Flash High Yield

Written on
04 | 11 | 2020

The resumption of the pandemic

The resurgence in Covid-19 cases in Europe has prompted governments to adopt new restrictive measures to contain the epidemic and ease pressure on health care services.

Thus, France, the United Kingdom, Ireland, Wales and Greece have opted for a second lockdown. Other countries such as Spain, Italy, Belgium and the Netherlands have favored more targeted measures such as the closure of restaurants, bars and advanced curfews.

Markets reacted negatively to these announcements with European and U.S. stocks declining by 7.5% and 5.6% respectively during the last week of October[1]. Credit spreads also widened by +30 bps[2] and the United States and Europe underperformed (+36 bps and 31 bps respectively).

What are the market impacts?

"Can we expect a credit market reaction similar to that of March, with a spread widening of about 550 bps? »

The current situation is different from that of March 2020 for various reasons.

Firstly, at the sanitary level:

- Scientists now have a better understanding of the virus, resulting in faster recovery and discharge times.
- Significant progress has been made in developing a vaccine: 13 candidate vaccines are in phase 3 (last phase of approval) and scientists expect results by the end of the year (e.g. Moderna and Astra Zeneca with the University of Oxford[3]).

Then at the economic level:

- Lockdown measures are more flexible than they were the first time:
  - **More geographically localized**: affect some European countries and not 90% of the world's economies as in March (with the major emerging economies, the United States and Europe)
  - **More focused in terms of sector**: industry, construction and other sectors are not affected this time around.
- **Companies have completed most of their refinancing programs for 2020 and Q1 2021.** As a reminder, the volume of primary issues on the U.S. High Yield market reached $300 billion since the beginning of the year (twice as much as the average issuance over the last 5 years) and issuances for the High Yield Euro are

[1] Source : Bloomberg, indices Eurostoxx 50 et S&P 500
[2] Source: Source : Bloomberg, BofAML, indice global (HW00), euro (HE00), US (H0A0), 30/10/2020
[3] Source : Bloomberg, 30/10/2020

€ 60 billion. Thus, the element of surprise and the risk of a liquidity crisis will be less significant than during the first lockdown[4].

- **Debt repayment over the next two years will be relatively limited** in both Europe and the United States, following major refinancing operations and the extension of bond maturities in recent years:
    - In Europe, around € 50 billion of High Yield bonds is due by the end of 2022 (of which € 20 billion in 2021 and 80% on "BB" issuers with easier access to the market), which represents less than 15% of the total European High Yield market size.
    - In the United States, nearly $170 billion of High Yield bonds are due by the end of 2022 (of which less than $60 billion in 2021 and 50% on "BB" issuers), which also represents less than 15% of the total outstanding US High Yield market[5].

As a result, we estimate that these low maturities with a 2-year horizon (<15% of outstanding in both Europe and the United States) **limit the refinancing risk for issuers and consequently the prospective default** risk in the European and US High Yield markets. Indeed, despite the impact of the COVID-19 pandemic on the credit ratios of most High Yield issuers, we believe that they will be able to operationally recover over the next two years in order to be able to refinance themselves on the market under better conditions.

"What about corporate defaults? Will these new sanitary measures have an upward impact on default expectations and thus on short to medium-term spreads (3-6 months)?"

Impacts from new sanitary measures will depend on two parameters: the generalization of these new measures to other regions/countries in the world and their duration.

- **If the lockdown is of short duration (4/6 weeks) and is not generalized →** impacts on companies will be relatively small. We anticipate a widening of High Yield spreads from 70 to 100 bps which remains localized in certain sectors (retail, catering, hotel, leisure ...) and without significant impact on default rates in the medium term.

- **If the lockdown is longer than expected (2 to 3 months) and extended to other countries/regions→** the impact on businesses will be greater. Spreads could widen by 100 to 300 bps. The entire High Yield market would then be affected by a more significant increase in default rates in the most sensitive sectors (retail, catering, hotels, leisure ...)

In conclusion, it is still too early to draw definitive conclusions on the impact of the new health measures in Europe. **Uncertainty about the evolution of the pandemic remains high**.

[4] Source : Bloomberg, 30/10/2020
[5] Source : Bloomberg, 30/10/2020

The health consequences of a second wave will probably be weaker than the first one, thanks to medical progress and the ability of the population and the medical community to better understand the pandemic.

On the economic level and the solvency of companies, **the consequences on the credit market are not expected to be similar to those of the first wave** (+ 550 bps) due to the support already put in place by central banks, the current liquidity situation of companies which have largely covered their cash needs for the end of the year and Q1 2021, and the choice of governments to better target health measures.

Our convictions

At this stage, it is necessary to be attentive to sector exposure, issuer quality and capital structure to be able to deal with the two aforementioned scenarios.

Thus, we remain very cautious in our allocation to **the sectors that are the most impacted** by this pandemic, notably: non-food retail, restaurants, hotels, commercial and tertiary real estate (offices, retail), leisure (travel, games, sports, cinema, theater, amusement parks), air transport and all related sectors (rental, airport services, etc.).

We also pay close attention to the **quality of the issuers** and **to our position in the capital structure** of issuers operating in these sectors.

In these sectors that we consider to be sensitive, we are mainly exposed to Investment Grade/Fallen Angel or BB issuers. Our exposure to pure High Yield issuers is in the form of Senior/Secured bonds.

Disclaimer

Main risks include: capital loss, interest rate, credit risk, default risk.

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