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Investment-Grade Corporate Bonds

Focus on Long Duration at Attractive Valuations

While yields are attractive, macroeconomic uncertainty will continue to spark volatility.

Consistent credit fundamentals and higher yields kept spreads unchanged for the investment-grade Bloomberg U.S. Corporate Bond Index (the IG Index) in the third quarter. Yields increased 107 basis points to 5.69 percent. For context, these yields are well above the highs seen during the COVID outbreak in 2020, and similar to the average yield during the Great Financial Crisis (GFC).

While third quarter corporate earnings results could be in line with expectations, weaker earnings and economic forecasts for the fourth quarter suggest credit fundamentals are susceptible to deterioration, especially with rising funding costs due to higher interest rates. This could pressure yields and spreads a bit higher, but we think the downside is more limited now.

Historically high all-in yields of the IG Index relative to the S&P 500 dividend yield have prompted buying of investment-grade corporate bonds by domestic insurance companies, pension funds, and traditional asset managers. At the same time, overseas buying by Asian investors in particular has slowed materially due to increases in hedging costs. Nevertheless, the market has drawn support from domestic investors attracted by higher yields and low dollar prices across the investment-grade corporate bond universe. The average dollar price in the IG Index closed the quarter at around \$86, while the long duration portion closed at around \$80. The historical mean for both is \$96. This dollar price is attractive because it offers a buffer in the event of a negative credit event, and the discount will typically "pull to par" as it approaches maturity.

From a technical perspective, lower supply of new investment-grade bonds should support prices in the near term. Issuance of new supply (primary market issuance) was very choppy during the third quarter, with several lulls followed by days of overwhelming issuance. The third quarter set a record with over 50 days with zero issuance. When there is limited new issuance, coupon reinvestments and other regular inflows are forced to find opportunities in already-outstanding bonds (the secondary market), which supports secondary market prices and credit spreads. But in our experience, a very long period of low new issuance could negatively impact the information flow necessary for investors and traders to know where spreads should be.

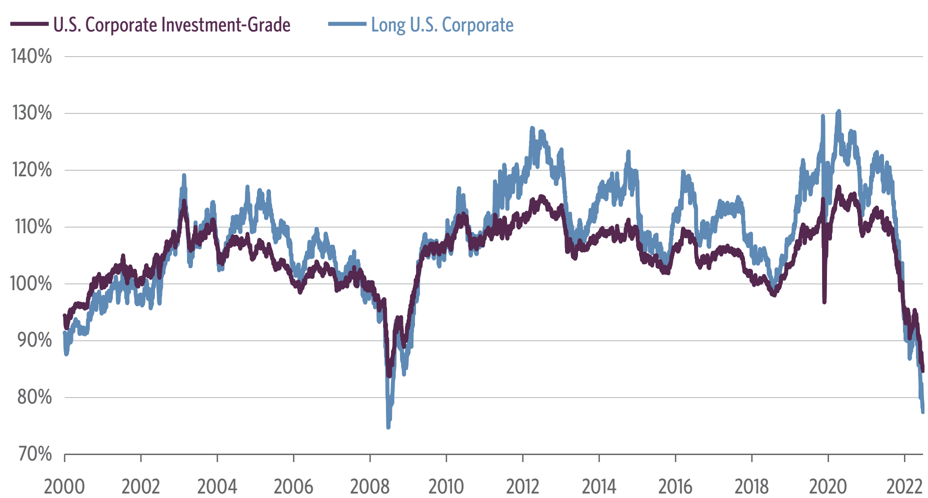
Investment-grade bond yields appear attractive around these levels, but macroeconomic uncertainty will continue to create volatility for spreads. The market has been operating in an orderly fashion, but spreads will likely remain under pressure throughout the fourth quarter. We continue to favor long duration, low dollar price corporates for longer-term investment.

By Justin Takata

The market has drawn support from domestic investors attracted by higher yields and low dollar prices across the investment-grade corporate bond universe. The average dollar price in the IG Index closed the quarter at around \$86, while the long duration portion closed at around \$80. The historical mean for both is \$96.

Low Dollar Prices Have Drawn Investor Support

Average Bond Price as a % of Par



Source: Guggenheim Investments, Barclays, Bloomberg. Data as of 10.20.2022.

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