

High Yield

Single-B Selection at a Premium

We have a preference for single-Bs in 2020, as the high call-constrained rate of BBs limits upside and decelerating growth should weigh on CCCs. Dispersion has increased across high yield, especially for single-Bs, placing an increased importance on credit selection. We highlight select single-Bs that screen as cheap.

While global growth has slowed, the macro backdrop for US credit should remain supportive in 2020. We forecast modest spread tightening and total return for the high yield index of 3.5-4.5% next year, as a slight increase in defaults should weigh on returns in 2020 more than this year.

We favor single-Bs, expecting spread tightening of 25-30bp for the cohort. While we expect the spread for the US High Yield Index to remain near current levels, upside for BBs is limited, given the high rate of BB bonds trading above next call price. Conversely, decelerating growth should weigh on CCCs, as investors remain cautious about the lowest-rated portions of the market. As a result, we believe the path of least resistance for spread compression next year is from single-Bs.

Given this preference, we believe it is worth taking a deeper look at the cohort, specifically in regards to trading levels within the rating bucket. While dispersion has increased across high yield, it has been greatest for single-Bs, which places increased focus on single name selection. The bifurcated performance between higher and lower quality has led to a sharp decrease in the number of bonds trading close to the levels of the index as a whole. Figure 2 shows the percent of bonds with yield to worst within a range of 100bp in either direction to the high yield index since 2000. The number of bonds within this range has declined significantly this year and now sits at 22%.

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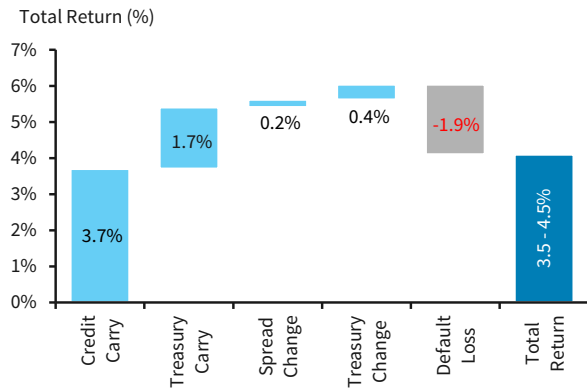
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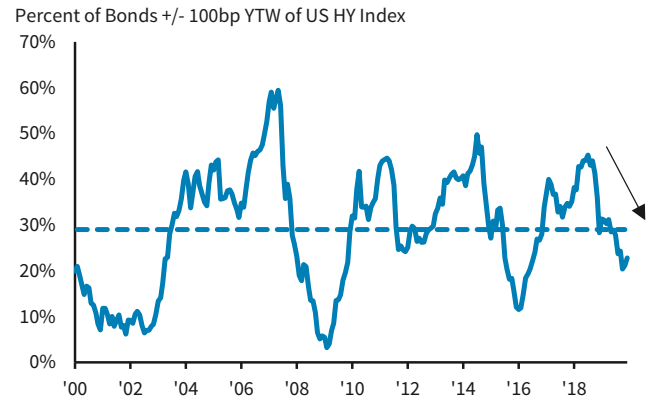
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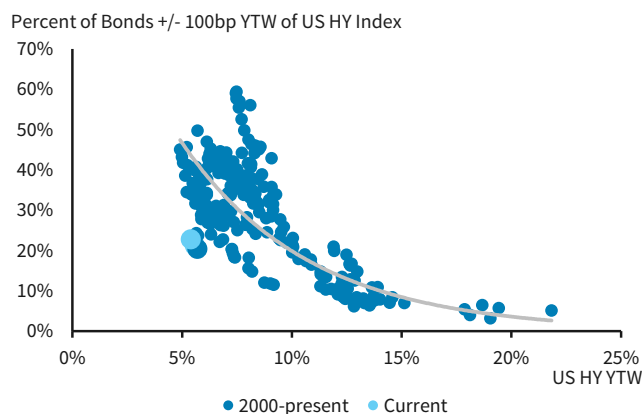
FIGURE 1. Breaking Down the Components of the 2020 Return Forecast

Source: Bloomberg, Barclays Research

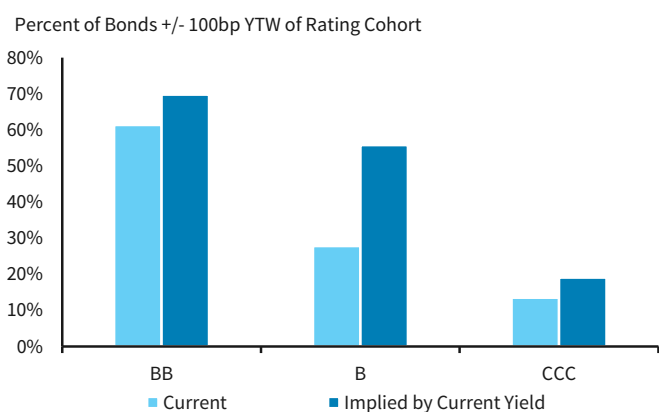
FIGURE 2. Few Bonds Currently Have a Yield Close to that of the IndexNote: Dashed line is average level from 2000 to present.
Source: Bloomberg, Barclays Research

Understandably, the rate of bonds within this yield band is greater during periods of compressed yields, while fewer bonds trade close to the yield band when the index is at greater yields. In Figure 3, we compare the index yield to worst to the percentage of bonds within that 100bp band. The current yield of the index implies that 44% of bonds should be trading within the yield band – double the current level. As we noted in [Better to 'B' stuck in the middle](#), while this analysis points to elevated dispersion across all ratings cohorts, single-Bs are the most dislocated.

Specifically, only 28% of single-B bonds trade within 100bp of the single-B index yield of roughly 5.4%, less than half of the implied rate (Figure 4). In fact, the current relationship is the largest differential between the actual and the implied rates, meaning that single-Bs are at a record level of dispersion based on where the single-B index trades. For comparison, the current rate for BBs and CCCs is lower than the expected levels, but much closer than single-Bs are. The underperformance of energy this year has contributed to increased dispersion, but when we run the same analysis excluding energy bonds, current levels are still well below expected, especially for single-Bs.

FIGURE 3. The Low Yield of the Index Implies Twice as Many Bonds Should Trade Close to the Yield of the Index

Source: Bloomberg, Barclays Research

FIGURE 4. The Rate of Single-Bs within +/- 100bp of the Index Yield to Worst Is Well below the Long-Term Average and Implied Level

Source: Bloomberg, Barclays Research

We believe this places an increased emphasis on credit selection for single-Bs in 2020, as there has been a clear bifurcation in yields of this cohort. In Figure 5, we highlight single-B bonds on which our fundamental analysts have an Overweight rating and that have a yield to worst of at

least 6.4% (100bp wide of the single-B index of 5.4%). We exclude distressed bonds (OAS of at least 1000bp) and less liquid bonds (amount outstanding of less than \$500mn).

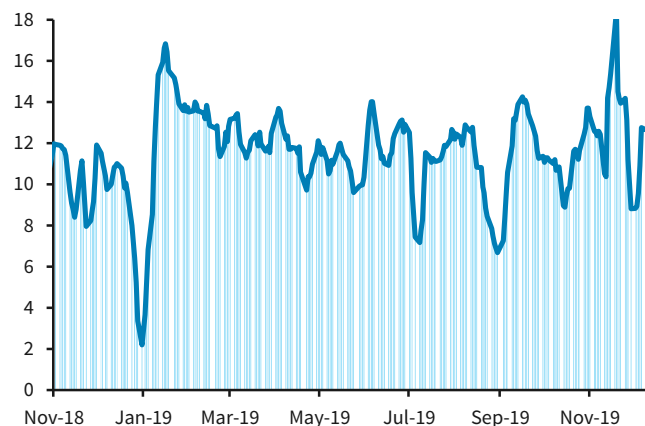
FIGURE 5. Select Overweight Rated Single-B Bonds

Issuer	Ticker	Coupon (%)	Maturity Date	Price (\$)	Yield to Worst (%)	OAS	Rating	Sector	Analyst
APX Group	APXSEC	7.875	12/1/2022	100	7.9	570	B3	Consumer Cyc Services	Greggory Price, CFA
CenturyLink	CTL	7.600	9/15/2039	103	7.3	528	B1	Wirelines	Jeff Harlib
Cleveland-Cliffs	CLF	5.875	6/1/2027	95	6.7	480	B1	Metals and Mining	Brian Lalli
Community Health	CYH	8.625	1/15/2024	104	7.2	526	B3	Healthcare	Rishi Parekh
Community Health	CYH	8.000	3/15/2026	100	8.0	596	B3	Healthcare	Rishi Parekh
Endo	ENDP	7.500	4/1/2027	97	8.0	612	B1	Pharmaceuticals	Rishi Parekh
Hudbay Minerals	HBMCN	7.625	1/15/2025	103	6.7	468	B3	Metals and Mining	Brian Lalli
Liberty Interactive	LINTA	8.250	2/1/2030	100	8.3	650	B1	Media Entertainment	Sandeep Gupta
Meg Energy	MEGCN	6.375	1/30/2023	99	6.8	481	B1	Independent	Paul Chambers
Meg Energy	MEGCN	7.000	3/31/2024	99	7.2	503	B1	Independent	Paul Chambers
PDC Energy	PDCE	5.750	5/15/2026	95	6.7	484	B1	Independent	Paul Chambers

Source: Bloomberg, Barclays Research

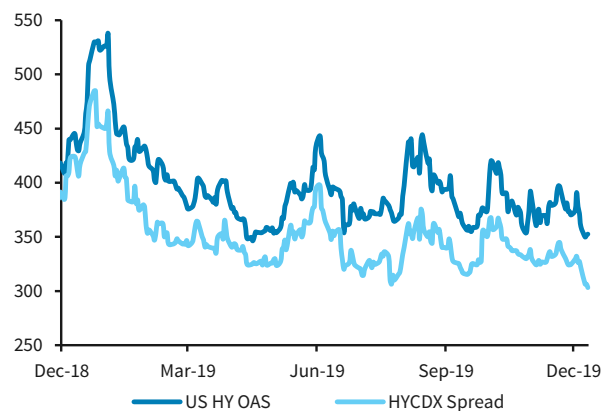
US High Yield At a Glance

FIGURE 6. High Yield Average Institutional Trade Volume (\$bn)



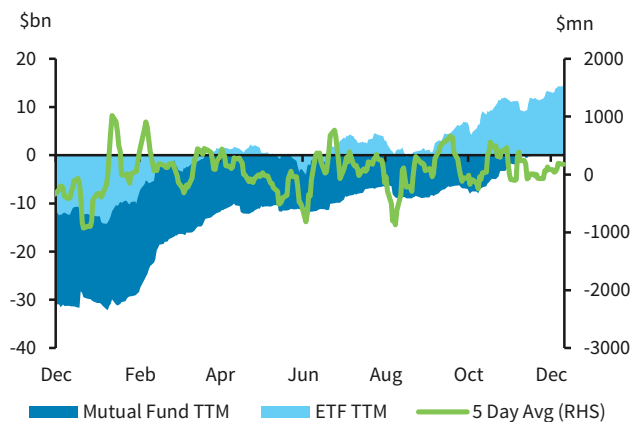
Note: Includes both registered and 144A volumes
Source: FINRA TRACE

FIGURE 7. On-the-Run HYCDX versus US High Yield Index (bp)



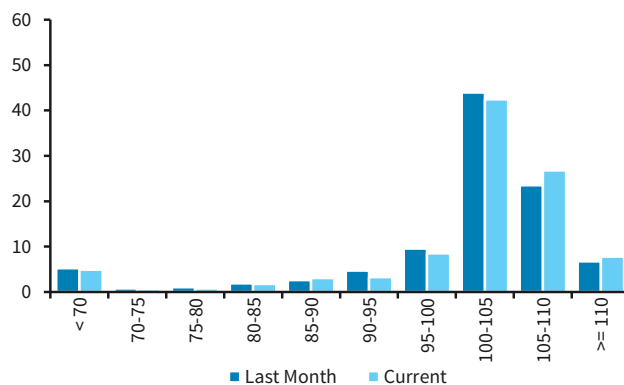
Source: Barclays Research

FIGURE 8. Flows to High Yield Mutual Funds and ETFs



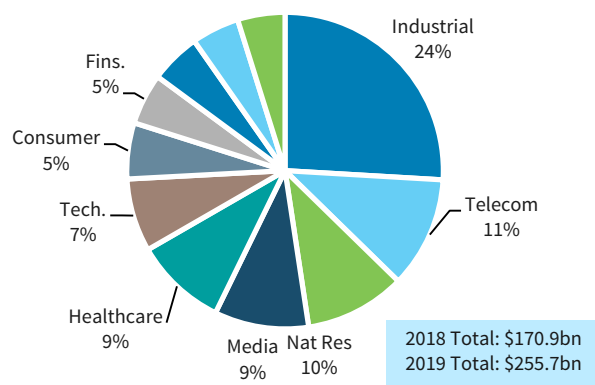
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Source: EPFR

FIGURE 9. High Yield Index Price Distribution by Par (%)



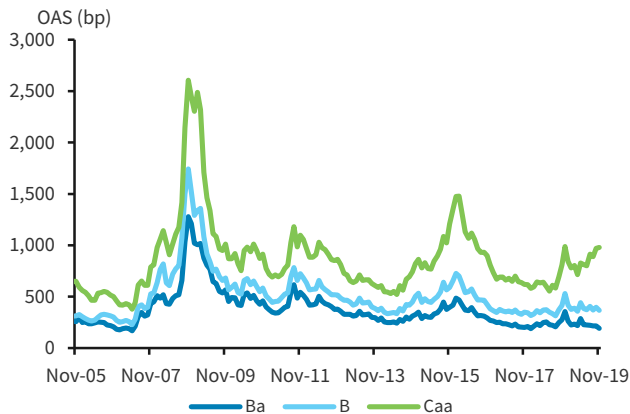
Source: Barclays Research

FIGURE 10. High Yield Supply by Sector



Note: 2019 new issue data as of December 11.
Source: Bloomberg Barclays Indices

FIGURE 11. High Yield Spreads by Credit Quality



Source: Bloomberg Barclays Indices

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CTL 7.6 09/15/39, Overweight (USD 103.25, 11-Dec-2019)

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CYH 8 03/15/26, Overweight (USD 99.75, 11-Dec-2019)

CYH 8 5/8 01/15/24, Overweight (USD 104.00, 11-Dec-2019)

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LINTA 8 1/4 02/01/30, Overweight (USD 99.50, 11-Dec-2019)

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MEGCN 6 3/8 01/30/23, Overweight (USD 98.75, 11-Dec-2019)

MEGCN 7 03/31/24, Overweight (USD 99.25, 11-Dec-2019)

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ENDP 7 1/2 04/01/27, Overweight (USD 97.00, 11-Dec-2019)

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