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Investment-Grade Corporate Bonds

Keeping an Eye on Technicals…and Fundamentals

Yields look attractive, despite tight spreads.

Despite tight credit spreads, yields are attractive, technical dynamics are solid, and fundamentals, though deteriorating, are doing so at a manageable pace. These factors present a good opportunity to reshape positioning on the credit curve and within different subsectors as we work through the first quarter and head into what may be a more volatile second quarter.

The favorable technical picture for investment-grade corporate bonds that we saw in the fourth quarter of 2023 should continue through the first quarter of 2024. On the supply side, we saw record breaking primary issuance in January of around $195 billion. This supply should be more than offset by the demand side of the equation, which remains strong due to historically attractive all-in yields for investment-grade corporates. As we go further into the year, we expect gross and net supply trends to continue reverting to the mean after reaching post-2020 record highs and to trend lower in 2024 relative to 2023.

Additionally, thematic asset shifts from insurers and pension funds continue to fuel the demand for longer duration corporate debt alongside the dearth of 30-year supply. Investor weighting to investment-grade credit was still defensive going into year-end 2023, but more offensive positioning was triggered when the Fed signaled no further rate hikes and potentially aggressive rate cuts in 2024. This was evidenced by accelerating inflows to both ETFs and mutual funds in the fourth quarter, from $5.8 billion of outflows in October to inflows of $14.4 billion in November and $20.2 billion in December. This sentiment continued into the New Year, with January inflows totaling $28.9 billion.

Strong technicals will likely continue to outweigh slowly deteriorating fundamentals, which should help keep spreads rangebound near the tighter end. While spreads are in historically low percentile ranges relative to the last 20 years, all-in yields remain attractive enough to support spreads this quarter.

We continue to favor financials over industrials. Financials are currently trading cheap to industrials on a historical basis and the market is well-positioned for an expected seasonally strong wave of issuance by large banks. As fundamentals shift, overbought industrial sectors like consumer cyclicals and energy should underperform. Although we expect 10/30s credit curves to remain flat this quarter, the duration in the industrial portion of the Bloomberg U.S. Corporate Bond Index is nearly 2.5 years longer than that of financials, which leaves industrial credit curves more vulnerable to the 10/30s credit curve steepening.

By Justin Takata

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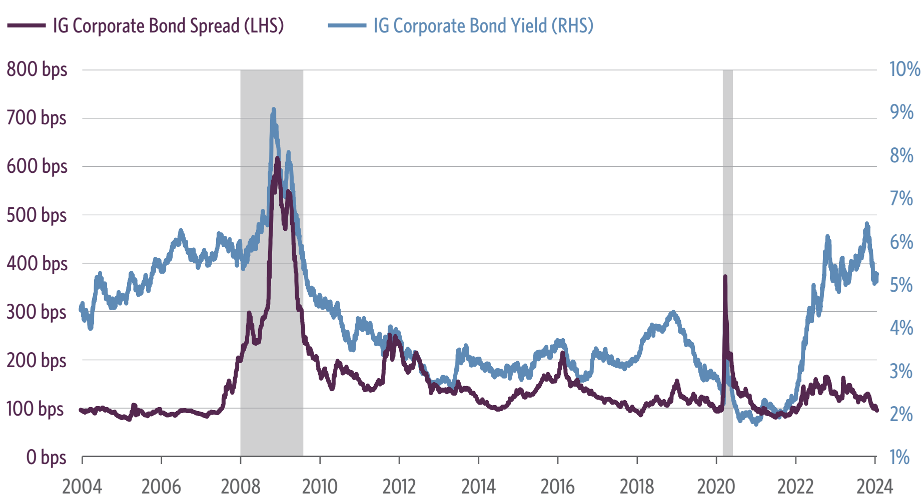
Elevated All-In Yields Support Relatively Low Spreads



Source: Guggenheim Investments, Bloomberg. Data as of 12.31.2023. Gray area represents recession. Past performance does not guarantee future returns.

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