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SKY HARBOR
CAPITAL MANAGEMENT

Weekly Briefing

SKYView: Technicals

The upcoming Fed meeting, Brexit developments, continued uncertainty surrounding US/China trade relations—there is no shortage of factors on the horizon likely to influence the pricing of risk. Absent these issues, we would be remiss not to mention that the month of November has historically been weak for the US high yield bond market. In this *Weekly Briefing*, we put aside near-term event risk and examine technical trends that have likely contributed to lackluster November returns in years past.

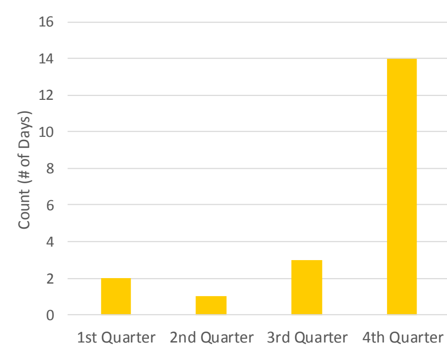
Historically speaking, November has been the weakest month for US high yield bond returns (as always, we use the ICE BofAML US High Yield Index, ticker H0A0, as our proxy). The table below, which aggregates data over a 20-year period, shows that November ranks at the bottom in average monthly returns and percentage of negative return months, and has seen total returns drop below zero in seven of the last ten years. Furthermore, we find that 14 of the 20 worst US high yield index total return days in the last two decades (well over 5,000 trading sessions) have occurred during the 4th quarter of the year.

November Returns Have Been Weak
ICE BoAML US High Yield Index (H0A0) monthly data, trailing 20 years

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2000	(0.38)	0.21	(1.47)	0.00	(1.26)	1.93	0.54	0.98	(0.87)	(3.19)	(3.84)	2.28
2001	6.33	1.52	(2.00)	(1.36)	1.76	(2.63)	1.63	0.79	(6.91)	3.20	3.52	(0.79)
2002	0.55	(1.32)	2.52	1.60	(0.77)	(7.74)	(3.88)	2.50	(1.56)	(0.84)	6.25	1.46
2003	3.00	1.35	2.64	5.81	1.15	2.80	(1.36)	1.28	2.71	2.07	1.38	2.37
2004	1.62	(0.11)	0.67	(0.66)	(1.57)	1.45	1.35	1.82	1.39	1.93	1.04	1.51
2005	(0.10)	1.43	(2.73)	(1.07)	1.79	1.90	1.57	0.36	(1.00)	(0.73)	0.48	0.92
2006	1.59	0.63	0.63	0.64	(0.06)	(0.38)	1.07	1.62	1.32	1.46	1.60	1.10
2007	1.07	1.39	0.23	1.32	0.71	(1.69)	(3.14)	1.12	2.44	0.61	(2.05)	0.29
2008	(1.36)	(1.19)	(0.52)	4.17	0.43	(2.68)	(1.60)	0.32	(8.30)	(16.30)	(8.43)	7.47
2009	5.31	(3.47)	3.30	11.47	7.11	3.18	6.18	2.03	5.98	1.79	1.01	3.14
2010	1.52	0.16	3.10	2.24	(3.52)	1.30	3.47	0.16	2.97	2.43	(1.12)	1.76
2011	2.10	1.34	0.42	1.52	0.49	(1.00)	1.24	(4.01)	(3.60)	5.96	(2.21)	2.48
2012	2.90	2.28	(0.09)	1.02	(1.21)	2.03	1.92	1.21	1.42	0.83	0.74	1.59
2013	1.38	0.46	1.03	1.86	(0.53)	(2.64)	1.88	(0.62)	0.99	2.46	0.47	0.55
2014	0.74	2.00	0.23	0.69	1.01	0.85	(1.32)	1.52	(2.10)	1.14	(0.72)	(1.47)
2015	0.69	2.39	(0.53)	1.20	0.30	(1.53)	(0.62)	(1.76)	(2.59)	2.73	(2.25)	(2.58)
2016	(1.58)	0.47	4.42	4.00	0.72	1.08	2.53	2.23	0.65	0.31	(0.39)	1.97
2017	1.34	1.56	(0.21)	1.13	0.89	0.11	1.15	(0.03)	0.90	0.39	(0.27)	0.29
2018	0.64	(0.93)	(0.62)	0.67	(0.02)	0.35	1.12	0.72	0.58	(1.64)	(0.91)	(2.19)
2019	4.59	1.69	0.98	1.40	(1.27)	2.45	0.51	0.39	0.32			
Monthly Avg.	1.60	0.59	0.60	1.88	0.31	(0.04)	0.71	0.63	(0.26)	0.24	(0.30)	1.16
Rank	2	7	6	1	8	10	4	5	11	9	12	3
% Neg Months	20%	25%	40%	15%	45%	40%	30%	20%	40%	26%	53%	21%
Rank	2	5	8	1	11	8	7	2	8	6	12	4

Source: SKY Harbor, ICE BofAML Indices

Distribution of Largest US High Yield Drawdown Days
20 worst return days, trailing 20 years



This dynamic, we would note, has not been confined to high yield bonds. As demonstrated below, November has been similarly weak for the US investment grade market (we use the ICE BofAML US Corporate Index, ticker C0A0, as our proxy), with the month registering worst in average returns and the prevalence of sub-zero return periods. Leveraged loans have similarly experienced woes, with November historically among the three weakest months of the year.

Investment Grade Credit Has Not Fared Better…
ICE BofAML US Corporate Index (C0A0) monthly data, trailing 10 years

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2010	2.01	0.38	0.35	1.76	(0.57)	2.06	2.05	2.19	0.59	0.21	(0.86)	(0.95)
2011	0.24	0.71	0.03	1.70	1.43	(0.83)	2.29	0.10	(0.13)	1.75	(1.87)	1.93
2012	2.18	0.85	(0.59)	1.28	0.58	0.50	2.81	0.40	0.74	1.32	(0.08)	(0.02)
2013	(0.72)	0.71	0.07	1.70	(2.28)	(2.76)	0.74	(0.67)	0.82	1.50	(0.29)	(0.18)
2014	1.78	1.10	0.07	1.17	1.53	0.17	(0.12)	1.43	(1.24)	0.93	0.64	(0.14)
2015	2.74	(0.84)	0.37	(0.53)	(0.51)	(1.64)	0.54	(0.67)	0.52	0.54	(0.22)	(0.87)
2016	0.44	0.74	2.71	1.36	(0.07)	2.18	1.45	0.27	(0.29)	(0.83)	(2.68)	0.63
2017	0.41	1.13	(0.12)	1.00	1.16	0.25	0.75	0.85	(0.23)	0.40	(0.14)	0.85
2018	(0.92)	(1.50)	0.22	(0.85)	0.45	(0.54)	0.74	0.54	(0.33)	(1.35)	(0.19)	1.50
2019	2.09	0.36	2.49	0.56	1.44	2.30	0.66	3.04	(0.62)			
Monthly Avg.	1.03	0.36	0.56	0.91	0.32	0.17	1.19	0.75	(0.02)	0.50	(0.63)	0.31
Rank	2	7	5	3	8	10	1	4	11	6	12	9
% Neg Months	20%	20%	20%	20%	40%	40%	10%	20%	60%	22%	89%	56%
Rank	2	2	2	2	8	8	1	2	11	7	12	10

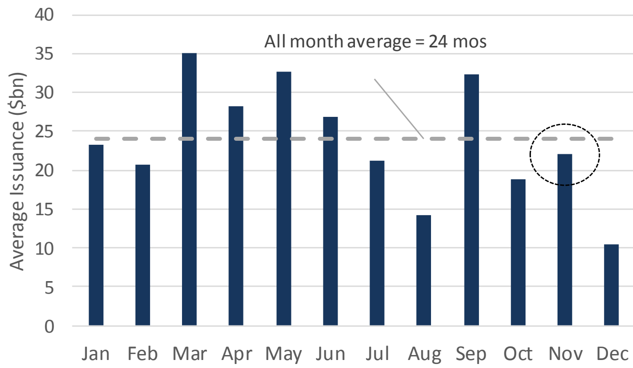
…Nor Have Leveraged Loans
Credit Suisse Leveraged Loan Index (LEVLOAN) monthly data, trailing 10 years

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2010	1.81	0.32	2.16	1.28	(2.06)	(0.24)	1.43	0.36	1.28	1.46	0.48	1.33
2011	1.96	0.53	0.14	0.60	0.06	(0.33)	0.16	(4.16)	0.25	2.59	(0.38)	0.51
2012	2.00	0.74	0.70	0.78	(0.51)	0.74	0.97	1.05	1.08	0.37	0.40	0.73
2013	1.12	0.39	0.85	0.75	0.23	(0.55)	1.07	0.04	0.29	0.80	0.48	0.53
2014	0.71	0.22	0.37	0.23	0.61	0.60	(0.04)	0.23	(0.52)	0.29	0.46	(1.10)
2015	0.26	1.41	0.39	0.90	0.20	(0.31)	0.09	(0.65)	(0.67)	(0.14)	(0.89)	(0.95)
2016	(0.73)	(0.56)	2.64	1.90	0.91	0.03	1.41	0.79	0.87	0.77	0.32	1.15
2017	0.53	0.59	0.08	0.44	0.38	(0.06)	0.78	(0.14)	0.41	0.66	0.12	0.39
2018	1.08	0.18	0.32	0.49	0.19	0.10	0.83	0.41	0.68	0.01	(0.82)	(2.29)
2019	2.30	1.57	(0.12)	1.59	(0.23)	0.22	0.78	(0.28)	0.42	(0.45)		
Monthly Avg.	1.10	0.54	0.75	0.90	(0.02)	0.02	0.75	(0.23)	0.41	0.64	0.02	0.03
Rank	1	6	3	2	11	9	4	12	7	5	10	8
% Neg Months	10%	10%	10%	0%	30%	50%	10%	40%	20%	22%	33%	33%
Rank	2	2	2	1	8	12	2	11	6	7	9	9

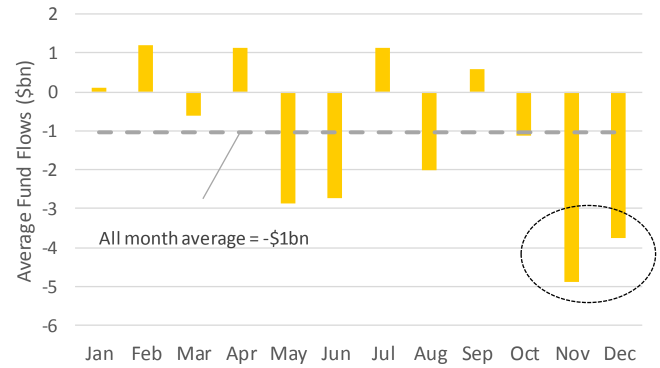
Source: SKY Harbor, ICE BofAML Indices, Credit Suisse

November weakness appears partially rooted in market technicals. As seen below, November new issuance is typically in line to modestly below the all-periods average. However, we surmise that the US Thanksgiving holiday and earnings season dynamics likely compresses the available issuance window, forcing management teams to roadshow and investors to absorb new supply in a narrow period before the holiday season slowdown (between Thanksgiving and New Year's Day). Additionally, data since 2015 suggests that high yield typically experiences heavier-than-usual outflows in November – perhaps the result of tax-loss harvesting – contributing to technical headwinds.

Average Monthly US High Yield New Issuance
monthly averages, 2014 through 2019



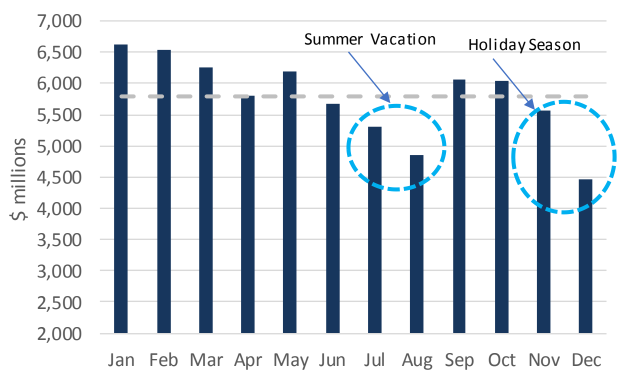
US High Yield Fund Flows
monthly averages, 2015 through 2019



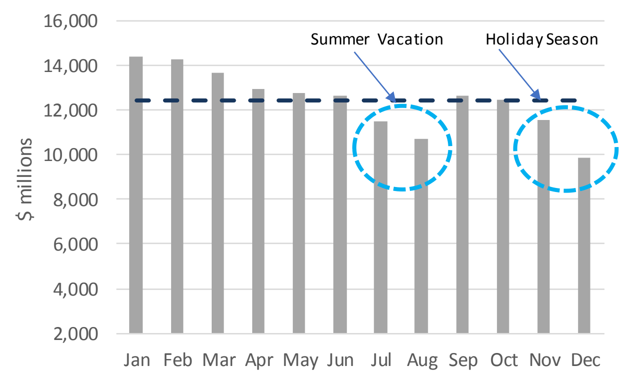
Source: SKY Harbor, JP Morgan

Sluggish returns in November also coincide with reduced trading volumes, as both high yield and investment grade bond market activity traditionally slows in summer months and during the year-end holiday season. Anecdotally, we think some managers and sell-side trading desks may attempt to lock in gains by November, unwilling to risk late-year reversals, particularly if performance has been strong.

FINRA TRACE HY Bond Dollar Volume
daily data since 2005, dotted line is daily average



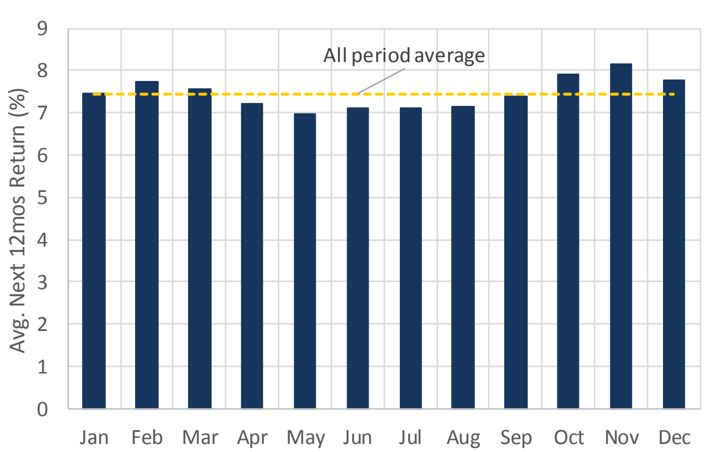
FINRA TRACE IG Bond Dollar Volume
daily data since 2005, dotted line is daily average



Source: SKY Harbor, FINRA, Bloomberg

We would, however, caution against attempting to opportunistically time the market. While we concede that November returns have been unambiguously weak over the last decade or two, the dynamic is fleeting. Running next-twelve-month total returns from each month-end period since 1999, we find that any disadvantage initially incurred during the month of November is subsequently reversed. On an even more granular basis, we note that 17 of the 20 worst trading days over the last two decades (again, over 5,000 observations) occurred within 27 days of one of the 20 best trading days over the last two decades (a range of 1 to 27 days, or an average of 9 days).

Next 12 Months Total Return by Starting Month
monthly data, trailing 20 years



Source: SKY Harbor, ICE BofAML Indices

Market Timing Poses Challenges
worst trading days, last 20 years

Date of Bottom 20 Day	Total Rtn. Of Bottom 20 Day (%)	Distance from Top 20 Day (days)	Date of Bottom 20 Day	Total Rtn. Of Bottom 20 Day (%)	Distance from Top 20 Day (days)
10/10/2008	-4.7	2	10/16/2008	-1.9	2
6/26/2002	-4.1	outlier	8/8/2011	-1.7	outlier
9/14/2001	-2.8	outlier	10/4/2011	-1.6	6
11/20/2008	-2.4	16	10/24/2008	-1.6	3
10/2/2008	-2.3	8	11/21/2008	-1.5	17
10/15/2008	-2.2	1	1/20/2016	-1.4	2
10/6/2008	-2.0	6	11/18/2008	-1.4	14
10/8/2008	-2.0	4	12/14/2015	-1.3	27
11/19/2008	-2.0	15	9/26/2008	-1.3	12
10/9/2008	-1.9	3	2/24/2009	-1.3	12

ex outlier average = 8.8 days

In conclusion, November total returns have historically been weak in both high yield and investment grade bond markets. This dynamic is likely the result of a tight new issuance schedule (ahead of the holiday season), fund outflows and limited trading activity amidst fund managers and trading desks attempting to "lock in" performance ahead of year-end (be it causal or coincident). Despite these trends, the efficacy of market timing is elusive given a tight grouping of both the weakest and strongest high yield trading days, all supporting our view of the asset class as a strategic – not tactical – allocation.

On the Calendar

Occurred

Event	Release Date	Period	Survey	Actual	Prior
Existing Home Sales	22-Oct-19	Sep	5.45m	5.38m	5.49m
Durable Goods Orders	24-Oct-19	Sep	-0.7%	-1.1%	0.2%
New Home Sales	24-Oct-19	Sep	702k	701k	713k

Upcoming

Event	Release Date	Period	Survey	Actual	Prior
Wholesale Inventories MoM	28-Oct-19	Sep	0.3%		0.2%
Conf. Bd. Consumer Confid.	29-Oct-19	Oct	128.0		125.1
FOMC Rate Decision (Upper)	30-Oct-19	30-Oct	1.75%		2.00%

Source: SKY Harbor, Bloomberg

Recommended Reading

Kiernan, Paul (2019, October 19). Officials View Trade Uncertainty as Biggest Global Economic Risk. *The Wall Street Journal* (subs. req.), Retrieved from https://www.wsj.com/articles/officials-view-trade-uncertainty-as-biggest-global-economic-risk-11571497200

Condon, Christopher and Middleton, Chris (2019, October 25). Fed Seen Cutting Rates Next Week and Then Hitting Pause Button. *Bloomberg*, Retrieved from https://www.bloomberg.com/news/articles/2019-10-25/fed-seen-cutting-rates-next-week-and-then-hitting-pause-button?srnd=economics-vp

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