Asset Management

HIGH YIELD: HARVESTING INCOME

As market volatility and economic uncertainty persists, investors are searching for defensive strategies and high-income opportunities. Although rising rates provide interesting opportunities to reinvest at higher coupon levels, market volatility and declining prices create uncertainty for many fixed income investors. The balancing act between income and price returns raises an interesting question—does income or price tend to drive total returns?

For most risk assets, total return is achieved predominantly via capital price return, but not in high yield. Over long-term periods, income tends to drive the bulk of the total return for high yield bonds. In fact, over 100% of the cumulative total return in global high yield since January 2015 has come via income. Exhibit 1 shows that income accrues over time and while the price/capital return moves around, it is a much smaller part of the overall total return. Looking at monthly data from 2015-2022, historically, income has comprised around 85% of the total return as most bonds are taken out above par. We believe this highlights a critical point—it is not timing the market that is important in high yield, but rather, it is the time in the market that drives long-term returns.

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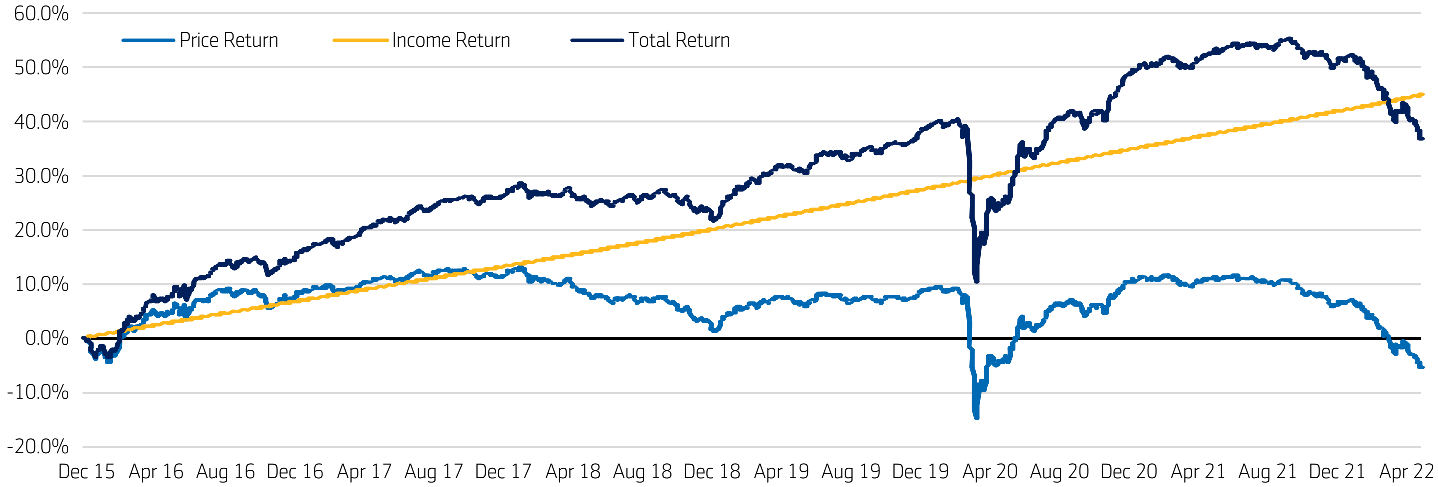
For asset allocators interested in timing their entry to the asset class, we believe it is important to remember the value of income over time. For this reason, we believe a strategic allocation to high yield offers compelling opportunities to generate high income and competitive long-term returns.

A strategic standalone allocation to high yield can be further supplemented by tactical increases or decreases depending on current valuations. This dynamic approach can help capitalize on high income and capital appreciation opportunities. For example, when valuations are relatively cheap and capital appreciation potential is compelling, as we are seeing in the current environment, an increased allocation to high yield may help enhance long-term total returns. While price movements are a component of total returns, the harvest from income typically drives long-term returns in this asset class.

Exhibit 1: Income drives the bulk of total returns in high yield



Source: Bloomberg, BofA. Based on the ICE BofA Global High Yield Index. Reflects the total cumulative return for the index split into the return from prices and income. Based on monthly data from December 2015 to March 2022.

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AdTrax code: 4791578.1.GBL
Exp Date: June 30, 2024