

Unlocking the High Yield Bond Market

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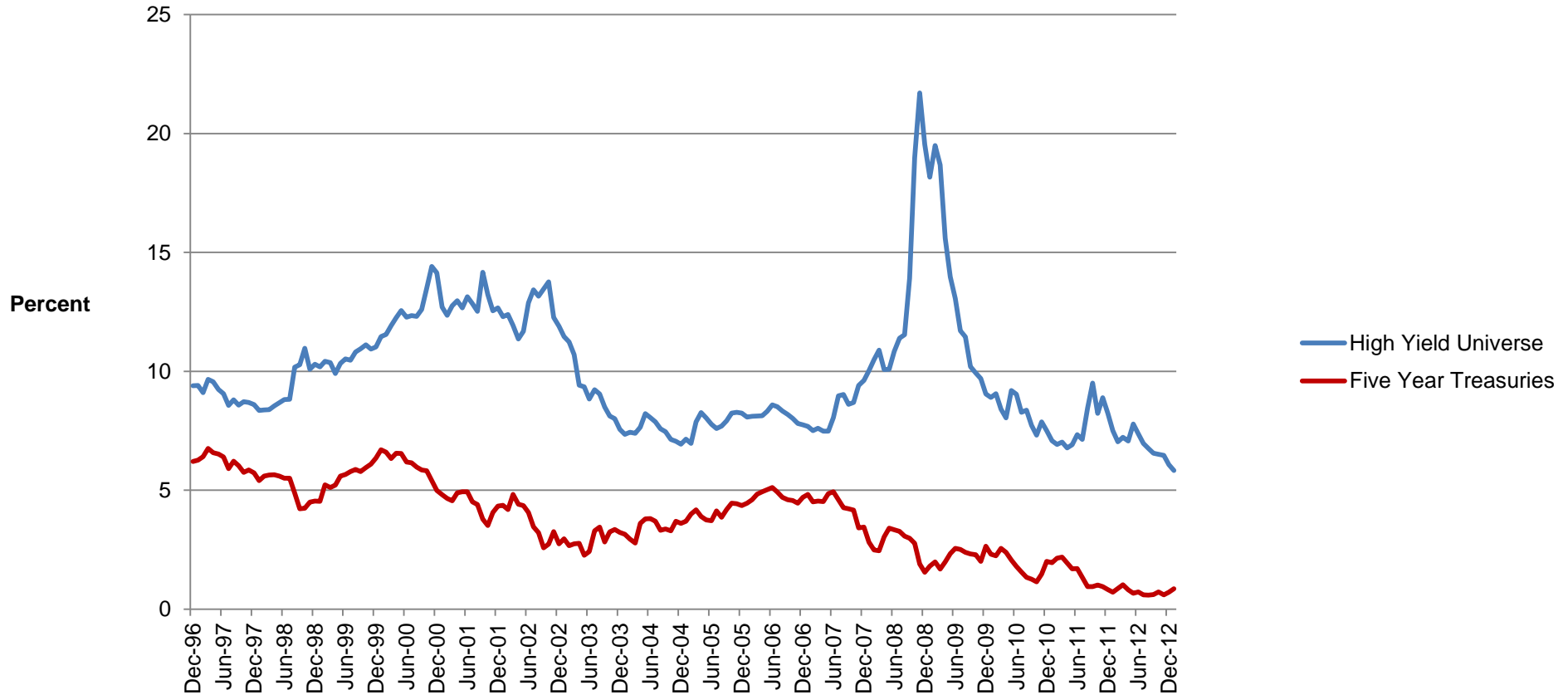
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Is There a Bubble in High Yield Bonds?

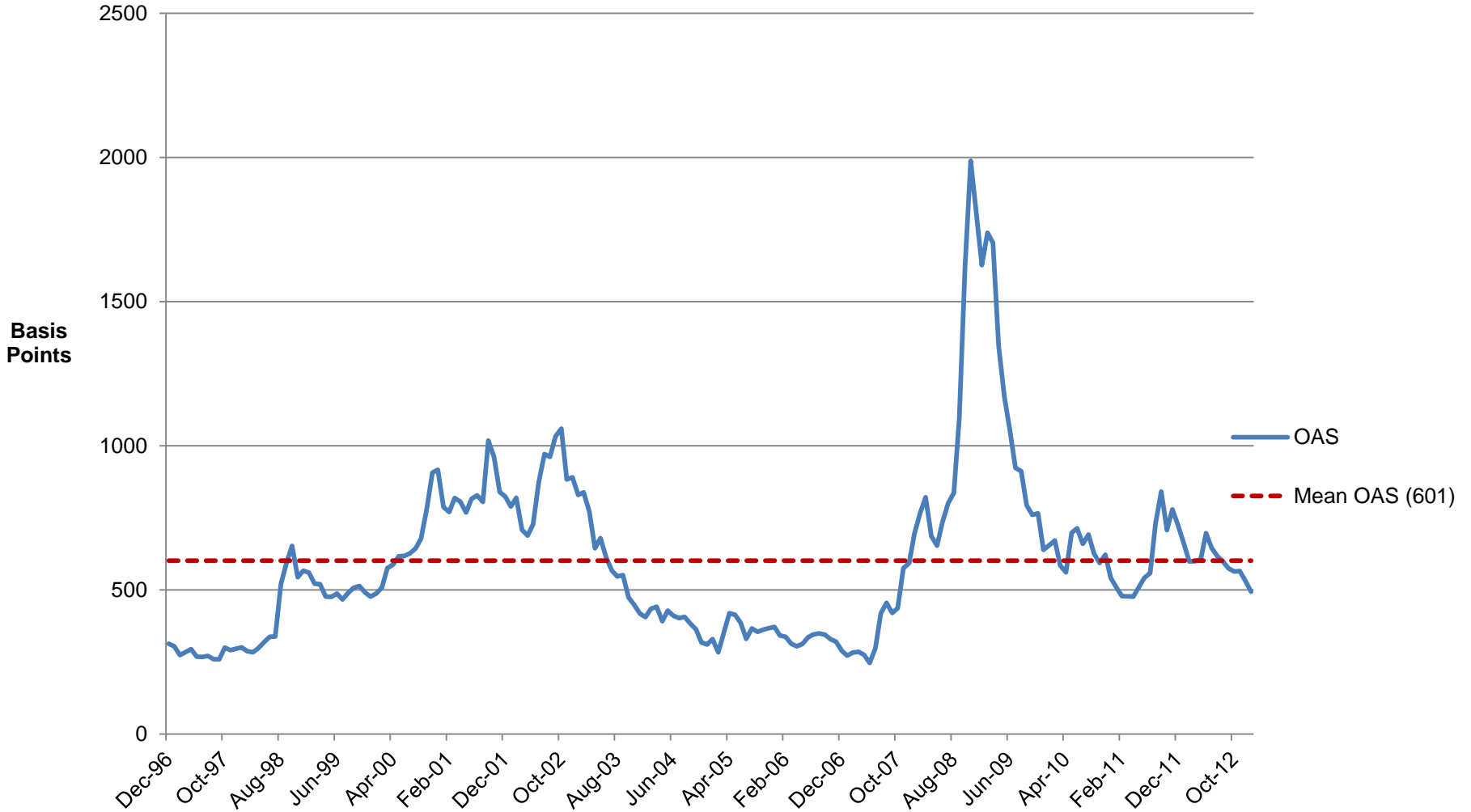
Yield-To-Worst: High Yield Master II Index and Five-Year Treasury Index Monthly, December 1996 – January 2013



Source: BofA Merrill Lynch Global Research, Used with Permission

Exhibit 2

Option-Adjusted Spread: High Yield Master II Index Monthly, December 1996 – January 2013

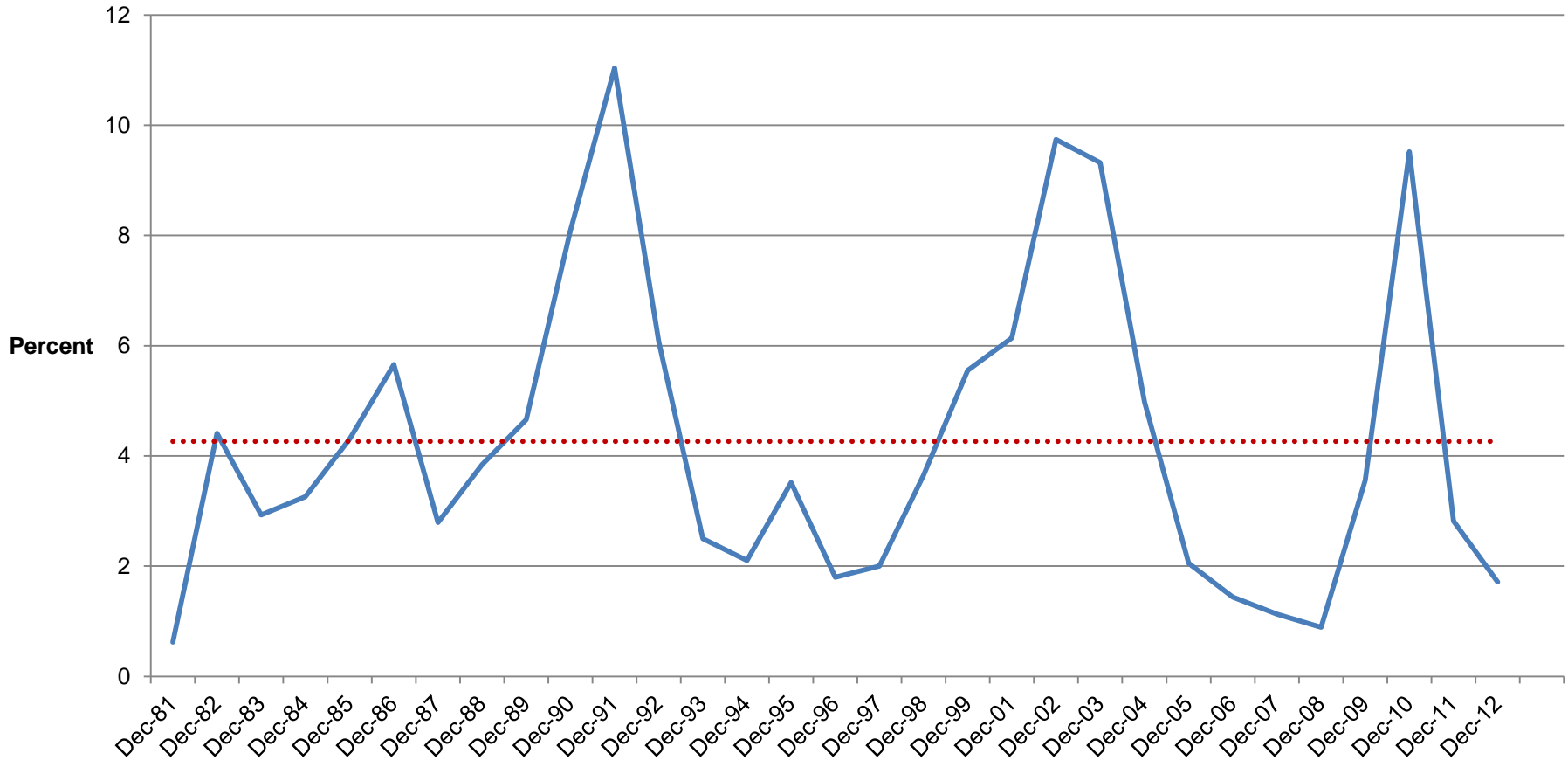


Source: BofA Merrill Lynch Global Research, Used with Permission

Global Default Rate

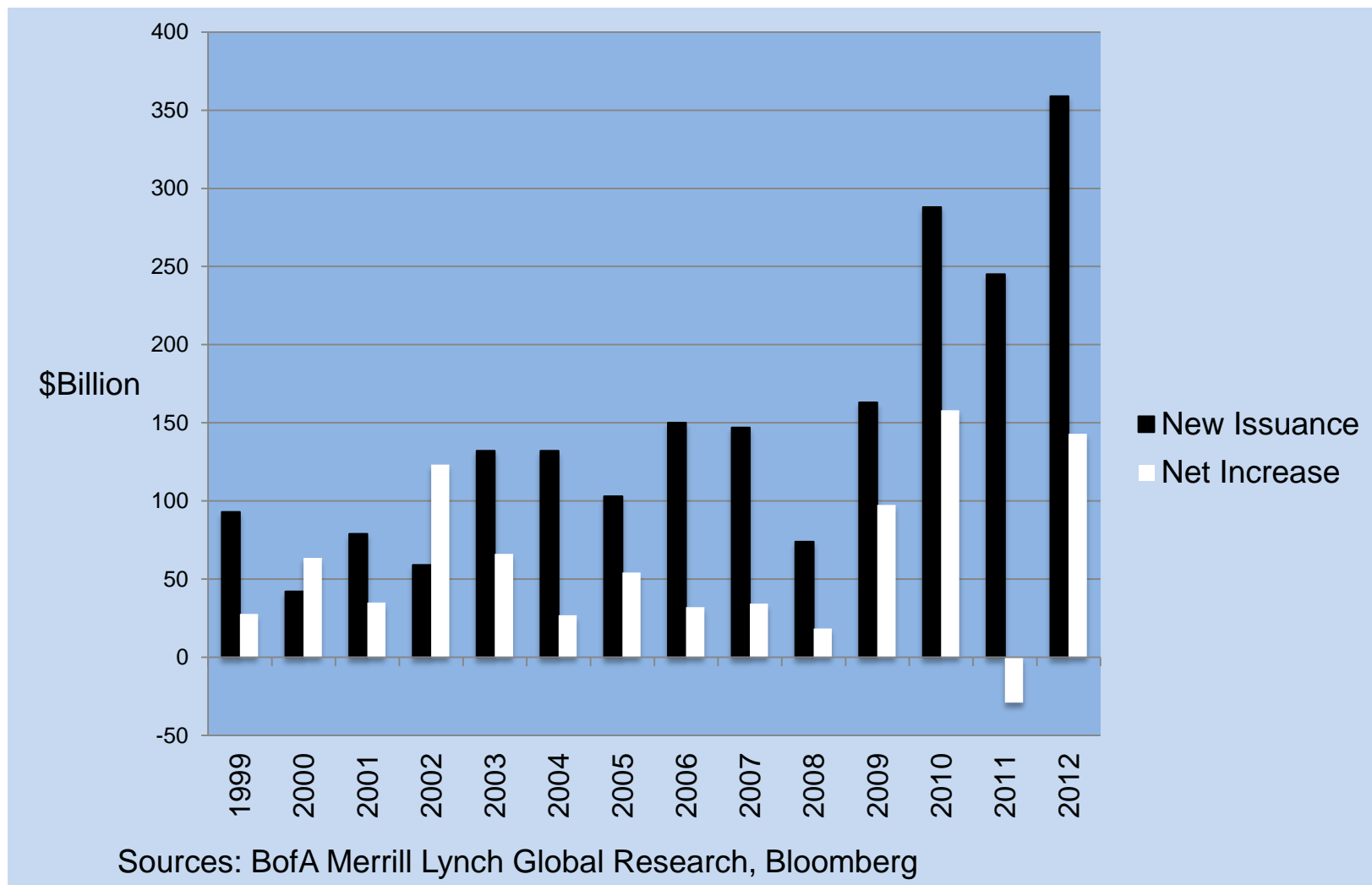
Percentage-of-Issuers Basis

Annually, 1981 – 2012

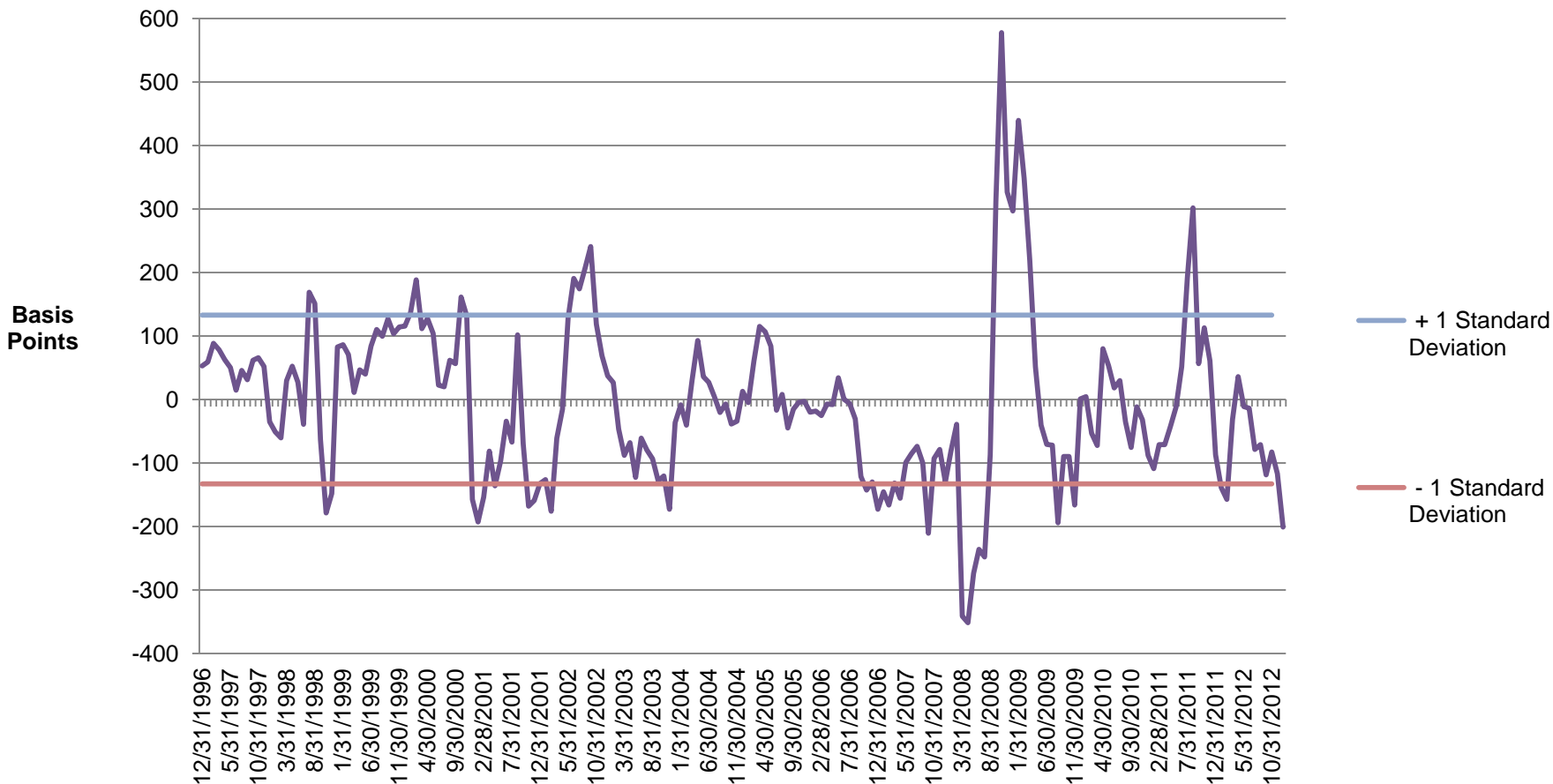


Source: Standard & Poor's

New Issuance vs Net Increase in Outstanding U.S. High Yield Bonds, 1999-2012



Actual Spread minus Fair Value Monthly, December 1996- January 2013



Sources: BofA Merrill Lynch Global Research, Bloomberg, S&P, Federal Reserve

Conclusion:

- High yield is extremely rich because Fed's low-interest rate policy is driving investors into risky assets.
- But buying is not driven by Greater Fool Theory

**Has New Issue Boom Trashed
Credit Quality?**

Triple-C as Percent of High Yield Universe

By Face Amount, 1996 - 2012



Source: BofA Merrill Lynch Global Research, Used with Permission

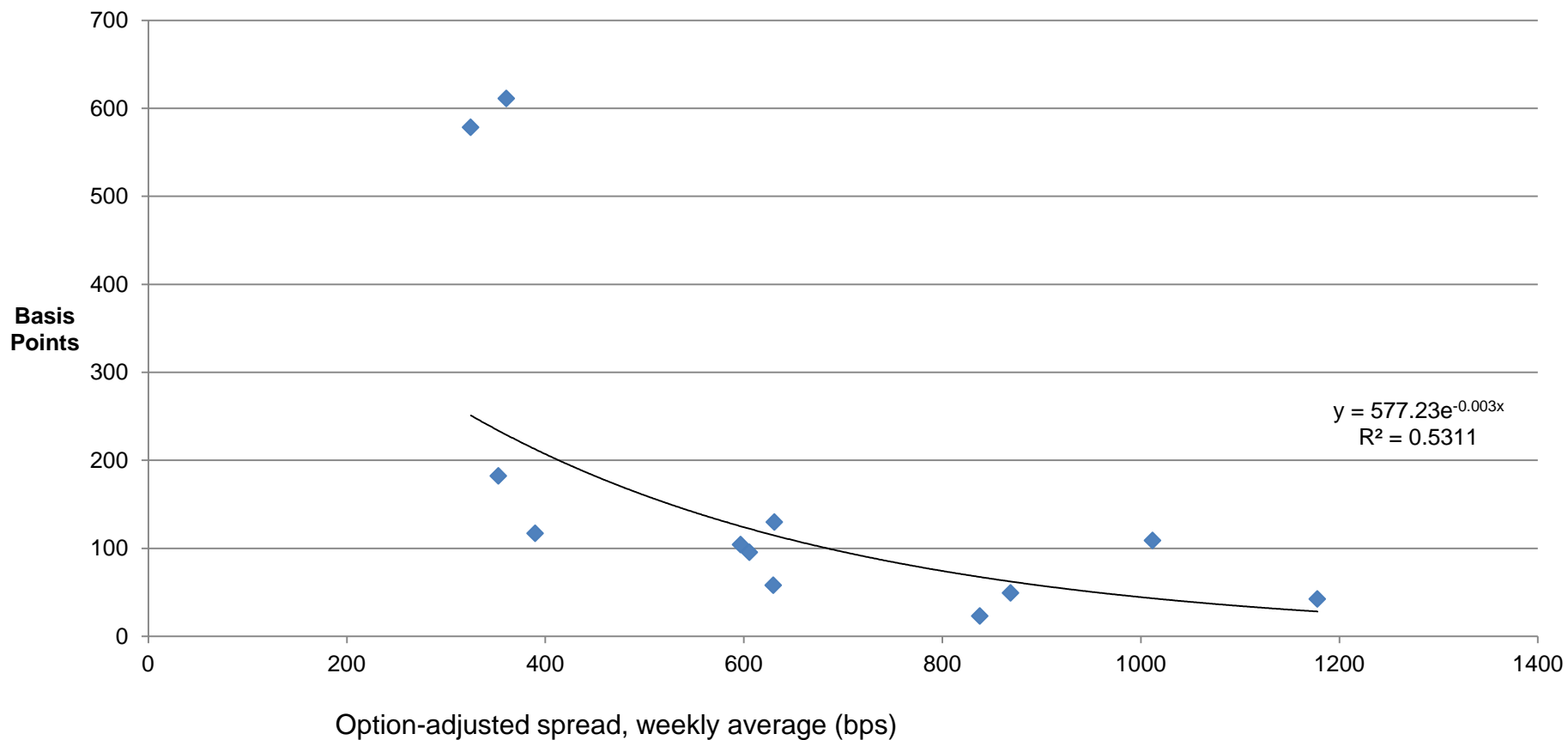
Conclusion:

- Credit quality deterioration of high yield universe has been modest
- Caveat: Seasoning of new issues also matters
- Ratings mix changes driven more by upgrading and downgrading than by new issuer quality

Is LBO Volume about to Surge?

High Yield Spread versus LBO Volume

U.S., Annually 2001-2012



Sources: BofA Merrill Lynch Global Research, Used with Permission, Bloomberg

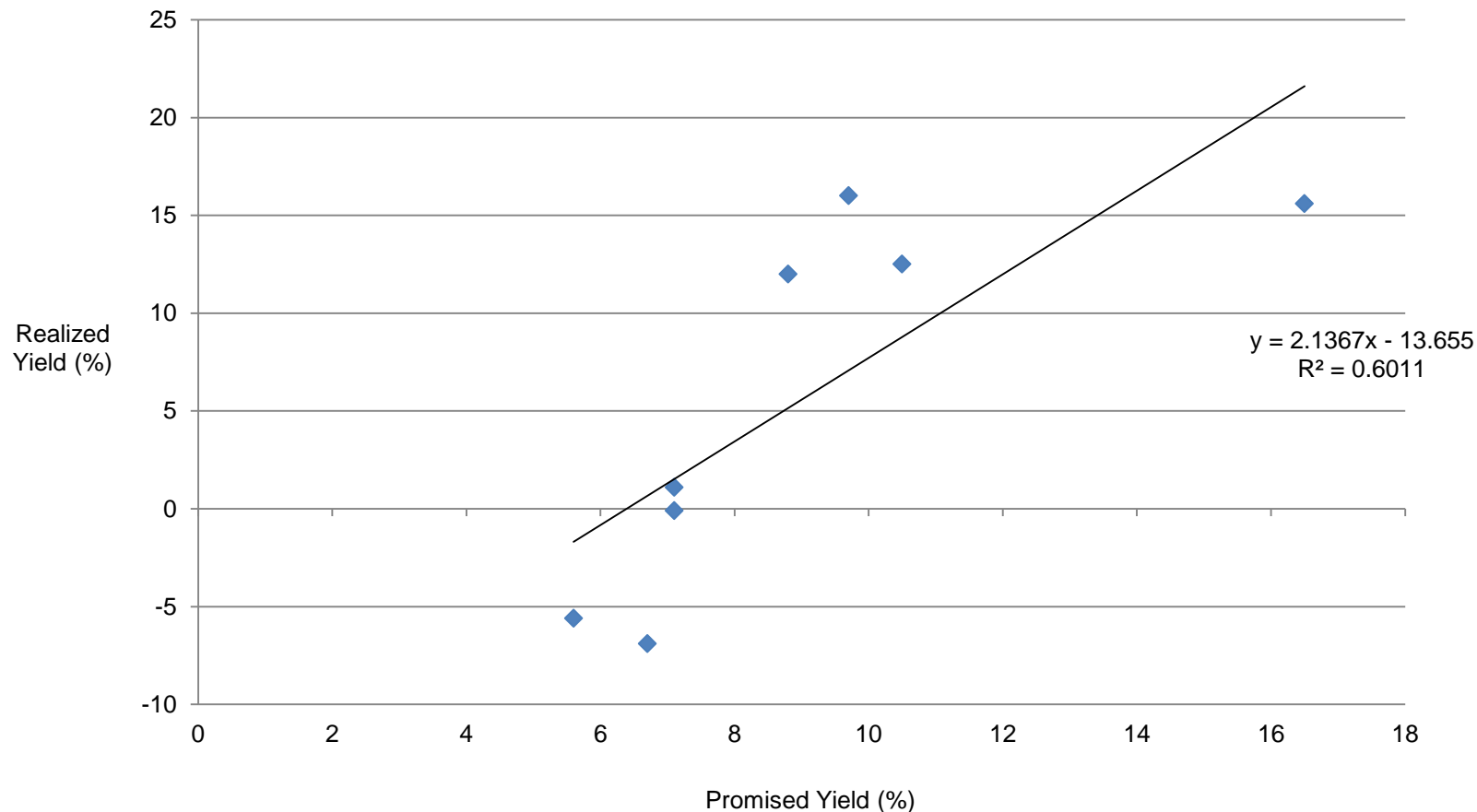
Conclusion:

- Modest rise in LBO volume likely in 2013
- Credit implications moderately unfavorable

**For the Past Century Beginning
Yield Has Controlled Annualized
Return over Next Four Years**

Quadrennial Promised and Realized Yields on Low-Rated Bonds

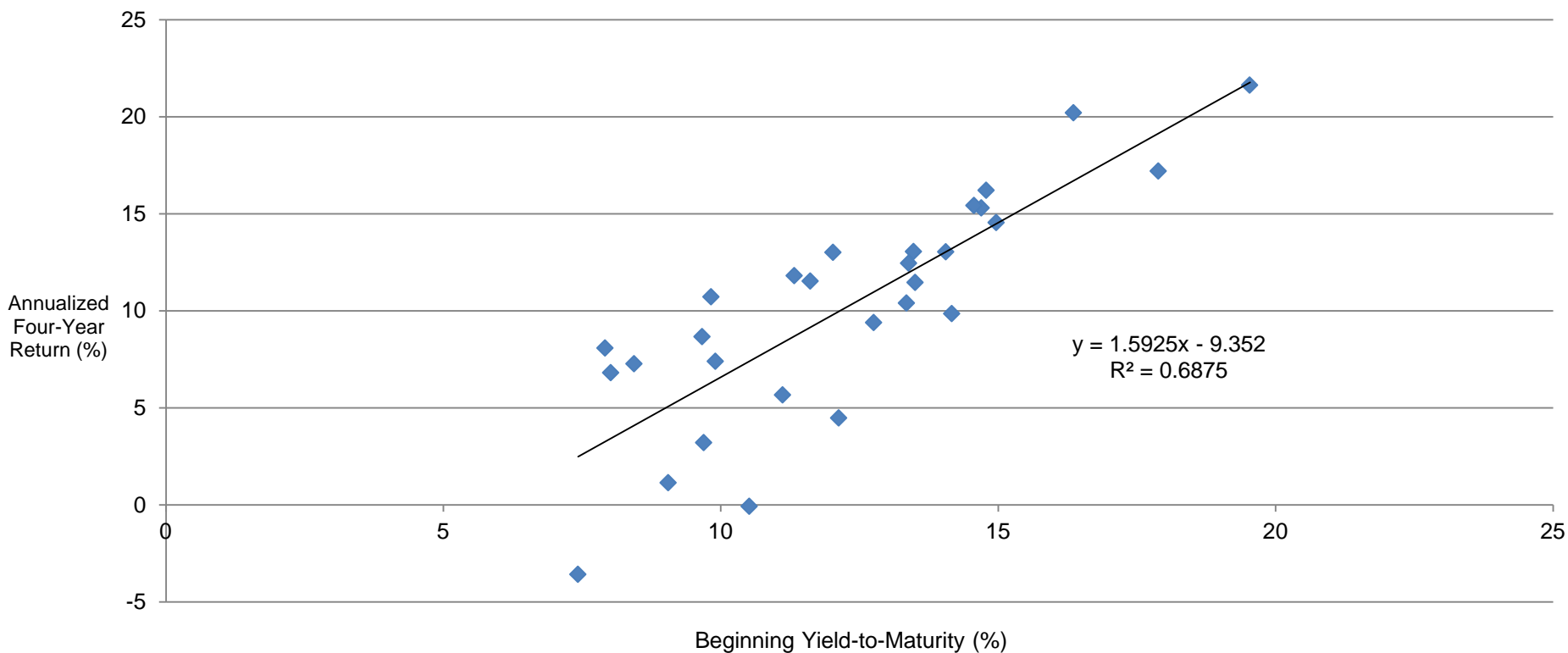
1912-1943



Source: W. Braddock Hickman, *Corporate Bond Quality and Investor Experience* (Princeton University Press, 1958)

Trailing-Four-Year Periods Beginning 1981-2009

Yield-to-Maturity and Annualized Return



Note: High Yield 100 (1981-1984), Master (1985-1987), Master II (1988-2009)

Source: BofA Merrill Lynch Global Research, used with permission

Conclusion

- Expected return for 2013-2016 is 1.40% annualized
- Something exceptional must occur for high yield to earn the coupon over that period

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