COLUMBIA THREADNEEDLE INVESTMENTS

High Yield forecast update

Default projections are down

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Our research team periodically provides a credit default forecast to be used across our portfolio management teams to gauge both specific and relative asset class risk for high yield (HY) bonds. The team of analysts evaluates the companies that they cover and assigns a specific probability of default to those companies. This bottom-up method is intended to identify individual companies as well as to evaluate overall sector and asset class risk through aggregated bottom-up company analysis.

High yield bond market outlook

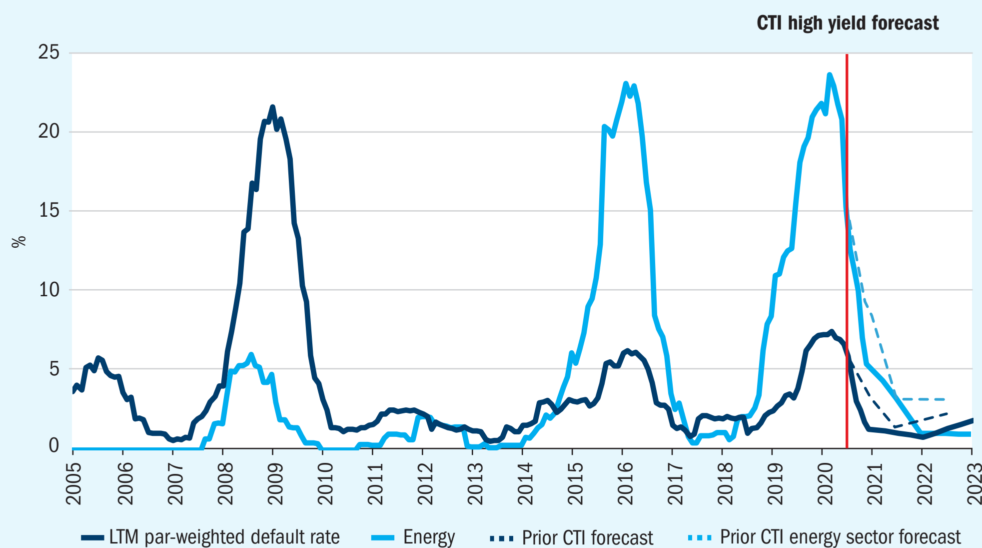
Exhibit 1: Columbia Threadneedle forecast default rates

Par-weighted forecast	Forward 12-month	Forward 24-month
Total default rate	0.8%	2.7%

Source: Columbia Threadneedle Investments High Yield Research team, as of October 2021. The 24-month forecast is cumulative and incorporates 12-month defaults. Forecast is for the High Yield Research team coverage universe of approximately 590 issuers or 85% of the HY universe.

- The par-weighted default rate is forecast to be 0.8% for the forward 12-month period and 2.7% for the forward 24-month period (cumulative). These are down from our last forecast in April 2021 of 1.4% and 3.6%, respectively. As of August 31, 2021, Bank of America Merrill Lynch calculated the last 12-month actual default rate to be 1.3%, down from a peak of 7.4% in November. These expectations are notably below the long-term default rate average of around 3.5%.
- The decline in the forecasted default rates was driven by improvements in expectations for the energy, transportation/airlines and leisure sectors. These sectors continue to see fundamental improvement in their medium- to longer term outlooks as their businesses recover from COVID, and as they benefit from robust capital market availability.
- The chart (exhibit 2) shows historical and forecast HY defaults, with the dark blue line representing the overall HY market default rate and the lighter blue line the energy sector. Our previous forecast is shown in the dashed line.

Exhibit 2: High yield par-weighted default rate — historical and forecast



Source: Bank of America Merrill Lynch; Columbia Threadneedle Investments High Yield Research team, as of October 2021.

Drivers of the lower 12-month forward-looking default forecast

- Strong capital market access for all companies, inclusive of the sectors that continue to be impacted by the COVID-19 pandemic, which has facilitated improvements in liquidity and maturity profiles. High yield is tracking to have its busiest year on record from a debt issuance perspective, following a record year in 2020.
- The emergence of the delta variant has not significantly impacted the outlook for business fundamentals.
- The quality of the high yield market has increased. Par value of the market has increased to $1.5 trillion from $1.2 trillion pre-COVID, and BB-rated credits as a percentage of par value have grown to 54% from 49% pre-COVID. Year-to-date 295 U.S. high yield companies have been upgraded totaling $467 billion, more than double the upgraded volume in 2020.

Potential risks to the forecast

- There is a modest risk of higher defaults due to uncertainty regarding the long-term impact of COVID-19 on sectors that have been most vulnerable to the effects of the pandemic and to the extent these sectors do not return to pre-pandemic levels of profitability.
- The sectors where we see the most risk for defaults to increase are in the leisure and transportation sectors.

In summary, the outlook for defaults is relatively benign, as the market remains robust with spreads and all-in yields that remain attractive to companies.

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