

High Yield 3Q Survey: Much Cash, Cheap But Underweight



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Team: Strategy
BI Chief European Credit Strategist

1. Junk Spreads Seen Cheap, Lots of Cash Yet Underweight: BI Survey

(Bloomberg Intelligence) -- Investors have had their fingers burnt in high yield before, which is why they are net underweight in euro junk despite seeing spreads as the cheapest ever in our 3Q survey. Investors expect low defaults but more of them than in the past two surveys, and just 10 billion euros of index-eligible supply (much less than previously). The cash proportion in junk portfolios is at its highest ever, which should support spreads.

Rising rates and central banks are runaway winners in driving returns, ahead of the war in Ukraine. Euro junk and high grade are seen at parity -- a first. By geographical preference, the US beats Europe comprehensively. BBs are top by rating, with CCCs the most avoided. Banking and communications are the most favored sectors; cyclicals the least. (07/19/22)

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Survey Topics

Market View

2. High Yield 3Q22 Outlook & Survey: BI Analyst Briefing, August 2

Join Mahesh Bhimalingam, Chief European Credit Strategist, Bloomberg Intelligence on August 2 at 9 am London time, when he will discuss the results of the 3Q22 High Yield Survey and comment on the market outlook and trends in a Q&A format with George Flynn, Head of Credit at Wisealpha Technologies.

Please click on the image to register for the webinar. (07/19/22)

Click to REGISTER



Source: Bloomberg Intelligence

3. Spreads Seen Cheap Yet Underweight as Junk-Rout Fatigue Sets In

Investor sentiment in high yield has become fatigued after the 1H battering, with the asset class delivering 13.2% total-return losses year-to-date. Some 37% of respondents believe high yield will deliver positive returns in 3Q, but 46% have negative-returns expectations, with the net positive view dropping by 20% from last time. Yet junk valuations are seen as the cheapest ever, with 52% of

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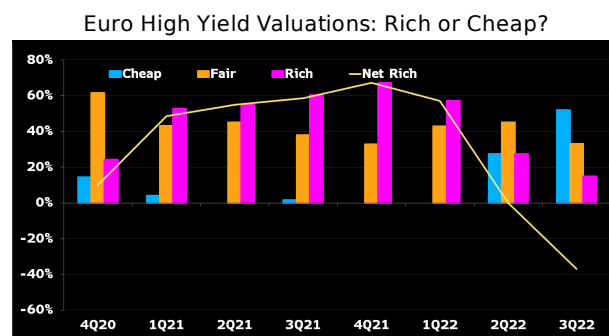
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respondents taking that view -- translating to a 37% net cheap view for 3Q (vs. 57% net rich in 1Q, when not a single respondent believed valuations were cheap).

However, despite the positive view on valuations, the damage in 1H demands caution as only 26% are now overweight high yield (with 42% underweight) for a net underweight of 17% vs. 9% net overweight in 2Q. (07/19/22)

4. Euro Junk Valuations Seen as Cheap for the First Time

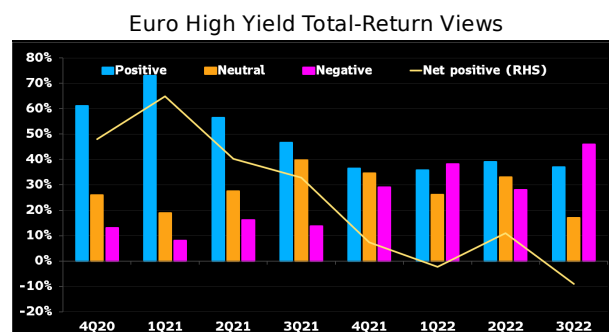
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Source: Bloomberg Intelligence

5. Yet Junk Return Views Turn Net Negative for 3Q on Rout

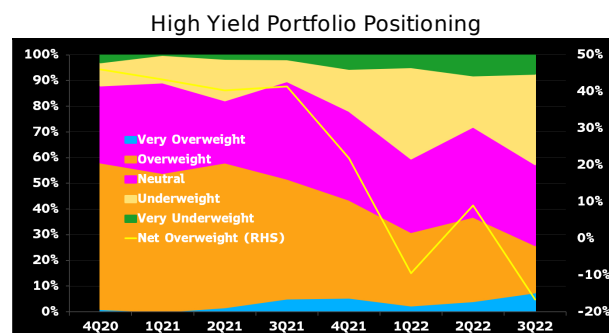
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Source: Bloomberg Intelligence

6. Rout Drives Junk Positioning Back to Net Underweight

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Source: Bloomberg Intelligence

Flows/Fundamentals

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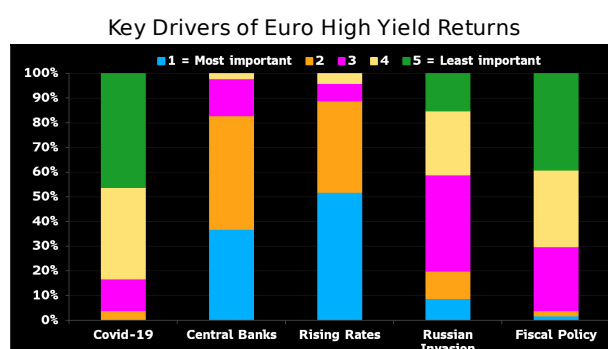
7. Default Expectations Low But Rise; Supply Expectations Decline

Respondents to our survey clearly believe that rising rates and central bank policy will be the key drivers of high yield returns -- much more than the Russian invasion of Ukraine. Default expectations are picking up slowly, with 73% saying there'll be fewer than three index defaults, but that number has dropped from 95% in 1Q. The survey mean picked up to 2.6 defaults but actual defaults are at zero. Cash in portfolios is very healthy with 79% having more than 3%, well above 4Q's 65%. This brings the survey mean to 6.8% cash -- the highest ever seen in our surveys.

This may result in the 10 billion euros of expected supply for 3Q (well below prior surveys) being easily digested. Index-eligible supply in 2Q was 5 billion euros vs. 12.7 billion predicted in the survey, and was accommodated despite market volatility. (07/19/22)

8. Rising Rates Top Central Banks, Russia as Junk Drivers

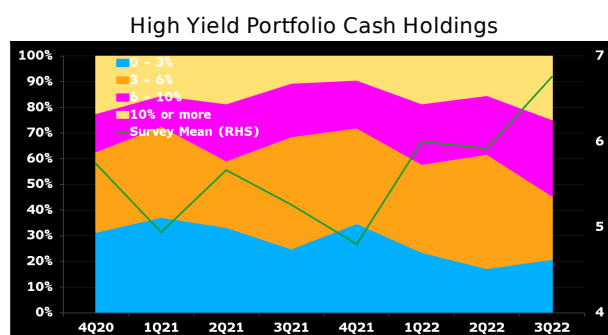
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Source: Bloomberg Intelligence

9. High Yield Portfolios Have Highest Cash Ever Seen (6.8%)

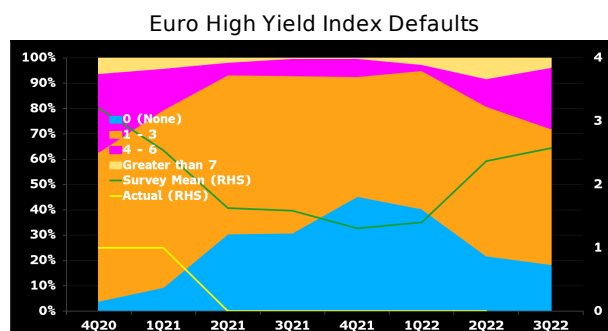
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Source: Bloomberg Intelligence

10. 28% See Four or More Defaults in 3Q; Actual Still at Zero

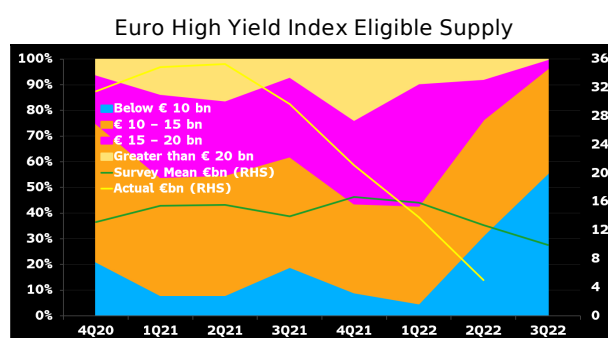
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Source: Bloomberg Intelligence

11. 10 Billion Euros of Junk Index Supply Expected for 3Q

(07/19/22)



Source: Bloomberg Intelligence

Relative Value

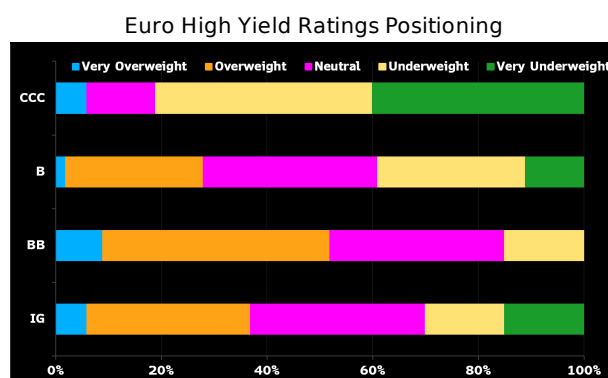
12. BB Top Rating; US Junk Favored vs. Euro Junk; High Grade at Par

Credits rated BB are the clear preference in this survey, ahead of single-B names, with a clear underweight on CCCs. Banking and communications are the most-favored sectors, with consumer cyclicals the least preferred. US high yield is now more entrenched in preference to euro junk. This has flipped since the beginning of 2022.

Euro high yield and euro investment grade are now seen as near equal in terms of return outlook for next quarter -- the first time this has happened since we started our surveys. (07/19/22)

13. BB Overweight; B, High Grade Neutral; CCC Underweight

(07/19/22)

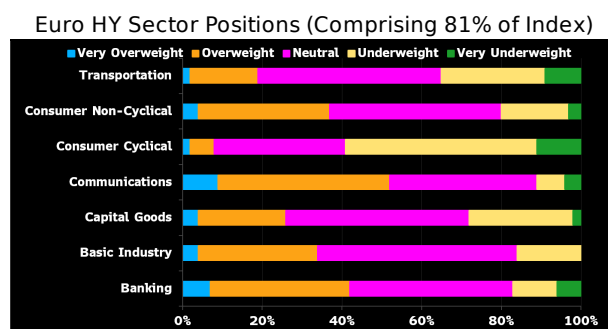


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14. Banking, Communications Overweight; Cyclical Underweight

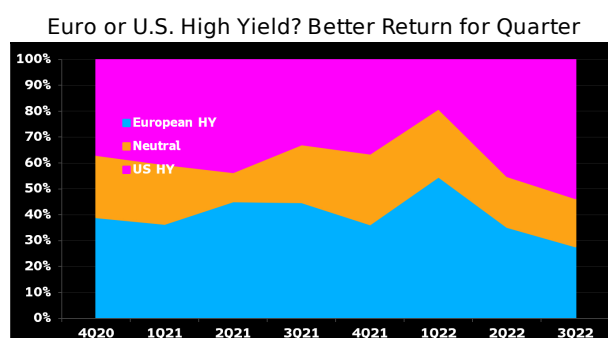
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Source: Bloomberg Intelligence

15. Most Ever Expect US Junk To Beat Euro in 3Q

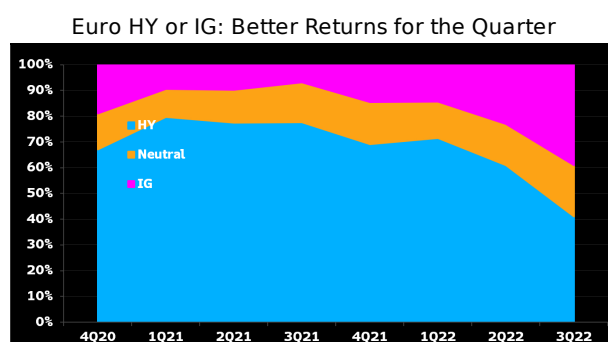
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Source: Bloomberg Intelligence

16. Junk And High Grade Seen Equally Good for the First Time

(07/19/22)



Source: Bloomberg Intelligence

Response Mix

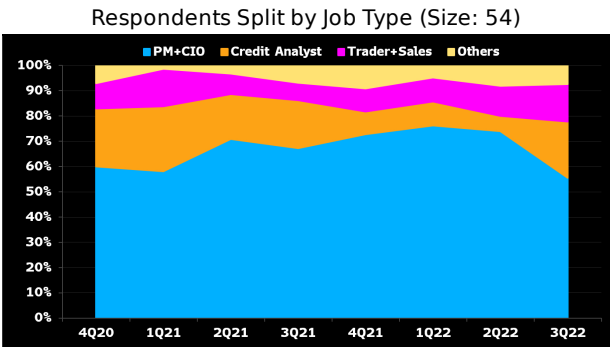
17. High Yield Survey Methodology and Respondent Mix

Our High Yield Survey for 3Q was conducted jointly by Bloomberg Intelligence and European High Yield Online. The survey, a regular quarterly feature, was conducted between June 20-July 15. The questions are based on the Bloomberg Euro High Yield Index (LP02, also called I02501), including sectors, ratings, supply and defaults. The survey had 54 respondents, dominated as usual by portfolio

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managers and CIOs (56% together) but less than prior surveys. For the cash in portfolio question, we have excluded non-buyside responses as not applicable. (07/19/22)



Source: Bloomberg Intelligence

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