

Weekly Briefing

SKYView: Active vs. Passive Management - The Short of It

In a *May Weekly Briefing*, we compared performance of the largest US high yield ETFs (HYG and JNK) to the ICE BofAML US High Yield Index (ticker H0AO, our proxy for US HY risk) and to a dataset of active high yield managers, all in an effort to gauge relative performance between active and passive strategies within our market niche. This analysis found that HYG and JNK were unfavorable proxies for broad US high yield market risk, as demonstrated by the capture of ~ 80% of H0AO returns and ~ 115% of H0AO volatility on an annualized basis going back to 2008. In this *Weekly Briefing*, we expand upon this analysis with a focus on short duration high yield strategies. In particular, we compare short duration high yield ETF (SHYG and SJNK) performance to the ICE BofAML 1-5 Year BB-B US High Yield Constrained Index (ticker JVC4, our proxy for short duration high yield risk), as well as a dataset of actively managed short duration high yield funds.

By way of background, two of the largest ETFs in the short duration US high yield space – iShares 0-5 Year High Yield Corporate Bond ETF (ticker: SHYG) and SPDR Bloomberg Barclays Short Term High Yield Bond ETF (ticker: SJNK) – have grown materially since 2013, and together now possess assets in excess of \$6bn. With a track record going back over five years (during both up and down markets), a sufficient set of data now exists to conduct an evaluation similar to the work previously done on broad market strategies.

ETFs vs. the ICE BofAML 1-5 Year BB-B US High Yield Constrained Index (JVC4)

We preface this section of our analysis with the disclosure that neither SHYG nor SJNK use the same benchmark as most active short duration US high yield managers. The benchmark for SHYG is the Markit iBoxx USD Liquid High Yield 0-5 Index, a market capitalization-weighted index consisting of liquid USD high yield bonds maturing within 5 years, while the benchmark for SJNK is the Bloomberg Barclays US High Yield \$350mn Cash Pay 0-5 Yr 2% Capped Index, an index designed to track a more liquid subset of USD-denominated high yield securities. Active high yield managers, on the other hand, typically use one of several short duration high yield market indices created by ICE Bank of America-Merrill Lynch, or are non-benchmarked strategies (typically seeking a % capture of the broad high yield market returns with limited volatility). For this analysis, we will be using the ICE BofAML 1-5 Year BB-B US High Yield Constrained Index (JVC4), one of the most commonly used benchmarks in the active space, as a proxy for the short duration US high yield index. Since a significant portion of the buyer base may view SHYG and SJNK as alternatives to actively managed short duration high yield exposure, we believe the comparison is a fair one to make.

Using data going back to 2014 (the first full year in which both ETFs have available statistics), we compare performance of the short duration high yield ETFs to JVC4, presented below in terms of relative capture.

ICE BofAML 1-5 Yr BB-B US High Yield Index (JVC4) vs. iShares 0-5 Yr High Yield Corporate Bond ETF (SHYG) and SPDR Bloomberg Barclays Short Term High Yield Bond ETF (SJNK)

monthly data, since 2014

Returns	2014	2015	2016	2017	2018	U/P vs. Index % of Periods	Rolling (annualized)				
							YTD	1yr	3yr	5yr	
JVC4 Total Return	1.7%	-3.0%	12.2%	5.4%	0.7%		JVC4 Total Return	5.7%	5.3%	6.0%	3.9%
SHYG Capture	19%	125%	102%	95%	3%	80%	SHYG Capture	90%	82%	95%	87%
SJNK Capture	-73%	209%	116%	98%	-40%	80%	SJNK Capture	91%	74%	99%	70%

Standard Deviation of Returns	2014	2015	2016	2017	2018	U/P vs. Index % of Periods	Rolling (annualized)				
							YTD	1yr	3yr	5yr	
SHYG Capture	109%	107%	73%	118%	122%	80%	SHYG Capture	134%	124%	119%	105%
SJNK Capture	121%	117%	113%	126%	132%	100%	SJNK Capture	127%	124%	124%	121%

Source: SKY Harbor, ICE BofAML Indices, Bloomberg

Note: ETF returns are calculated on a price basis; both H0AO and ETF returns and standard deviations are calculated using monthly data

As demonstrated above, on an annualized basis using monthly returns from the start of 2014 until the end of 2018, ETF performance has been weak relative to the ICE BofAML 1-5 Year BB-B US High Yield Constrained Index. In fact, over the five-year data set shown above, SHYG and SJNK only outperformed JVC4 in 2016. Additionally, we would note that total returns are not the only metric investors are concerned with – the volatility of those returns is also a meaningful part of this comparison. Looking at annualized standard deviation of returns, again using monthly data, we find that both ETFs exposed the buyer to greater volatility relative to JVC4 in every year except 2016 (SHYG showed less volatility than the index). Rolling returns through May 31 on a YTD, 1yr, 3yr, and 5yr basis show a similar story, with both ETFs underperforming JVC4. **In summary, we would conclude that on an annualized basis through the period of our data set, ETFs appear to pick up, on average, ~ 80% of JVC4 return with ~ 110% of the index volatility.**

We concede, however, that this comparison is somewhat unfair. Investors cannot get direct exposure to the ICE BofAML 1-5 Year BB-B US High Yield Constrained Index, and index performance benefits from no management fee, no transaction costs (frictional costs can be quite high, especially in less liquid markets), and an unfettered ability to gain exposure to any and all securities, even those that are illiquid and unavailable for actual purchase. Recognizing this, we attempt to level the playing field, and continue our analysis below, this time comparing ETFs to active managers.

ETFs vs. Active Managers

Using the eVestment Global Database, we created a data set of > 30 managers with short duration US high yield strategies. Below, we compare returns (net of fees) of the median manager within our data set to both SHYG and SJNK. The data below shows that short duration ETFs underperformed the median active manager in three of five years tested, and demonstrated greater volatility in all periods.

Median Active Short Duration HY Manager vs. iShares 0-5 Yr High Yield Corporate Bond ETF (SHYG) and SPDR Bloomberg Barclays Short Term High Yield Bond ETF (SJNK)

monthly data, since 2014

Returns	2014	2015	2016	2017	2018	U/P vs. Median Mgr. % of Periods
Median Short Duration Manager	1.2%	-0.3%	9.7%	4.7%	0.3%	
SHYG Capture	28%	1175%	129%	109%	6%	60%
SJNK Capture	-108%	1962%	146%	112%	-79%	60%

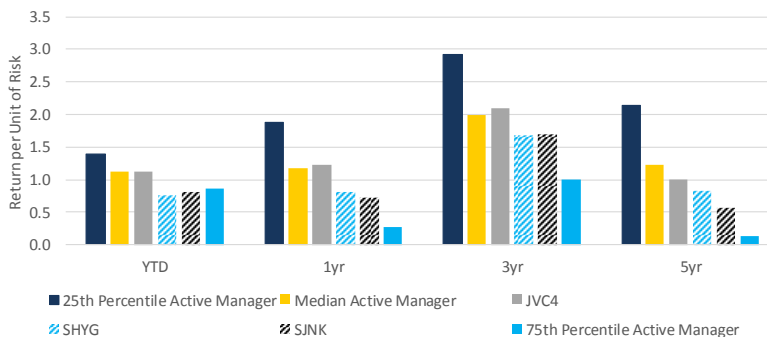
Standard Deviation of Returns	2014	2015	2016	2017	2018	U/P vs. Median Mgr. % of Periods
SHYG Capture	121%	151%	107%	135%	140%	100%
SJNK Capture	135%	165%	167%	145%	152%	100%

Source: SKY Harbor, ICE BofAML Indices, Bloomberg, eVestment Global Database; data through May 31, 2019
 Note: ETF returns are calculated on a price basis; JVC4, ETF, and manager returns and standard deviations are calculated using monthly data

Below, we compare risk-adjusted ETF returns to the index and the median active manager from our data set, and further augment our comparison to include 25th and 75th percentile active managers (gateway to top and bottom quartiles). On a rolling basis, both SHYG and SJNK have provided weaker risk-adjusted returns in all periods relative to the 25th percentile and median manager in our data set. **As such, we would say that short duration high yield ETF risk-adjusted returns are in line with 3rd quartile active manager performance over the long run.**

Risk-Adjusted Returns

monthly data through May 31, 2019

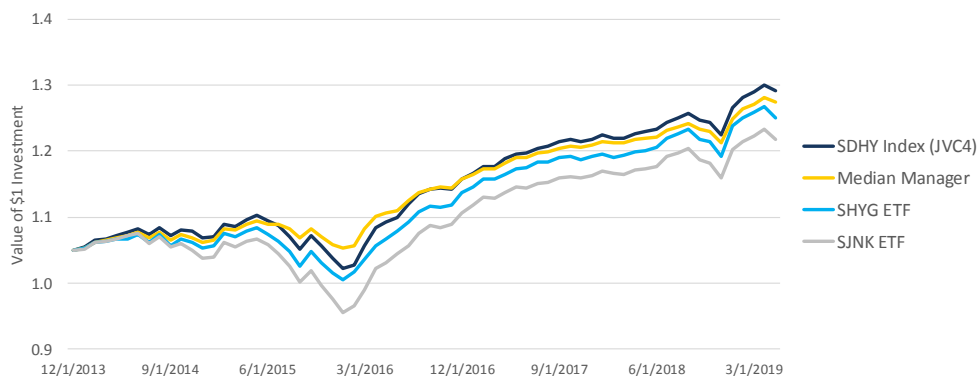


Source: SKY Harbor, ICE BofAML Indices, Bloomberg, eVestment Global Database; data through May 31, 2019

While total returns of SHYG and SJNK relative to the short duration high yield index and active managers tend to vary by year, a net drag has emerged over time. Presented below is a hypothetical investment of \$1 at the start of 2014.

Hypothetical Growth of \$1 - January '14 to May '19

monthly data



Source: SKY Harbor, ICE BofAML Indices, Bloomberg, eVestment Global Database; data through May 31, 2019

On the Calendar

Occurred

Event	Release Date	Period	Survey	Actual	Prior
Empire Manufacturing	17-Jun-19	Jun	11.0	-8.6	17.8
Housing Starts	18-Jun-19	May	1239k	1269k	1235k
Retail Sales Advance MoM	14-Jun-19	May	0.6%	0.5%	-0.2%

Source: SKY Harbor, Bloomberg

Upcoming

Event	Release Date	Period	Survey	Actual	Prior
ISM Manufacturing	1-Jul-19	Jun	51.0		52.1
ADP Employment Change	3-Jul-19	Jun	138k		27k
Factory Orders	3-Jul-19	May	-0.4%		-0.8%

Recommended Reading

Meyer, Gregory (2019, June 28). China Buys US Soybeans Ahead of Trump-Xi Meeting. *Financial Times* (subs. req.), Retrieved from <https://www.ft.com/content/24c3f30a-99b8-11e9-9573-ee5cbb98ed36>

Pickert, Reade (2019, June 28). Core Inflation in US Shows Signs of Life While Sentiment Cools. *Bloomberg*, Retrieved from <https://www.bloomberg.com/news/articles/2019-06-28/u-s-core-inflation-shows-signs-of-life-as-fed-weighs-rate-cut>

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