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Private Wealth Management

Corporate Bond Commentary

Both investment grade and high yield bond market volatility waned somewhat last week as domestic markets were closed for the President's Day holiday and trading activity was lower on Friday because of the Chinese New Year – the year of the Dog. In high yield, the commodity and retail sectors seem to be returning to favor with investors and investment grade issuance is improving.

PWM Fixed Income Research

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Corporate Bond Market Comments

Investment grade corporate bond issuance improved last week with $17.4 billion in deals coming to the market but activity remains well below last year. Year-to-date we have seen a total of $174.5 billion in new issuance which is down approximately 27% from the same time in 2017. High yield issuance was slightly higher last week with $5.6 billion priced.

Investment-grade corporate bonds yields ended last week at 3.69% while the spread level over comparable Treasury yields was 95 bps. Investment-grade corporate bonds have a year-to-date total return of negative 2.60% and 2.55% over the past 12-months.

Preferred securities have a year-to-date total return of negative 1.70% and a trailing-12 month total return of 4.27%, according to data from Bank of America Merrill Lynch Indices. Leveraged loans have a total return this year of 1.12% and a trailing-12 month total return of 4.27%, according to the same indices.

High yield spreads were wider ending the week at 344 bps over comparable Treasury yields while the yield level was 6.18% (see high yield spread chart below*)*. High yield corporate bonds have a total return of negative 0.55% year-to-date and 4.12% over the trailing 12-months, according to data from the Bloomberg Barclay's Indices.

High Yield Bond Spreads for the Last Year

Sources: Bank of America Merrill Lynch and St. Louis Federal Reserve.

Moody's LSI Stays at Historic Lows

Moody's reported that its Liquidity Stress Indicator remains near historically low levels sitting at 2.6% in mid-January, down from 2.7% at the end of January but slightly higher than the 2.5% at the end of 2017. They indicated that they expect the LSI to be flat to slightly higher this year because of the anticipated gradual tightening of monetary policy and higher interest rates, as well as less room for improvement in the commodity sector liquidity. However, liquidity strains and default risk will continue to remain low in 2018 as companies still have access to the capital markets and credit metrics remain "healthy" for corporate bond issuers. Moody's is currently forecasting a default rate down to 2.0% in January 2019, down from 3.2% in January 2018.

S&P Forecast the U.S. Spec-Grade Default Rate to Drop

S&P is forecasting that the U.S. speculative-grade default rate will fall to 2.6% by the end of 2018, down from 3.0% at the end of 2017 and 5.1% at the end of 2016. S&P indicated that (at the industry level) the energy & natural resources and consumer services sectors are still experiencing higher levels of credit stress. Energy & natural resources accounted for 30% of all U.S. defaults in 2017 and over 50% in 2016.

Investment-Grade Corporate Bond Total Return and Statistical Data – 2/23/18

	TR-12	YTD	Yield	Spread	Price	Coupon	Mat	Dur	Convexity
IG Corporate	2.55%	-2.60%	3.69%	95	$102.40	3.94%	10.93	7.42	1.06
Aaa	3.08%	-4.09%	3.41%	54	$100.95	3.33%	17.32	10.56	2.07
Aa	1.41%	-2.29%	3.17%	55	$100.29	2.96%	8.86	6.22	0.87
A	2.01%	-2.86%	3.50%	77	$102.59	3.73%	10.69	7.43	1.07
Baa	3.22%	-2.35%	3.95%	119	$102.68	4.32%	11.22	7.48	1.04
Industrial	2.72%	-2.70%	3.75%	98	$102.61	4.04%	12.10	7.97	1.21
Utility	2.79%	-3.46%	3.77%	91	$104.76	4.20%	15.13	9.83	1.67
Financial	2.16%	-2.21%	3.55%	90	$101.53	3.70%	7.83	5.86	0.65

Source: Bloomberg Barclay's Indices

High Yield Corporate Bond Total Return and Statistical Data – 2/23/18

	TR-12	YTD	Yield	Spread	Price	Coupon	Mat	Dur	Con
High Yield	4.12%	-0.55%	6.18%	344	$99.44	6.36%	6.23	4.07	-0.24
Ba	3.84%	-1.27%	4.89%	216	$102.02	5.56%	6.81	4.60	-0.10
B	3.66%	-0.28%	6.09%	338	$99.81	6.58%	6.05	3.80	-0.41
Caa	6.00%	0.79%	8.82%	608	$94.69	7.82%	5.23	3.32	-0.21
Ca-D	6.57%	1.37%	25.73%	2,184	$66.51	8.56%	3.14	2.39	0.09
Ba/B	3.76%	-0.80%	5.46%	274	$100.96	6.05%	6.45	4.22	-0.25
Industrials	3.86%	-0.52%	6.29%	355	$99.08	6.39%	6.26	4.06	-0.26
Energy	4.45%	-0.32%	6.72%	392	$97.76	6.48%	6.71	4.46	-0.07
Retailers	3.21%	1.78%	8.69%	586	$91.94	6.46%	6.51	3.81	-0.26
Utilities	7.76%	-0.33%	5.72%	295	$100.13	6.30%	6.44	3.87	-0.55
Financial	5.62%	-0.84%	5.20%	255	$102.90	6.13%	5.90	4.24	-0.02

Source: Bloomberg Barclay's Indices

Sources:

Bloomberg: Bond News
Bloomberg Barclay's Indices
CreditSights: Monday Morning Meeting Notes. What Will Powell Say? February 26, 2018.
Moody's: SGL Monitor. February 20, 2018.
S&P: Global Fixed Income Research. February 20, 2018.
St. Louis Federal Reserve Bank and Bank of America Merrill Lynch. February 23, 2018.

Appendix – Important Disclosures

Some of the potential risks associated with fixed income investments include call risk, reinvestment risk, default risk and inflation risk. Additionally, it is important that an investor is familiar with the inverse relationship between a bond's price and its yield. Bond prices will fall as interest rates rise and vice versa.

When considering a potential investment, investors should compare the credit qualities of available bond issues before they invest. The two most recognized rating agencies that assign credit ratings to bond issuers are Moody's Investors Service ("Moody's") and Standard & Poor's Corporation ("S&P"). Moody's lowest investment-grade rating for a bond is Baa3 and S&P's lowest investment-grade rating for a bond is BBB-. Ratings are measured on a scale that ranges from AAA or Aaa (highest) to D or C (lowest).

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