# RBC High Yield Bond Fund

## Commentary as at December 31, 2023

U.S. high-yield bonds outperformed Canadian investment-grade bonds in 2023, leading to strong overall returns for the Fund.

The high-yield recovery started in the spring after regulators defused a short-lived banking crisis that led to the second- and third-biggest U.S. bank failures by assets. The speed at which the U.S. Federal Reserve raised rates – it was the most aggressive rate-hiking cycle since the early 1980s – was partly responsible for investors' loss of confidence in the banks. Returns were bolstered in the second half of 2023 by optimism that stubbornly high inflation was receding following almost two years of benchmark interest-rate hikes.

Also aiding returns in 2023 was a modest supply of newly issued bonds and a shrinking high-yield market as many companies were upgraded to investment-grade status. Given these factors and strong U.S. economic growth, defaults remained low and lower-rated bonds outperformed higher-rated bonds for the year as a whole.

The Fund's allocation to high-yield bonds aided relative returns in 2023 given that high-yield bonds significantly outperformed investment-grade bonds, which the Fund also holds and which make up the benchmark by which performance is measured. The Fund's overweight position in the Energy sector also boosted returns after energy prices recovered in the third quarter of the year. Limiting returns were the Fund's allocation to cash, and positions in a hospital real estate investment trust and a low-fare U.S. domestic airline.

Riskier assets have rallied on market expectations that we may have seen the peak in interest rates, increasing the probability of an economic "soft landing." The rise in prices of high-yield bonds resulted in the benchmark yield falling to 7.6% at the end of 2023 from 9.5% just two months earlier (prices rise as yields fall) and has limited the potential for gains in 2024.

While high-yield-bond valuations are still somewhat attractive, the premium to own lower-rated corporate bonds is less than the historical average and may be insufficient to compensate for increasing risks. Moreover, the outlook for the U.S. economy is cloudy, and the portfolio manager remains cautious. Bonds of some companies that missed earnings estimates have fallen in recent months. For now at least, high-yield defaults remain low, the quality of the companies in the high-yield market remains relatively high, and corporate earnings are strong.

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