

**Weekly Briefing**

**SKYView: Short Duration High Yield – US vs EM**

Stable credit fundamentals and positive technical tailwinds have served to bolster sentiment for US high yield bonds, particularly strategies that focus on the shorter duration part of the market. As such, we remain constructive on the asset class despite spread tightening in 2019. At the same time, we recognize that some competing strategies – most notably EM short duration high yield – have offered similarly attractive returns for investors over the last several years. In this *Weekly Briefing*, we provide an update of our comparison of US and EM short duration high yield in the current market environment.

**Periodic Performance**

Using performance for the SKY Harbor Short Duration High Yield strategy (SKY) in comparison to what we understand are commonly used EM short duration high yield benchmarks – the JP Morgan CEMBI Broad Diversified 1-3yr Index (CEMBI) and the JP Morgan EMBI Global Diversified 1-3yr Index (EMBI) – we create the total return and volatility comparisons below. In general, total returns over the last three years have been most favorable for SKY, while CEMBI has generally provided the best return per unit of volatility (although periodic exceptions exist, namely 2017).

**SKY Short Duration High Yield vs. EM Short Duration High Yield**

monthly data through December 31, 2019

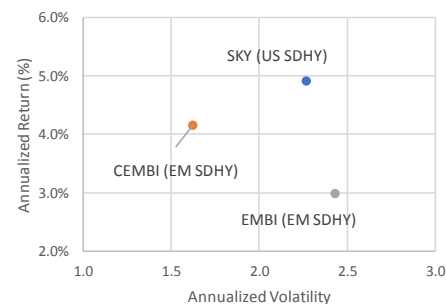
Total Returns	YTD	Annualized		2019	2018	2017
		1 Year	3 Year			
SKY Harbor US Short Duration HY	9.0%	9.0%	4.9%	9.0%	0.9%	5.0%
JP Morgan CEMBI Broad Diversified 1-3yr	7.3%	7.3%	4.2%	7.3%	1.8%	3.4%
JP Morgan EMBI Global Diversified 1-3yr	4.1%	4.1%	3.0%	4.1%	0.6%	4.2%

Return per Unit of Standard Deviation	YTD	Annualized		2019	2018	2017
		1 Year	3 Year			
SKY Harbor US Short Duration HY	3.2%	3.2%	2.2%	3.2%	0.4%	4.7%
JP Morgan CEMBI Broad Diversified 1-3yr	4.3%	4.3%	2.6%	4.3%	1.0%	3.9%
JP Morgan EMBI Global Diversified 1-3yr	1.2%	1.2%	1.2%	1.2%	0.3%	3.1%

Source: SKY Harbor, ICE BofA Indices, JP Morgan Markets

**Return & Risk Comparison**

Trailing 3yrs through December 2019

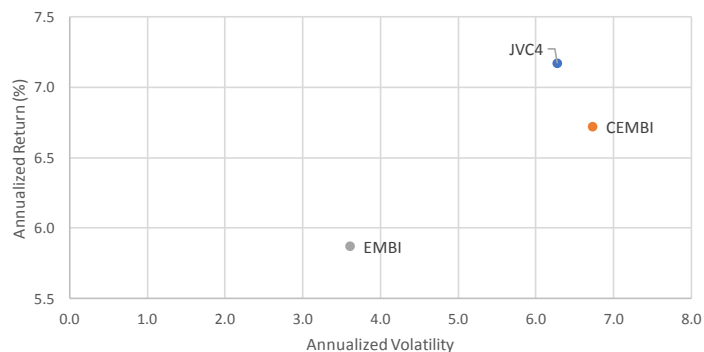


**Long-Term Performance**

In order to provide risk and return metrics over a longer period of time (beyond SKY Harbor’s inception), we ran a similar analysis, this time substituting the SKY Harbor Short Duration High Yield strategy (SKY) performance with a widely used US short duration high yield index – the ICE BofA 1-5yr BB-B US Cash Pay High Yield Constrained Index (JVC4). Using all available information (in this case, the CEMBI BD 1-3yr is the limiting factor, with monthly returns starting January 2002), we generated the risk/return comparisons below. In the full data set (~ 18 years of monthly returns), we find JVC4 (our proxy for US short duration high yield) to be more efficient than CEMBI in terms of return per unit of risk.

**Return & Risk Comparison**

full data series (Jan '02 through December '19)

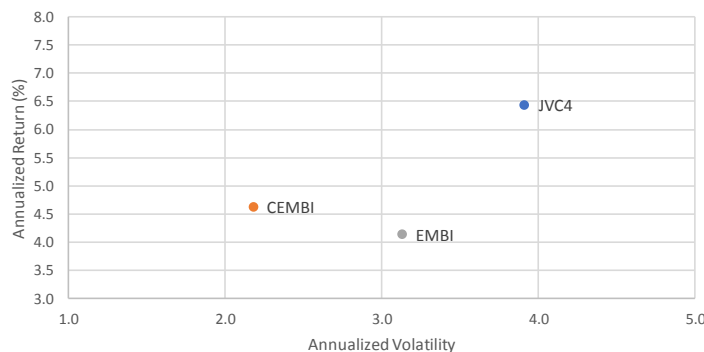


JVC4 = ICE BofA 1-5yr BB-B US Cash Pay High Yield Constrained Index (proxy for US Short Duration High Yield)  
CEMBI = JP Morgan CEMBI Broad Diversified 1-3yr Index (proxy for EM Short Duration High Yield)  
EMBI = JP Morgan EMBI Global Diversified 1-3yr Index (proxy for EM Short Duration High Yield)

Source: SKY Harbor, ICE BofA Indices, JP Morgan Markets. Data set January 2002 (start of CEMBI) through December 2019.

**Return & Risk Comparison**

Trailing 10yrs through December 2019

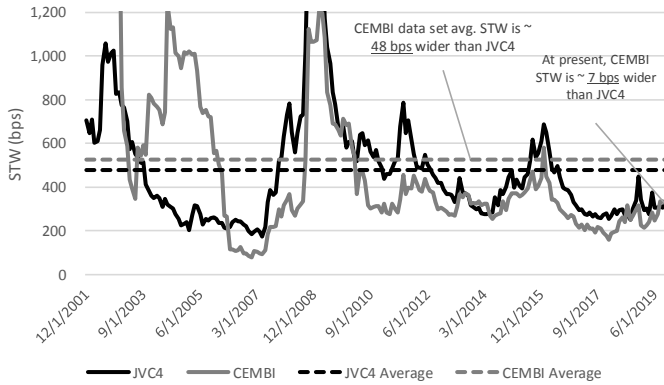


## Current Spread Levels

At present, the CEMBI BD 1-3yr spread-to-worst (STW) is ~ 7 bps wide of JVC4, despite the former trading ~ 48 bps wide relative to JVC4 over the long run (data going back to January 2002). Furthermore, peak spreads for CEMBI BD 1-3yr within our data set (3,137 bps) are well above peak spreads for JVC4 (1,900 bps). Normalizing spread levels by using percentile ranks, we find CEMBI (spreads are 37<sup>th</sup> percentile relative to the time series) screens modestly better than JVC4 (spreads are 30<sup>th</sup> percentile relative to the time series). Putting all factors together (historical trading differentials, spread peaks, percentile rankings), we find similar relative value between the two indices.

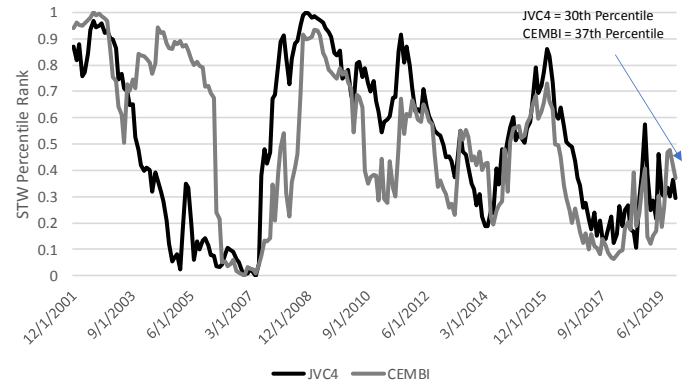
### Spread to Worst History: US vs EM Short Duration High Yield

monthly data since December 2001 (max CEMBI data)



### Spread to Worst History: US vs EM Short Duration High Yield

monthly data since December 2001 (max CEMBI data)



Source: SKY Harbor, ICE BofA Indices, JP Morgan Markets. Data set January 2002 (start of CEMBI) through December 2019.

## China Slowdown

In our view, the threat of a reduction in global growth, most notably through weakening expectations for China GDP, represents the dominant risk factor in leveraged credit markets at present. As such, we compared relative correlations of China GDP growth and the STW of both US and EM short duration indices over time. The EMBI GD 1-3yr is the only index with a statistically significant correlation and, as such, we view spreads to be more at risk of widening should China GDP growth decline with consensus expectations.

### China GDP Growth

quarterly data, actuals and consensus expectations

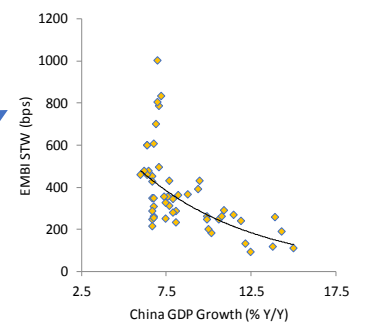


### Correlation to China GDP Growth

quarterly data since Q4'06 (furthest back for EMBI data)

Correlation to China GDP Growth	China GDP Growth vs. US Short Duration HY STW
JVC4 (0.01)	p-value = 0.95, statistically insignificant
CEMBI (0.13)	China GDP Growth vs. CEMBI BD 1-3yr STW
EMBI (0.56)	p-value = 0.37, statistically insignificant
	China GDP Growth vs. EMBI GD 1-3yr STW
	p-value = 1.31E-05, statistically significant

### China GDP Growth vs. EM Short Duration HY STW (EMBI)



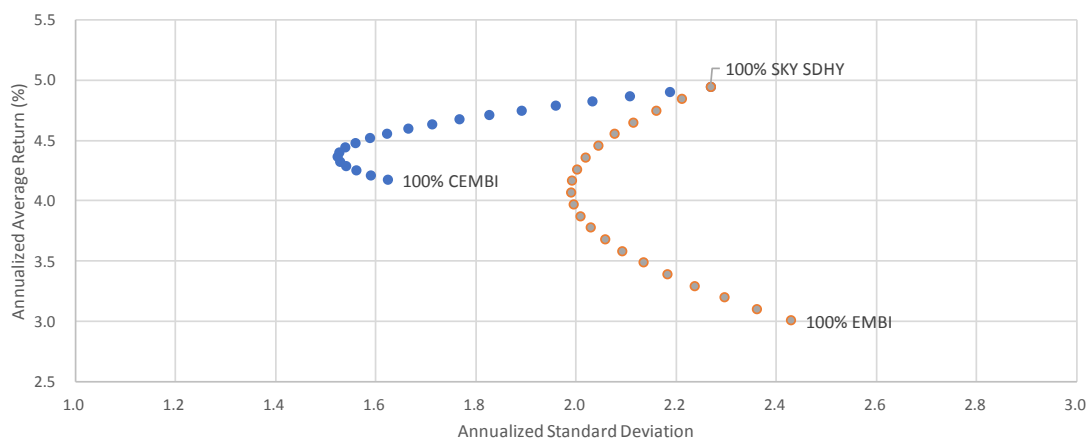
Source: SKY Harbor, ICE BofA Indices, JP Morgan Markets

## Benefits of Diversification

By virtue of limited correlation to EM short duration high yield indices, we believe the SKY Harbor Short Duration High Yield strategy (SKY) can improve portfolio diversification. As demonstrated below, an allocation to SKY can expand the efficient frontiers of a CEMBI BD 1-3yr (CEMBI) and an EMBI GD 1-3yr (EMBI) portfolio. Furthermore, using a longer data set (~ 18 yrs, limited by EMBI history), JVC4 (proxy for US short duration high yield) can improve the efficient frontier of a CEMBI-only portfolio.

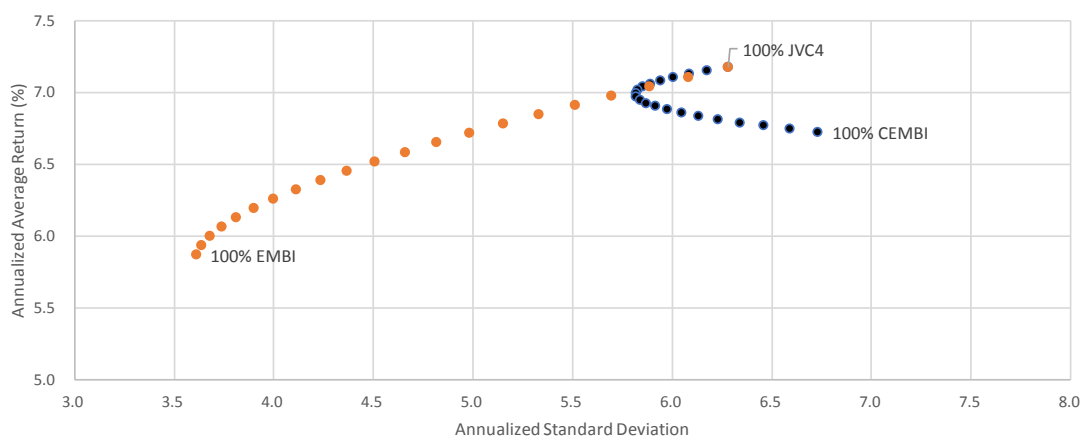
**SKY Harbor Short Duration High Yield (SKY SDHY) vs. JP Morgan CEMBI Broad Diversified 1-3yr (CEMBI) and JP Morgan EMBI Global Diversified 1-3yr (EMBI)**

monthly data, trailing 3 years



**ICE BofAML 1-5 Yr BB-B US Cash Pay HY Index (JVC4) vs. JP Morgan CEMBI Broad Diversified 1-3yr (CEMBI) and JP Morgan EMBI Global Diversified 1-3yr (EMBI)**

monthly data, trailing 18 years (EMBI data max)



Source: SKY Harbor, ICE BofA Indices, JP Morgan Markets

**Conclusion**

We remain constructive on US short duration high yield, with stable credit fundamentals and technical tailwinds supporting positive sentiment within the market. In comparison to EM short duration high yield, we find US spreads at present to represent similar relative value. Furthermore, we think greater insulation from falling China GDP growth represents a key area of differentiation that favors US over EM short duration high yield. Finally, we highlight the benefits of diversification arising from the inclusion of the SKY Harbor US Short Duration High Yield strategy to existing CEMBI and EMBI portfolios by virtue of improved efficient frontiers.

**On the Calendar**

Event	Release Date	Period	Survey	Actual	Prior
ISM Manufacturing	3-Jan-20	Dec	48.9	47.2	48.1
Trade Balance	7-Jan-20	Nov	-43.6	-43.1	-47.2
Initial Jobless Claims	16-Jan-20	11-Jan	218k	204k	214k

Event	Release Date	Period	Survey	Actual	Prior
Industrial Production	17-Jan-20	Dec	-0.2%		1.1%
University of Michigan Cons. Sentiment	17-Jan-20	Jan-Prelim	99.3		99.3
Housing Starts	17-Jan-20	Dec	1,380k		1,365k

Source: SKY Harbor, Bloomberg

**Recommended Reading**

Bradsher, Keith (2020, January 16). A Trade Deal Meant to Heal Rifts Could Actually Make Them Worse. *The New York Times* (subs. req.), Retrieved from <https://www.nytimes.com/2020/01/16/business/us-china-trade.html>

Stearns, Jonathan and Donnan, Shawn (2020, January 14). US, EU Square Up for Trade Brawl After Trump’s China Deal. *Bloomberg* (subs. req.), Retrieved from <https://www.bloomberg.com/news/articles/2020-01-14/u-s-eu-square-up-for-trade-brawl-after-trump-s-china-deal>

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