ADVISOR PERSPECTIVES

High Yield Bonds versus Equities

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Investors are often led down the path that they must invest in equities in order to generate a decent return, and that the high yield market is too risky and speculative. However, reality and the data points suggest otherwise. Looking over the past couple decades and various periods in between, you can see that high yield has outperformed the equity market (as measured by the S&P 500 Index) on a risk adjusted basis (return/risk) over the past 5, 10, 15 and 25 years, and performed equivalently over the last 3 years.[1]

	Average Annual Returns						Average Annual Volatility						Return/Risk (Modified Sharpe Ratio[2])					
	1 Year	3 Year	5 Year	10 Year	15 Year	25 Year	1 Year	3 Year	5 Year	10 Year	15 Year	25 Year	1 Year	3 Year	5 Year	10 Year	15 Year	25 Year
High Yield Bonds	4.58%	10.07%	10.44%	8.22%	8.04%	9.25%	4.13%	4.43%	5.87%	9.81%	9.08%	8.27%	1.11	2.27	1.78	0.84	0.89	1.12
S&P 500	16.85%	20.92%	15.95%	8.06%	4.66%	9.73%	8.23%	9.04%	12.98%	14.69%	15.32%	14.64%	2.05	2.31	1.23	0.55	0.30	0.66

Sources: J.P. Morgan; Bloomberg. Data as of 11/28/2014.
[2] Annualized returns divided by the annualized standard deviation of return.

Here, risk is defined as standard deviation, or volatility of returns. Even taking into account the enormous technology and internet rallies of the late 1990's, high yield bonds have performed only slightly lower than equities over the past 25 years, but with nearly half of the risk (standard deviation), for a significant risk adjusted outperformance.[3]

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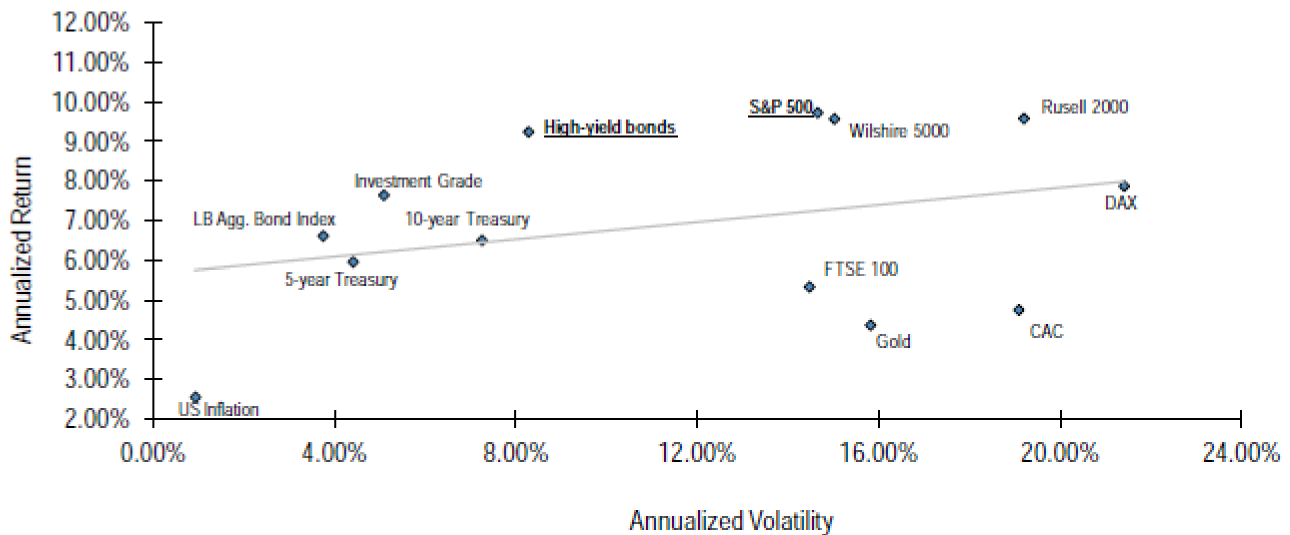
High-yield bonds remain excellent substitutes for equities



Source: J.P. Morgan.

Looking at that “riskiness” of the high yield asset class in another way, investors need to remember that in a company’s capital structure, equities fall below bonds, no matter the bond rating (investment grade or high yield). This means that in any sort of difficult situation, the bonds get paid back first. Further, as the data above shows, high yield bonds have much lower risk as measured by volatility (annualized standard deviation), giving high yield bonds what we see as a significant return/risk advantage.

The data speaks for itself: it may be time for investors to reconsider their sizable allocations to the equity market and instead, consider an increased allocation to the high yield bond market. We believe that the compelling historical long-term returns profile and lower risk (volatility) relative to equities warrants investors paying more attention to the high yield asset class and that it supports the argument that high yield should be a core part of an investment portfolio, especially in today’s low-yielding environment. And with the advent of high yield exchange traded funds, accessing the high yield market is now available to retail and institutional investors alike.

[1]Acciavatti, Peter, Tony Linares, Nelson Jantzen, CFA, Rahul Sharma, and Chuanxin Li. “2014 High Yield-Annual Review,” J.P. Morgan North American High Yield Research, December 29, 2014, p. A144. “High Yield Bonds” as represented by the JPMorgan High Yield Bond Index, which consists of fixed income securities with a maximum credit rating of BB+ or Ba1.

[2] Sharpe ratio consists of annualized returns divided by the annualized standard deviation of return.

[3] Acciavatti, Peter D., Tony Linares, Nelson Jantzen, CFA, Rahul Sharma, and Chuanxin Li. “2014 High-Yield Annual Review.” J.P. Morgan, North American High Yield and Leveraged Loan Research. December 29, 2014, p. 123.

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