WEEKLY MARKET RECAP: March 04 – March 08, 2024

Happy Friday, traders.

Welcome to our weekly market wrap, where we look back at these last five trading days with a focus on the market news, economic data and headlines that had the most impact on the financial market – and may continue to into the future for the US Dollar and other key correlated assets.

Given high short-term yields, many investors seeking income have recently piled into cash. Others, however, have been attracted to high yield (HY) bonds, given yields of close to 8% in a falling inflation, steady growth environment.

After two years of significant outflows, demand for HY has rebounded with January marking a third consecutive month of inflows. On the supply side, HY bond issuance also saw an uptick after hitting a decade low in 2022. However, demand pressures appear to be dominant, leading to a further 10bps compression of spreads year-to-date to 340bps. This spread reduction may also reflect a recent improvement in the quality of the HY index, with the bulk of bonds now rated BB and above. Moreover, near-term defaults should remain subdued as refinancing activity, which dominated the recent supply mix of HY bonds, has extended the maturities of most bonds well past 2027.

That being said, some companies rated CCC or NR are facing refinancing challenges amidst stiff rates, leading to above-average defaults in that sector and dampening the overall recovery rate. While this may not translate to a broader surge in defaults, at least in the short run, investors should recognize that spreads are priced for a perfect economic soft landing – they have only been tighter 5% of the time over the last quarter-century. Given the reinvestment risk of staying in cash, HY bonds present an attractive opportunity to lock in elevated yields. However, tight spreads and a wide dispersion in quality within the HY space point to the need for active management to achieve superior risk-adjusted returns.

Thanks for reading! Have a great weekend.

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