

High Yield Talking Points

Winners and losers

At the start of the month we predicted that single-Bs would outperform double-Bs over the remainder of the year, but that stock picking was more important than a blanket single-B Overweight. In other words, we were **more concerned about dispersion than decompression**, given that the ratings curve was already steep (see [High Yield Talking Points: Trade versus technicals](#)).

Since then, single-Bs have returned 0.7% more than double-Bs, with the latter negatively impacted by the back-up in rates that occurred in during the first half of the month. The real story, however, is the wide range of performance within the market.

One way to look at this is to compare the standard deviation of high yield bond returns over the month, with the average move. For example, if the average price change is small, but the standard deviation is large, this tells us that **there are a lot of big winners and losers, which cancel each other out** at the index level; this is what we see over the past two months, which are highlighted in Figure 1. In Table 1 we show the largest single name moves over the month-to-date.

European Credit Strategy

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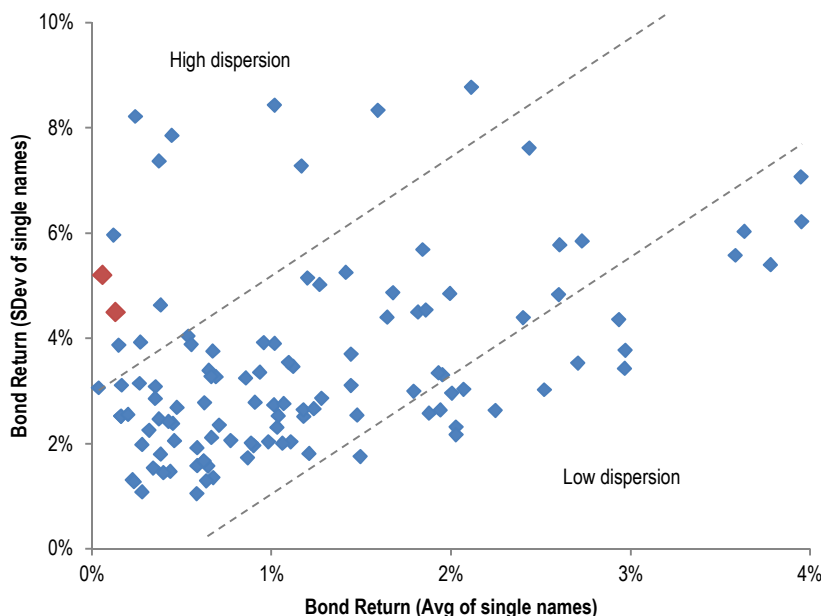
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Figure 1: Dispersion of European High Yield Bond Monthly Price Changes



Source: J.P. Morgan. Average returns are absolute values, i.e. not positive or negative. Red data points are Aug and Sep 2019. Dashed lines are for context only.

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We viewed our move down the ratings spectrum as a **tactical trade through to year end, given the low visibility we have for the economy heading into 2020**. The premise was that it would take time for weakness to spread beyond Industrial and trade-related sectors that are the epicentre of credit stress. **This week's disappointing Euro area flash PMI is testing that thesis**, showing clear signs of spillover to the broader economy.

Table 1: Biggest High Yield Bond Price Changes

BIGGEST GAINERS							BIGGEST LOSSES						
ISIN	Ticker	Cpn	Maturity	30-Aug	27-Sep	Chg	ISIN	Ticker	Cpn	Maturity	30-Aug	27-Sep	Chg
XS1082472587	BOPRLN	5.5	Jul-21	50.30	61.66	11.36	XS1733958927	PROGST	3.25	Dec-24	87.10	54.74	-32.36
XS1082473395	BOPRLN	4.375	Jul-21	51.94	62.25	10.31	DE000A19FW97	STLNSW	5.625	Jul-22	82.76	60.00	-22.77
XS1577958058	SUP	6	Jun-25	84.71	94.73	10.02	XS1028959754	ALDESA	7.25	Apr-21	55.25	39.31	-15.93
XS1458413728	LECTA	6.5	Aug-23	32.68	41.99	9.31	XS1756722069	KMEAGR	6.75	Feb-23	95.94	81.04	-14.91
XS1710653137	TAKKO	5.375	Nov-23	86.62	95.47	8.85	XS1608040090	SENGR	3.875	Oct-22	25.35	13.47	-11.88
XS1710653483	TAKKO	5.375	Nov-23	84.19	92.92	8.73	XS1713475058	LPLAYG	5.375	Nov-22	87.88	76.02	-11.86
XS1647645081	HEMABV	8.5	Jan-23	72.05	80.41	8.36	XS1577963058	NORICA	4.5	May-23	92.88	82.19	-10.69
XS1458414023	LECTA	6.375	Aug-22	34.42	41.96	7.55	XS1733231663	TCGLN	3.875	Jul-23	16.51	6.00	-10.51
FR0012369122	COFP	3.58	Feb-25	84.54	90.44	5.90	XS1531306717	TCGLN	6.25	Jun-22	16.76	6.47	-10.30
FR0012074284	COFP	4.048	Aug-26	84.65	90.40	5.75	XS1713858576	BORMPH	3.5	Nov-24	95.10	87.46	-7.64
XS0880578728	ENQLN	7	Apr-22	80.96	86.25	5.29	XS1713464953	EAGRUY	5.375	May-23	96.86	90.25	-6.61

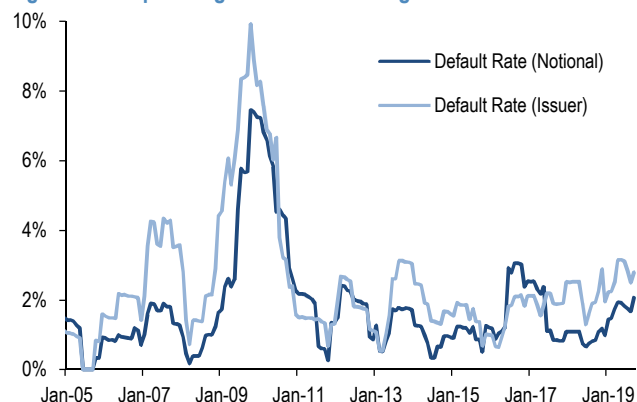
Source: J.P. Morgan, Bloomberg.

For now we stick with our single-B Overweight, not wanting to change positioning too frequently, and on the back of a single economic data point. We also believe that technicals remain strong, and that default rates, while clearly up from a year ago, will stabilise at around the current level.

This week's Thomas Cook filing pushes the notional-weighted rate up to 2.1%, close to our 2% target (Figure 2). There are three defaults from 4Q18 that will fall out of the 12 month lookback period over the coming quarter; these will likely be replaced by fresh defaults in our view, for example, Lecta, which announced a [recapitalisation plan](#) this week.

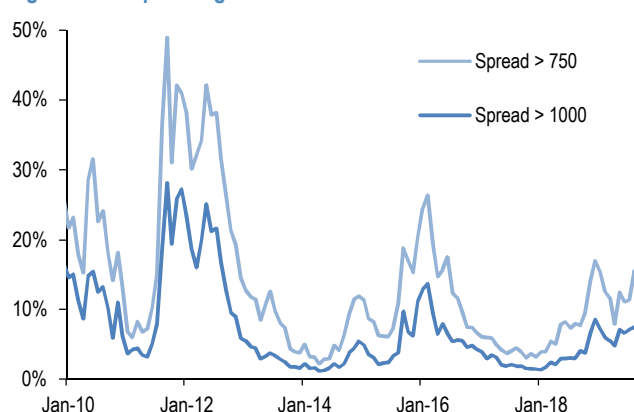
The distressed ratio – which we define as the proportion of the market trading wide of 1000bp – has been stuck at a somewhat elevated level for some time now (Figure 3). To us this indicates that dispersion will remain a relevant theme for some time to come. Our preferred way to play this is via **Crossover-Main decompression in the new S32 indices**.

Figure 2: European High Yield 12M Trailing Default Rate



Source: J.P. Morgan.

Figure 3: European High Yield Distressed Ratio



Source: J.P. Morgan.

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