May 2021 / Investment Insights

Why Global High Yield is here to stay

Selectivity and diversification – Two key elements in managing high yield bonds to protect on the downside and take advantage of market dislocations. Going global offers diversification and alpha opportunities, not only during times of volatility and uncertainty.

Why is Global HY here to stay?

When looking at the High Yield (HY) market, it can be beneficial to take a global perspective. With recent volatility and ongoing uncertainty related to the effects of the COVID-19 pandemic for global financial markets, within the high yield (HY) bond markets, we believe selectivity and diversification are key in protecting the downside as well as in taking advantage of market dislocations.

Over the last decade, the Global HY bond market has more than doubled in size, and now stands at $2.7 trillion (as of 12/31/20). In particular, the European and Emerging Markets (EM) have taken on an added significance to the broader HY market. Accordingly, there is evidence that engaging the HY bond market with a global approach, rather than a US-centric perspective, could provide additional diversification and alpha opportunities. Among other aspects, these potential diversification benefits can be observed from a ratings, sector and regional perspective.

Key Takeaways

_ The growth of the European and EM High Yield markets has made the Global High Yield asset class more diversified and too large to be overlooked.
_ Global High Yield offers several diversification benefits versus US High Yield from a credit quality, sector and geographic perspective.
_ Global market inefficiencies and pricing discrepancies between bonds denominated in different currencies can present attractive investment opportunities.
_ Secured High Yield is an interesting segment of the Global High Yield market that can add value.

Performance and Risk

Since the inception of the Global HY index in 1997, Global HY has outperformed US HY in 13 of 23 calendar years between 1998 and 2020. The largest periods of underperformance were 2001 during the dot com bubble, 2008 during the global financial crisis, 2011 during the European debt crisis and in 2016 when EM experienced volatility due to the Fed rate hike and the U.S. presidential election.

EXHIBIT 1. CALENDAR YEAR RETURNS

	1998	1999	2000	2001	2002	2003
Global High Yield	2.91	2.89	-5.26	3.43	-2.23	28.06
US High Yield	2.95	2.51	-5.12	4.48	-1.89	28.15
	2004	**2005**	**2006**	**2007**	**2008**	**2009**
Global High Yield	11.29	3.26	12.02	1.73	-27.01	60.70
US High Yield	10.87	2.74	11.77	2.19	-26.39	57.51
	2010	**2011**	**2012**	**2013**	**2014**	**2015**
Global High Yield	15.39	3.18	18.89	7.10	2.53	-2.03
US High Yield	15.19	4.38	15.58	7.42	2.50	-4.64
	2016	**2017**	**2018**	**2019**	**2020**	
Global High Yield	16.21	8.02	-1.90	14.54	6.61	
US High Yield	17.49	7.48	-2.26	14.41	6.17	

Source: Morningstar as of 12/31/20; Global High Yield is represented by the ICE BofA Global High Yield Hedged Index; US High Yield is represented by the ICE BofA US High Yield Index

On an annualized basis, Global HY has outperformed US HY on an absolute and risk-adjusted basis over 1-, 3-, 5-, 10-, 15- and 20-years as of 12/31/20.

EXHIBIT 2. ANNUALIZED PERFORMANCE

	1-Year	3-Year	5-Year	10-Year	15-Year	20-Year
Global High Yield	6.61	6.20	8.50	7.09	7.74	7.87
US High Yield	6.17	5.89	8.43	6.62	7.35	7.61

Source: Morningstar as of 12/31/20; Global High Yield is represented by the ICE BofA Global High Yield Hedged Index; US High Yield is represented by the ICE BofA US High Yield Index

Global HY also has generally outperformed US HY during periods of positive returns and has experienced smaller losses during periods of negative returns historically.

EXHIBIT 3. UPSIDE/DOWNSIDE CAPTURE (VS. US HY)

Upside Capture

	1-Year	3-Year	5-Year	10-Year	15-Year	20-Year
Global High Yield	105.94	100.61	98.87	101.55	101.70	101.08

Down-side Capture

	1-Year	3-Year	5-Year	10-Year	15-Year	20-Year
Global High Yield	105.32	97.17	95.94	95.82	98.55	98.93

Source: Morningstar as of 12/31/20; Global High Yield is represented by the ICE BofA Global High Yield Hedged Index; Upside and downside capture have been calculated versus the ICE BofA US High Yield Index

Wider option-adjusted spreads (OAS) and lower average prices in Global HY vs. US HY also make the expanded opportunity set more attractive. During the volatility in March 2020, the market saw HY OAS exceed 1,000 bps and an average price below $80 across Global HY, US HY and EM HY. While spreads have tightened significantly, current levels, as well as the historical averages, continue to favor Global HY over US HY.

EXHIBIT 4. INDEX CHARACTERISTICS

Option-Adjusted Spread (OAS)

	Year End Level	5-Year Avg	10-Year Avg	20-Year Avg
Global High Yield	410	471	508	582
US High Yield	386	461	492	572

Price

	Year End Level	5-Year Avg	10-Year Avg	20-Year Avg
Global High Yield	103.71	98.15	99.19	95.03
US High Yield	104.71	97.97	99.61	95.47

Source: Source: ICE BofA Indices; Global High Yield is represented by the ICE BofA Global High Yield Index; US High Yield is represented by the ICE BofA US High Yield Index; as of: 12/31/2020

During periods of extreme market volatility, employing selective active management within the larger Global HY universe is critical.

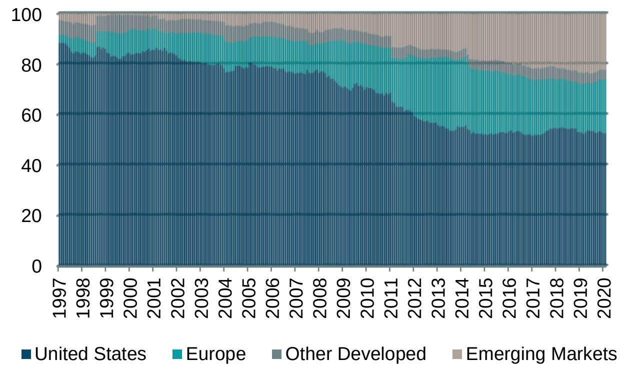
Evolution of Global High Yield Market

From the 1980s through the early 2000s, the HY bond market was primarily a US High Yield (US HY) market. However, after the early 2000s, the European High Yield (Euro HY) and Emerging Market High Yield (EM HY) portions of the Global High Yield (Global HY) market grew tremendously. Euro HY and EM HY currently make up 42% of the Global HY universe.

To put this into perspective, at the inception of the Global HY index in December 1997, the US HY segment represented 98% of the Global HY market (with 88% of the issuers in the index domiciled in the US). A decade later, at the beginning of the 2008, the US HY segment had decreased to 84% of the Global HY market (with US issuers representing 76% of the Global HY index). Currently, the US HY segment represents 57% of the Global HY market with US issuers making up 52% of the index (as of 12/31/20).

EXHIBIT 5. EVOLUTION OF COMPOSITION OF GHY

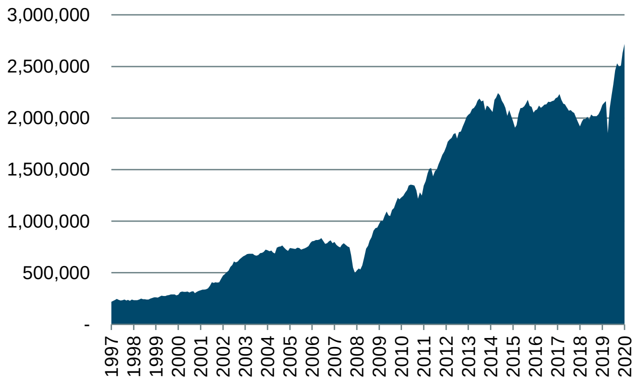
Market Value in % by region



Source: Source: ICE BofA Indices; Global High Yield is represented by the ICE BofA Global High Yield Index; as of: 12/31/2020

In addition to the composition of the market, as previously mentioned, the Global HY market has grown significantly in size. At inception in 1997, the Global HY index was $219 billion. By January 2010, the index had reached a market value of $1 trillion, and the index is currently $2.7 trillion in market value (as of 12/31/20).

EXHIBIT 6. SIZE OF THE GLOBAL HY MARKET



Source: ICE BofA Indices; Global High Yield is represented by the ICE BofA Global High Yield Index; as of: 12/31/2020

Diversification Benefits

A Broader Universe and Credit Quality

The most obvious diversification benefits for Global HY is the broader investment universe and overall higher credit quality versus US HY. As of the end of December 2020, there were 3,720 issues and 1,555 tickers in the Global HY Index versus 2,030 issues and 860 tickers in the US HY index. The Global HY investment universe is nearly double the size of US HY for investors and provides more investment options for managers.

EXHIBIT 7. INDEX SUMMARY BREAKDOWN

	Market Value ($bn)	# of issues	# of tickers
Global High Yield	2,718.37	3,720	1,555
US High Yield	1,543.27	2,030	860

Source: ICE BofA Indices; Global High Yield is represented by the ICE BofA Global High Yield Index; US High Yield is represented by the ICE BofA US High Yield Index; as of: 12/31/2020

When compared to US HY, Euro HY and EM HY have an overall higher credit quality as the average credit rating for Euro HY and EM HY is BB3 versus B1 for US HY (as of 12/31/20).

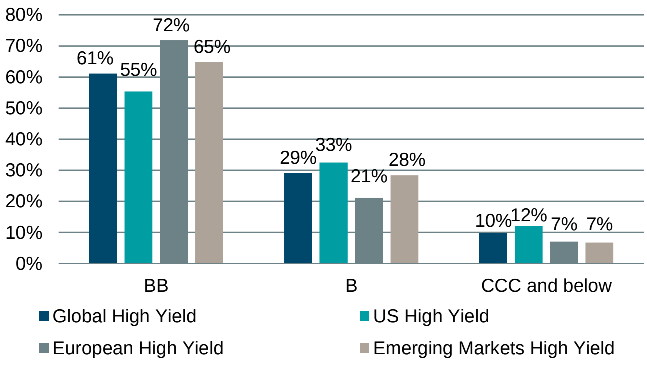
EXHIBIT 8. AVERAGE INDEX CREDIT QUALITY

	Average Rating
Global High Yield	BB3
US High Yield	B1
European High Yield	BB3
Emerging Markets High Yield	BB3

Source: Source: ICE BofA Indices; Global High Yield is represented by the ICE BofA Global High Yield Index; US High Yield is represented by the ICE BofA US High Yield Index; European High Yield is represented by the ICE BofA European Currency High Yield Index; Emerging Markets High Yield is represented by the ICE BofA High Yield US Emerging Markets Corporate Plus Index; as of: 12/31/2020

Furthermore, credits rated CCC and below, the lowest rating categories in the HY universe, make up approximately 7% of the Euro HY market and 7% of the EM HY market while they represent 12% for the US HY market (as of 12/31/20)

EXHIBIT 9. INDEX RATINGS BREAKDOWN



Source: ICE BofA Indices; Global High Yield is represented by the ICE BofA Global High Yield Index; US High Yield is represented by the ICE BofA US High Yield Index; European High Yield is represented by the ICE BofA European Currency High Yield Index; Emerging Markets High Yield is represented by the ICE BofA High Yield US Emerging Markets Corporate Plus Index; as of: 12/31/2020

The addition of Euro HY and EM HY to the US HY market results in an average credit rating of BB3 for the Global HY market with 10% of credits rated CCC and below (as of 12/31/20).

Looking at default rates across EM HY, Euro HY and US HY, investors have the added benefit of lower default rates in Euro HY and EM HY which improves the credit risk profile for Global HY. Most noticeably, the average default rate from 2004 through 2020 is 1.6% for Euro HY, 2.5% for EM HY and 3% for US HY. Even during during the volatile times of 2008, 2009 and 2020, the historical default rates for Euro HY were much lower versus its US and EM peers, which is primarily driven by the higher quality of the Euro HY universe.

EXHIBIT 10. HISTORICAL DEFAULTS

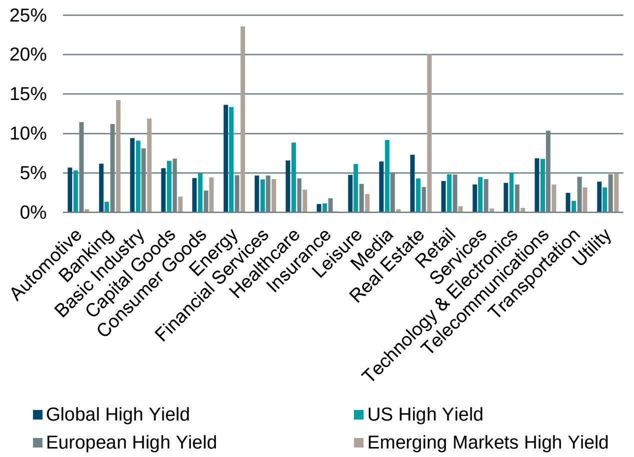
	US HY	European HY	Emerging Markets HY
Average 2004-2020	3.0%	1.6%	2.5%

Source: JP Morgan; as of: 12/31/2020

Sector Exposure

Equally important is the diversification amongst sectors. For example, when comparing US and EM HY to Euro HY, US and EM HY have higher exposure to the Energy sector relative to Euro HY. The Energy sector is quite sensitive to commodity prices, such as oil, and makes up 13% of the US HY and 24% of EM HY indices but only 5% of the Euro HY index (as of 12/31/20). Furthermore, the Euro HY index does have a noticeably larger exposure to the Telecommunication sector which is a less cyclical sector. The Euro HY and EM HY indices also carry a much larger weight in the Real Estate and Banking sectors at a combined 16% and 15%, respectively. The US HY index has significantly less exposure to these sectors with 6% combined (as of 12/31/20). Another stand-out sector is the Automotive (Autos) sector. Within Euro HY, Autos make up 11% of the index compared to 5% in the US HY index (as of 12/31/20). These differences in sector exposure among the three markets provide Global HY managers more alpha generation opportunities and diversification benefits.

EXHIBIT 11. INDEX SECTOR BREAKDOWN



Source: ICE BofA Indices; Global High Yield is represented by the ICE BofA Global High Yield Index; US High Yield is represented by the ICE BofA US High Yield Index; European High Yield is represented by the ICE BofA European Currency High Yield Index; Emerging Markets High Yield is represented by the ICE BofA High Yield US Emerging Markets Corporate Plus Index; as of: 12/31/2020

Market Inefficiencies

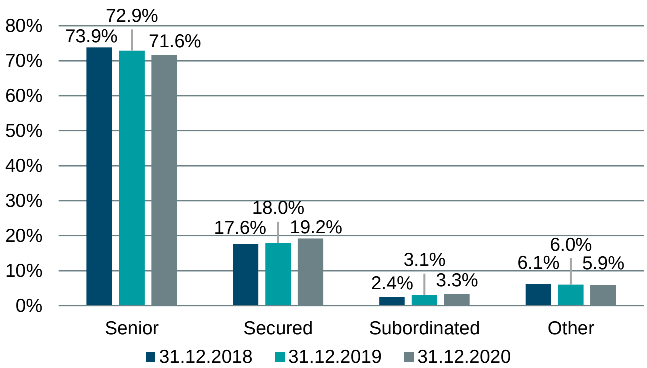
Another benefit that a well-equipped Global High Yield manager could enjoy is the concept of home issuer bias. In essence, EUR bonds of a US-based issuer can carry a higher yield-to-worst after hedging the currency risk relative to the same company's USD bonds, as a result of home country bias. The opposite is true for a EUR issuer. The EUR issuers' USD bonds could trade at a higher yield-to-worst relative to its EUR bonds. A truly global strategy can exploit this mispricing and invest opportunistically in either the EUR or USD bond as they see fit.

Growth of Secured Debt

Furthermore, an additional advantage of the Global HY market is the growing secured HY segment. Secured HY bonds are collateralized by equity pledges of operating subsidiaries and / or underlying assets such as machinery, patents, licenses, etc. This collateralization often lowers the financing cost for the issuer, and provides enhanced recovery rates in the event of issuer insolvency, thereby leading to higher issue-specific ratings.

Senior secured bonds are legally recognized as sitting in a position of seniority in the case of issuer default, with respect to the underlying collateral. With the collateralization, this could result in higher recovery rates and lower loss potential for secured bondholders. The recovery rates of secured bonds are, on average, 15-20 points higher than unsecured bonds. Currently, 19% of the Global HY universe is secured, which includes 21% for US HY, 24% for Euro HY and 11% for EM HY (as of 12/31/20). This segment has grown from 17% to 19% over the last three-years and has provided another opportunity for a Global HY manager to get additional downside protection and diversification.

EXHIBIT 12. INCREASE IN SECURED ISSUANCE



Source: ICE BofA Indices; Global High Yield is represented by the ICE BofA Global High Yield Index; as of: 12/31/2020

It is important to note that the collateral underlying all HY bonds is not created equal, so it is essential to have an experienced manager with deep research capabilities when investing in this segment of the market.

Conclusion

Given the growth of the Global HY market, we expect the benefits of a larger investment universe will continue to prevail. Global managers with experience managing through multiple market cycles and strong risk management skills to selectively size positions will drive success in this Global High Yield Strategy.

The Authors

Gary Russell
Co-Head of US Credit – Head of US High Yield Bonds and Loans
gary.russell@dws.com

Robin Kelly
Fixed Income Product Specialist
robin.kelly@dws.com

Important information

DWS is the brand name of DWS Group GmbH & Co. KGaA and its subsidiaries under which they operate their business activities. The respective legal entities offering products or services under the DWS brand are specified in the respective contracts, sales materials and other product information documents. DWS, through DWS Group GmbH & Co. KGaA, its affiliated companies and its officers and employees (collectively “DWS”) are communicating this document in good faith and on the following basis.

This document has been prepared without consideration of the investment needs, objectives or financial circumstances of any investor. Before making an investment decision, investors need to consider, with or without the assistance of an investment adviser, whether the investments and strategies described or provided by DWS, are appropriate, in light of their particular investment needs, objectives and financial circumstances. Furthermore, this document is for information/discussion purposes only and does not constitute an offer, recommendation or solicitation to conclude a transaction and should not be treated as giving investment advice.

The document was not produced, reviewed or edited by any research department within DWS and is not investment research. Therefore, laws and regulations relating to investment research do not apply to it. Any opinions expressed herein may differ from the opinions expressed by other legal entities of DWS or their departments including research departments.

The information contained in this document does not constitute a financial analysis but qualifies as marketing communication. This marketing communication is neither subject to all legal provisions ensuring the impartiality of financial analysis nor to any prohibition on trading prior to the publication of financial analyses.

This document contains forward looking statements. Forward looking statements include, but are not limited to assumptions, estimates, projections, opinions, models and hypothetical performance analysis. The forward looking statements expressed constitute the author‘s judgment as of the date of this document. Forward looking statements involve significant elements of subjective judgments and analyses and changes thereto and/ or consideration of different or additional factors could have a material impact on the results indicated. Therefore, actual results may vary, perhaps materially, from the results contained herein. No representation or warranty is made by DWS as to the reasonableness or completeness of such forward looking statements or to any other financial information contained in this document. Past performance is not guarantee of future results.

We have gathered the information contained in this document from sources we believe to be reliable; but we do not guarantee the accuracy, completeness or fairness of such information. All third party data are copyrighted by and proprietary to the provider. DWS has no obligation to update, modify or amend this document or to otherwise notify the recipient in the event that any matter stated herein, or any opinion, projection, forecast or estimate set forth herein, changes or subsequently becomes inaccurate.

Investments are subject to various risks, including market fluctuations, regulatory change, possible delays in repayment and loss of income and principal invested. The value of investments can fall as well as rise and you might not get back the amount originally invested at any point in time. Furthermore, substantial fluctuations of the value of any investment are possible even over short periods of time. The terms of any investment will be exclusively subject to the detailed provisions, including risk considerations, contained in the offering documents. When making an investment decision, you should rely on the final documentation relating to any transaction.

No liability for any error or omission is accepted by DWS. Opinions and estimates may be changed without notice and involve a number of assumptions which may not prove valid. DWS or persons associated with it may (i) maintain a long or short position in securities referred to herein, or in related futures or options, and (ii) purchase or sell, make a market in, or engage in any other transaction involving such securities, and earn brokerage or other compensation.

DWS does not give taxation or legal advice. Prospective investors should seek advice from their own taxation agents and lawyers regarding the tax consequences on the purchase, ownership, disposal, redemption or transfer of the investments and strategies suggested by DWS. The relevant tax laws or regulations of the tax authorities may change at any time. DWS is not responsible for and has no obligation with respect to any tax implications on the investment suggested.

This document may not be reproduced or circulated without DWS written authority. The manner of circulation and distribution of this document may be restricted by law or regulation in certain countries, including the United States.

This document is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, including the United States, where such distribution, publication, availability or use would be contrary to law or regulation or which would subject DWS to any registration or licensing requirement within such jurisdiction not currently met within such jurisdiction. Persons into whose possession this document may come are required to inform themselves of, and to observe, such restrictions.

Important Information - UK
Issued in the UK by DWS Investments UK Limited. DWS Investments UK Limited is authorised and regulated by the Financial Conduct Authority (Registration number 429806).

DWS is the brand name of DWS Group GmbH & Co. KGaA. The respective legal entities offering products or services under the DWS brand are specified in the respective contracts, sales materials and other product information documents. DWS, through DWS Group GmbH & Co. KGaA, its affiliated companies and its officers and employees (collectively "DWS") are communicating this document in good faith and on the following basis.

This document is a financial promotion and is for general information purposes only and consequently may not be complete or accurate for your specific purposes. It is not intended to be an offer or solicitation, advice or recommendation, or the basis for any contract to purchase or sell any security, or other instrument, or for DWS to enter into or arrange any type of transaction as a consequence of any information contained herein. It has been prepared without consideration of the investment needs, objectives or financial circumstances of any investor.

This document does not identify all the risks (direct and indirect) or other considerations which might be material to you when entering into a transaction. Before making an investment decision, investors need to consider, with or without the assistance of an investment adviser, whether the investments and strategies described or provided by DWS, are suitability and appropriate, in light of their particular investment needs, objectives and financial circumstances. We assume no responsibility to advise the recipients of this document with regard to changes in our views.

We have gathered the information contained in this document from sources we believe to be reliable; but we do not guarantee the accuracy, completeness or fairness of such information and it should not be relied on as such. DWS has no obligation to update, modify or amend this document or to otherwise notify the recipient in the event that any matter stated herein, or any opinion, projection, forecast or estimate set forth herein, changes or subsequently becomes inaccurate.

DWS does not give taxation or legal advice. Prospective investors should seek advice from their own taxation agents and lawyers regarding the tax consequences on the purchase, ownership, disposal, redemption or transfer of the investments and strategies suggested by DWS. The relevant tax laws or regulations of the tax authorities may change at any time. DWS is not responsible for and has no obligation with respect to any tax implications on the investment suggested.

This document contains forward looking statements. Forward looking statements include, but are not limited to assumptions, estimates, projections, opinions, models and hypothetical performance analysis. The forward looking statements expressed constitute the author's judgment as of the date of this document. Forward looking statements involve significant elements of subjective judgments and analyses and changes thereto and/ or consideration of different or additional factors could have a material impact on the results indicated. Therefore, actual results may vary, perhaps materially, from the results contained herein. No representation or warranty is made by DWS as to the reasonableness or completeness of such forward looking statements or to any other financial information contained in this document.

PAST PERFORMANCE IS NO GUARANTEE OF FUTURE RESULTS.

Important Information - APAC
DWS is the brand name of DWS Group GmbH & Co. KGaA. The respective legal entities offering products or services under the DWS brand are specified in the respective contracts, sales materials and other product information documents. DWS Group GmbH & Co. KGaA, its affiliated companies and its officers and employees (collectively "DWS Group") are communicating this document in good faith and on the following basis.

This document has been prepared without consideration of the investment needs, objectives or financial circumstances of any investor. Before making an investment decision, investors need to consider, with or without the assistance of an investment adviser, whether the investments and strategies described or provided by DWS Group, are appropriate, in light of their particular investment needs, objectives and financial circumstances. Furthermore, this document is for information/discussion purposes only and does not constitute an offer, recommendation or solicitation to conclude a transaction and should not be treated as giving investment advice.

DWS Group does not give tax or legal advice. Investors should seek advice from their own tax experts and lawyers, in considering investments and strategies suggested by DWS Group. Investments with DWS Group are not guaranteed, unless specified.

Investments are subject to various risks, including market fluctuations, regulatory change, possible delays in repayment and loss of income and principal invested. The value of investments can fall as well as rise and you might not get back the amount originally invested at any point in time. Furthermore, substantial fluctuations of the value of the investment are possible even over short periods of time. The terms of any investment will be exclusively subject to the detailed provisions, including risk considerations, contained in the offering documents. When making an investment decision, you should rely on the final documentation relating to the transaction and not the summary contained herein. Past performance is no guarantee of current or future performance. Nothing contained herein shall constitute any representation or warranty as to future performance.

Although the information herein has been obtained from sources believed to be reliable, DWS Group does not guarantee its accuracy, completeness or fairness. No liability for any error or omission is accepted by DWS Group. Opinions and estimates may be changed without notice and involve a number of assumptions which may not prove valid. All third party data (such as MSCI, S&P, Dow Jones, FTSE, Bank of America Merrill Lynch, Factset & Bloomberg) are copyrighted by and proprietary to the provider. DWS Group or persons associated with it may (i) maintain a long or short position in securities referred to herein, or in related futures or options, and (ii) purchase or sell, make a market in, or engage in any other transaction involving such securities, and earn brokerage or other compensation.

The document was not produced, reviewed or edited by any research department within DWS Group and is not investment research. Therefore, laws and regulations relating to investment research do not apply to it. Any opinions expressed herein may differ from the opinions expressed by other DWS Group departments including research departments. This document may contain forward looking statements. Forward looking statements include, but are not limited to assumptions, estimates, projections, opinions, models and hypothetical performance analysis. The forward looking statements expressed constitute the author's judgment as of the date of this material. Forward looking statements involve significant elements of subjective judgments and analyses and changes thereto and/or consideration of different or additional factors could have a material impact on the results indicated. Therefore, actual results may vary, perhaps materially, from the results contained herein. No representation or warranty is made by DWS Group as to the reasonableness or completeness of such forward looking statements or to any other financial information contained herein.

This document may not be reproduced or circulated without DWS Group's written authority. The manner of circulation and distribution of this document may be restricted by law or regulation in certain countries, including the United States.

This document is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, including the United States, where such distribution, publication, availability or use would be contrary to law or regulation or which would subject DWS Group to any registration or licensing requirement within such jurisdiction not currently met within such jurisdiction. Persons into whose possession this document may come are required to inform themselves of, and to observe, such restrictions.

Unless notified to the contrary in a particular case, investment instruments are not insured by the Federal Deposit Insurance Corporation (”FDIC“) or any other governmental entity, and are not guaranteed by or obligations of DWS Group.

In Hong Kong, this document is issued by DWS Investments Hong Kong Limited and the content of this document has not been reviewed by the Securities and Futures Commission.

For marketing materials that distribute in Singapore as well, please add the following:
In Singapore, this document is issued by DWS Investments Singapore Limited and the content of this document has not been reviewed by the Monetary Authority of Singapore.

In Australia, this document is issued by DWS Investments Australia Limited (ABN: 52 074 599 401) (AFSL 499640) and the content of this document has not been reviewed by the Australian Securities Investment Commission.

CRC 082735 (04/2021)