Short Duration High Yield

The Power of Fixed Income Diversification

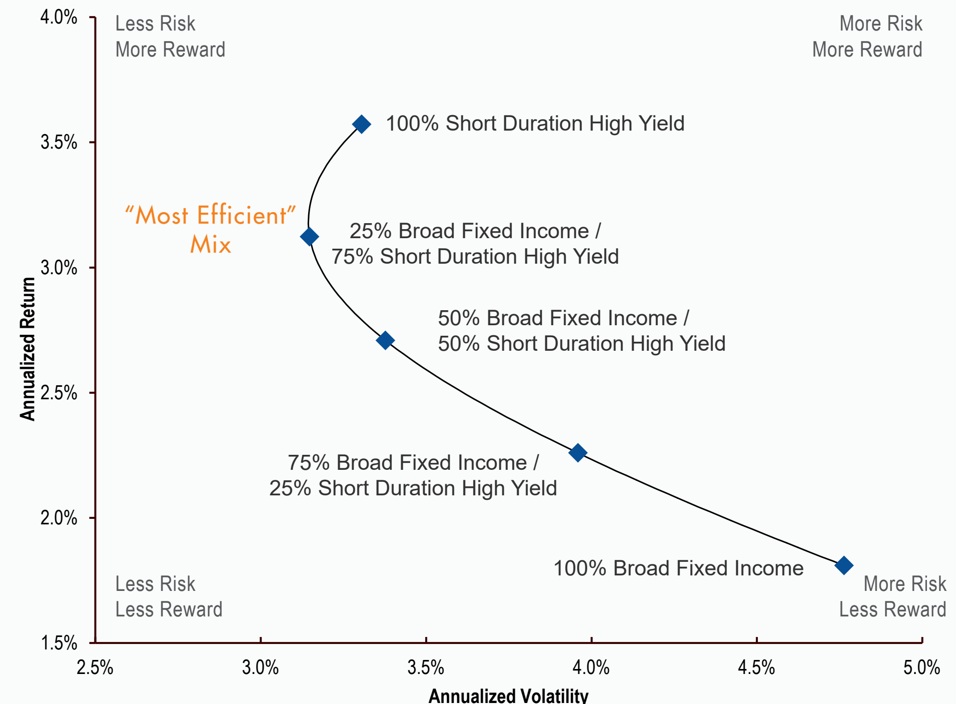
ADVISORS ASSET MANAGEMENT

Many people think high yield and immediately think high risk. We disagree. High yield securities, particularly those with a short duration and at the higher-end of the high yield spectrum (BB and B rated), can be an important component of a well-diversified fixed income allocation. **Today especially, such short duration high yield may help balance investors' need for current income with the risk of interest rate and credit-driven price volatility.**

The graph to the right is an efficient frontier showing the volatility and total return of a portfolio comprised of various percentages of the broad fixed income market (Bloomberg US Aggregate Bond Index) and "high quality" short duration high yield (H42C). As you can see:

- *A 100% allocation to the broad fixed income market returned an annualized 1.81% with volatility of 4.76% (1/1/14–12/31/23).*
- *By adding select percentages of short duration high yield to the broad market allocation, an investor was able to increase the portfolio's annualized return, while decreasing volatility.*
- *After an extremely difficult two-year period for almost all fixed income – when the broad market generated a negataive annualized return of -4.19% versus an annualized gain of 3.77% for H42C (1/1/22–12/31/23) – the most efficient mix appears to be approximately 24% broad market and 76% short duration high yield. This mix generated an annualized 3.1% total return with a standard deviation of 3.2% (1/1/14–12/31/23), as illustrated in the graph to the right.*

Given this, we believe it is essential to examine your fixed income allocation, particularly in a volatile rate environment, and consider allocating to "high quality" short duration high yield. Doing so has the potential to enhance total return, provide current income and lower volatility.



Source: Shenkman Capital Management. **Past performance does not guarantee future results.** Broad fixed income is represented by the Bloomberg US Aggregate Bond Index. Short duration high yield is represented by the ICE BofA 0-2 Year Duration BB-B US HY Constrained Index (H42C). This graph is not indicative of the performance of any AAM product.

In times of market uncertainty, one option to help investors achieve peace of mind is to invest in a diversified portfolio with the potential to generate current income.

It is not possible to invest directly in an index. Diversification does not assure a profit or protect against loss. See reverse for indexes used, index definitions and additional important information.

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KEY TAKEAWAYS:

An allocation to short duration high yield is a potential solution for:

- Fixed income and/or equity allocation concerns.
- Softening the likely negative impact of rising rates and widening credit spreads while maintaining exposure to fixed income.
- Generating current income, helping protect principle by minimizing interest rate risk and volatility, while delivering strong risk-adjusted returns.

Visit www.aamlive.com or contact a financial professional to discuss how diversifying your fixed income allocation may potentially enhance total return, provide current income and lower volatility.

All investments involve risk; principal loss is possible. Investing in the bond market is subject to risks, including market, interest rate, issuer, credit, inflation risk, and liquidity risk. The value of most bonds and bond strategies are impacted by changes in interest rates. Bonds and bond strategies with longer durations tend to be more sensitive and volatile than those with shorter durations; bond prices generally fall as interest rates rise. Bond investments may be worth more or less than the original cost when redeemed. Diversification does not ensure against loss.

DEFINITIONS: The broad fixed income market is represented by the **Bloomberg US Aggregate Bond Index**, which is an unmanaged, broad based index composed of US dollar denominated, investment grade, fixed-rate taxable bonds with at least $250 million par amount outstanding and at least one year to final maturity.

Short duration high yield is represented by the I**CE BofA 0-2 Year Duration BB-B US High Yield Constrained Index (H42C)** which is a subset of the HUC4 that consists of all securities that have a duration-to-worst of 2 years or less. The ICE BofA US High Yield, BB/B Rated, Constrained Index (HUC4) has an inception date of December 31, 1996, and is a subset of the ICE BofA US High Yield Index (H0A0) that consists of all securities rated BB1 through B3, based on an average of Moody's, S&P and Fitch, but caps issuer exposure at 2%. The ICE BofA US High Yield Index (H0A0) has an inception date of August 31, 1986 and tracks the performance of US dollar denominated below investment grade corporate debt publicly issued in the U.S. domestic market.These indices are unmanaged, not available for direct investment and do not reflect deductions for fees or expenses.

Duration is a measure of the sensitivity of the price of a fixed-income investment to a change in interest rates expressed as a number of years.

A **bond rating** is a grade typically given by a private independent rating service that indicates a security's credit quality, which is intended to evaluate a bond issuer's financial strength, or its ability to pay a bond's principal and interest in a timely fashion. High-yield bonds are debt obligations with a bond rating of Baa or lower according to Moody's, or BB or lower on the Standard & Poor's scale. High yield securities involve greater risk than higher-rated securities; portfolios that invest in them may be subject to greater levels of credit and liquidity risk than portfolios that do not.

An **efficient frontier** is the set of optimal portfolios that offers the highest expected return for a defined level of risk or the lowest risk for a given level of expected return. Portfolios that lie below the efficient frontier are sub-optimal, because they do not provide enough return for the level of risk. Portfolios that cluster to the right of the efficient frontier are also sub-optimal, because they have a higher level of risk for the defined rate of return.

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