

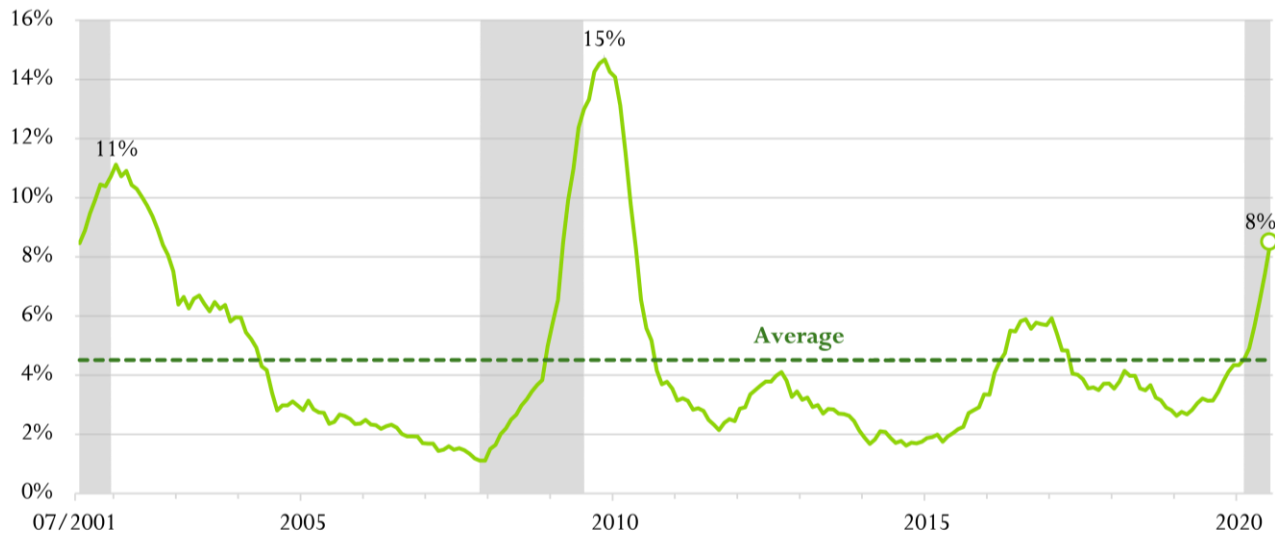
## How Tactical High Yield Income Strategies Handle Rising Defaults

An eye-catching [rise in corporate default rates](#) has investors wondering whether now is a good time to invest in high-yield corporate bonds. We believe investors should be cautious about using default rates to try to time the market. Bond prices tend to reflect rising credit risk *before* default rates rise; historically, defaults are a lagging indicator. However, systematic tactical trend following can potentially help investors manage high yield default risk.

### The Default Rate Is a Slow, Noisy Signal

Investors who focus on corporate bond defaults can easily get caught wrong-footed. Default rates in high-yield bonds have spiked above their longer-term average four times in the past 20 years: during the dot-com bust, during the Great Recession, during the 2015 Shale Bust, and during the 2020 COVID outbreak. In each of the three past cases, the market has tended to predict a rise in credit risk *before* defaults started piling up. After each crisis passed, defaults only tended to fall well after the next bull market was underway. This makes intuitive sense: company management will often delay default as long as possible, even as worsening economic conditions become obvious to bond investors.

### U.S. Speculative-Grade Default Rates



Source: Moody's.

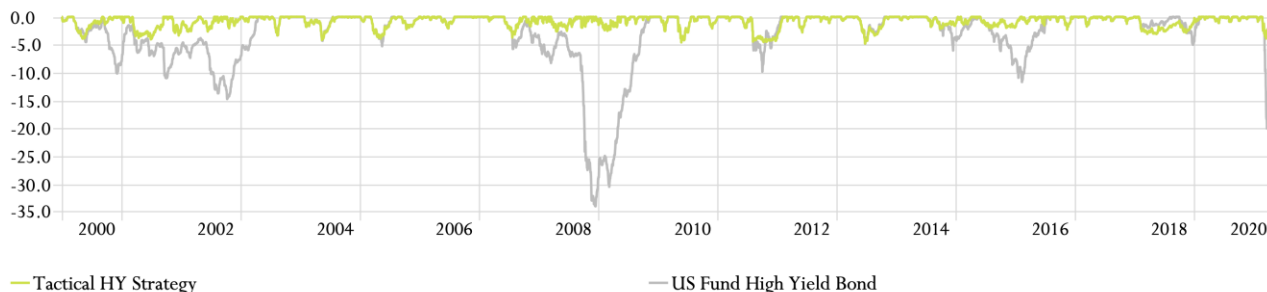
Investors who focus too intently on spiking default rates could be double-counting information the market has already accounted for. This makes the default rate a slow, noisy signal – and potentially useless for timing the high-yield bond market.

### Tactical High Yield Strategies Can Help Manage Credit Risk

The misleading nature of the default rate reinforces the lesson: Discretionary market-timing decisions in high yield credit often leave investors worse off for their efforts. Meanwhile, [systematic trend-following strategies](#) in high yield credit have a strong track record in [helping investors avoid portfolio drawdowns during periods of market stress](#). The following chart compares passive investment in high yield credit with a systematic 200 day moving average tactical timing strategy applied to the same high yield index.

## High Yield vs. Tactical High Yield Drawdown

Time Period: 1/1/2000 to 4/30/2020



Source: Morningstar. The Tactical High Yield Strategy is defined by buying the Morningstar High Yield Category when it closes above its 200-day moving average the prior day. The strategy entirely switches to exposure of the Bloomberg U.S. Treasury 3-5 Year Total Return Index when the Morningstar High Yield Category closes below its 200-day moving average.

We believe investor should be cautious about focusing too intently on corporate defaults. However, statistically validated timing strategies have historically stood a good chance of [helping investors manage high yield credit risk](#).

### Conclusion

Corporate default rates are often a slow, noisy signal. If history is a guide, the recent spike in high yield defaults could just as easily be a contrarian buy indicator as a sign of trouble ahead. Whatever the default rate is telling us, we believe investors should rely on systematic tactical strategies with a stronger track record for managing risk. Investors who [let their strategies do the work](#) can potentially avoid biased market timing mistakes.

### Important Risk Information

Past performance is no guarantee of future results. There is no guarantee that any investment will achieve its objectives, generate positive returns, or avoid losses. The Adviser's reliance on its strategy and judgments about the attractiveness, value and potential appreciation of particular securities and the tactical allocation among investments may prove to be incorrect and may not produce the desired results.

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3990-NLD-9/16/2020