher.
- When the selling began, the street was reluctant to provide liquidity to the market and this exacerbated the price decline. This led to more money being yanked from the market last week (a record $4.6 billion was withdrawn from HY ETFs and Mutual Funds and $1.5 billion from EM funds[2]).

Why we believe this is a correction and not a crash

Most of the factors cited above are technical and not fundamental. Corporates continue to produce healthy earnings and default rates remain well below historic averages. We expect growth in the US to be muted for the foreseeable future which implies rates may rise, but not as sharply as in May. Investors are still looking for yield and the Fed will not likely withdraw from the market before year-end. We believe the price action we experienced over the last two weeks is a healthy correction and with yields now above 6%[3], global high yield markets are looking attractive.

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[1] Bank of America Merrill Lynch US High Yield Cash Pay Index, May 9, 2013
[2] AMG Lipper Weekly Fund Flow Report Ending June 5, 2013
[3] Bank of America Merrill Lynch US High Yield Cash Pay Index, June 6, 2013