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Amid the Volatility, HY Portfolio Products Sub in for Bonds

- The OAS of the Bloomberg Barclays US High Yield Index widened 74bp in May, as growth and trade concerns led to a reversal in risk sentiment.
- Notably, the weakness in spreads did not lead to a pickup in TRACE volumes; in fact, bond activity remained subdued.
- Instead, it appears that investors are substituting bond trading with portfolio product trading.
- CDX.HY and ETF volumes rose sharply in May, and both products underperformed cash benchmarks. Anecdotal evidence also suggests that iBoxx HY TRS volumes picked up last week.
- The increase in portfolio product trading activity should not be surprising as CDX and ETF positioning have historically shown a strong relationship with spread changes.
- We expect investors to continue to use portfolio products to manage liquidity and beta exposure, and, as a result, portfolio product volumes are likely to grow during periods of volatility at the expense of bond volumes.
- From a valuation perspective, despite the underperformance of CDX.HY, spreads do not appear dislocated to cash. However, we found cheapness in products that track cash benchmarks, such as ETF and TRS. For investors looking to go long risk in HY, we have a preference for using HYG or iBoxx HY TRS in the short term. We would also recommend implementing a spread compression trade via long HYG or iBoxx HY TRS versus CDX.HY to take advantage of the dislocation in spread performance.

May 2019: Spreads Moved Significantly Wider. But Bond Volumes Remained Subdued