January 2025

High Yield Quarterly Commentary

Environment

The high yield market experienced another positive quarter of performance in Q4'2024, marking it as the 9th straight quarter of positive returns. Monthly performance was mixed during the quarter as October and December months had negative returns, with October having the worst performance in the quarter. The strong rally in November allowed the high yield market to eke out a positive return for the full quarter. Investors turned more cautious in December as the FED indicated that persistent inflation and resilient economic data will allow the central bank to slow the pace of rate cuts. Current market expectations are for both the FED and Bank of Canada to reduce rates by another 50 bps in 2025. Both banks are hinting that they are nearly done with rate cuts as the current policy rate is seen as coming closer to neutral. Investor risk appetite also waned in December as investors positioned to await policy clarity from the new incoming Trump administration, especially with respect to any potential tariffs. The FED cut rates by 50 bps during the quarter while the Bank of Canada reduced rates by 100 bps. The inverted yield curve normalized in December as the long rates sold off and rose above the shorter rates for the first time since 2022. The US 10-year bond yield moved higher during the quarter, ending the year at 4.57% compared to 3.78% seen at the end of Q3'2024. On the commodity side, oil prices were higher during the quarter as WTI Crude ended December at $71.72, up from the previous quarter closing of $68.17, but reflecting an overall supply surplus that has anchored and steadied prices in the lower range while necessitating production cuts from OPEC. Lower energy costs over longer periods will go a long way towards easing inflationary pressures and will greatly benefit economic activity.

Performance

The Steinberg High Yield Series-O Fund outperformed relative to the market, with a positive return of 0.67% for the quarter. Within the High Yield market, BB bonds underperformed both single B and CCC bonds during the quarter as the riskiest bonds enjoyed the most upside while higher quality paper was pressured by the sell-off in the treasury market and had negative returns in the quarter. November was the strongest month in the quarter in terms of performance, while both October and December had negative returns. Much of our outperformance was due to being more defensively positioned with shorter duration names that held up well during the market turmoil.

Portfolio Highlights

During the quarter, we continued to improve the credit quality of the portfolio. The Fund added new positions in ATS Corporation (capital goods), Enbridge Gas Inc. (energy), Goodyear Tire & Rubber (automotive), Fortress Transportation and Infrastructure Investors (financial services), Sirius XM Radio Inc. (media) and Univision Communications (media). The Fund had reduced holdings of Corus Entertainment (media) and had the bond of Icahn Enterprises LP (financial services) partially called from the portfolio. The Fund had bonds of American Airlines (transportation), Aragvi Finance International (consumer goods), Empire Communities Corp (homebuilders), and TransCanada Pipelines (energy) called from the portfolio. We maintained adequate liquidity throughout the quarter with cash averaging roughly 4.2% over the fourth quarter. We continue to prefer lower duration, higher quality names to add to our holdings as we remain defensively positioned for 2025 while looking for good entry points to enhance yields. Our U.S. dollar holdings will remain hedged as we look for favorable opportunities to deploy capital and add to our existing holdings.

Outlook

The outlook for high yield bonds remains optimistic as we anticipate mid to high single digit returns in high yield next year. Current market expectations are for both the US FED and the Bank of Canada to cut rates by another 50 bps in 2025, while becoming more cautious with further adjustments to the policy rate. With the US economy continuing to post strong economic numbers, the FED is likely to slow and carefully evaluate data before continuing rate cuts in 2025. We are still encouraged by waning inflationary pressures world-wide and by reasonable oil prices that should further support economic activity. While rate cuts are not expected to be the main driver of fixed income performance next year, they can serve as an anchor point for returns and we are encouraged by the ample rate cutting capacity the central banks have in order to navigate any adverse unforeseen circumstances.

We expect new issuance to accelerate as companies take advantage of market opportunities to refinance their bonds. We anticipate 2025 new issuance to be robust, providing good opportunities to buy credit. Defaults are expected to remain below historical average which should also support positive returns for the full year. We continue to view high yield as an attractive asset class within fixed income and likely to benefit from easing monetary policy along with other fixed income credit next year.

As always, we are committed to the disciplined investment approach and long-term perspective that defines Lorne Steinberg Wealth Management.

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