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 internally across 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

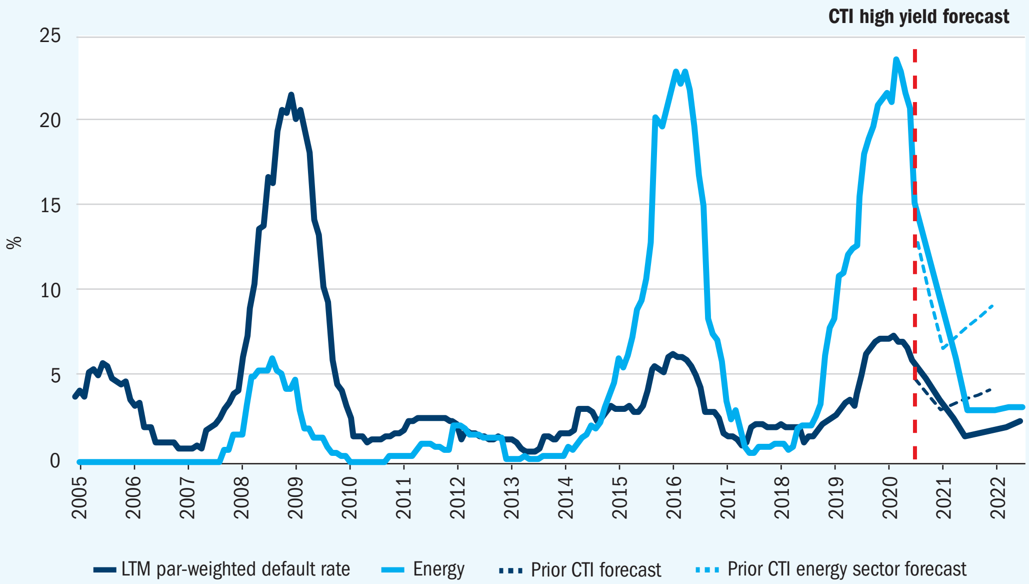
Exhibit 1: Columbia Threadneedle forecast default rates

Par-weighted forecast	Forward 12-month	Forward 24-month
Total default rate	1.4%	3.6%

Source: Columbia Threadneedle Investments High Yield Research team, as of April 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 1.4% for the forward 12-month period and 3.6% for the forward 24-month period (cumulative). These are down considerably from our last forecast in September 2020 of 2.9% and 7.2%, respectively. As of March 31, Bank of America Merrill Lynch calculated the last 12-month actual default rate to be 5.9%, down from a peak of 7.4%.
- Energy has led default activity by par value and by the number of defaults; however, our expectations for the sector have declined as WTI oil prices have increased, HY debt and equity markets have been open to providing capital, and fallen angels and bankruptcies have increased the quality of the HY E&P sector.
- The chart below (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 March 2021.

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

- The high yield market has been open and accessible with record new issuance on a year-to-date basis. Companies have continued to add significant liquidity and refinance near-term maturities, reducing default and liquidity risk.
- The efficacy and rollout of vaccines has been above market expectations, aiding fundamental recovery and market confidence in the recovery for certain sectors.
- Increased fiscal stimulus including two additional stimulus checks, revised and extended unemployment benefits, and passage of the $1.9 trillion American Rescue Plan.
- Index composition changes from both fallen angels and the realization of expected defaults have improved the overall credit quality of the market.

Potential risks to the forecast

- There is a modest risk of higher defaults due to the impact of COVID-19 on certain sectors that have been vulnerable to the effects of the pandemic, and their overall recovery remains contingent upon successful reopening.
- The sectors where we see the most risk for defaults to increase are energy, leisure, real estate, and transportation.

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TPDF (06/21) 3607109