October 30, 2017 | Fixed Income Strategy

Corporate Bond Commentary

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Corporate Bond Market Comments

Corporate bond spreads continue to tighten as economic activity is relatively strong (the advanced read of third quarter GDP showed the economy growing at 3.0%) and issuers continue to report healthy earnings. In addition, there is optimism that Congress can get something accomplished on tax reform that will be favorable to business although this may be a 2018 event.

The FOMC meets on Wednesday but according to Bloomberg there is less than a 1% chance of a rate hike at this meeting, however there is an 83% chance of the Fed raising interest rates 25 bps at its December meeting. The Fed is expected to follow this with 2-3 rate hikes of 25 bps in 2018.

The market focus this week is President Trump's announcement of his nomination to head the Federal Reserve which is currently scheduled for Thursday. At this time the favorite for the nomination is current Fed Governor Jerome Powell. Powell, a Republican, was nominated by President Obama to the board, and is considered a moderate by most Fed watchers. His nomination will not likely result in price volatility in the markets or impact spread levels in the credit markets.

Also this week, the BLS will release the Employment report on Friday morning with expectations of nonfarm payroll growth of 313,000 jobs (range of 130,000-to-400,000) and the unemployment rate remaining at 4.2%. Other employment stats include average hourly earnings (a view into future inflation) is expected to increase by 0.2% in October and 2.7% year-over-year and average weekly hours forecast to remain stable at 34.4 hours per week. If the numbers come in stronger than anticipated expectations for a rate hike in December are likely to increase and if they show signs of weakness it could reduce the market expectations for a rate hike.

Investment-grade corporate bonds yields ended last week at 3.19% while the spread level over comparable Treasury yields was 94 bps. The IG yield level began the year at 3.39% resulting in yields falling 20 bps this year while spread levels were 122 bps over at the onset of 2017 resulting in spread tightening of 28 bps this year. Investment-grade corporate bonds have a year-to-date total return of 5.27% and 3.14% over the past 12-months.

Investment-Grade Corporate Bond Total Return and Statistical Data – 10/27/17

	TR-12	YTD	Yield	Spread	Price	Coupon	Mat	Duration	Convexity
IG Corporates	3.14%	5.27%	3.19%	94	$105.52	3.97%	10.92	7.50	1.09
Aaa	2.63%	6.02%	2.96%	52	$104.41	3.28%	17.29	10.62	2.14
Aa	1.78%	3.88%	2.65%	53	$104.03	3.12%	9.39	6.66	0.96
A	2.50%	4.76%	2.97%	74	$105.91	3.75%	10.75	7.56	1.11
Baa	3.97%	5.94%	3.47%	120	$105.55	4.34%	11.08	7.50	1.05
Industrial	3.16%	5.46%	3.27%	98	$105.73	4.06%	12.03	8.04	1.23
Utility	2.56%	5.61%	3.37%	94	$108.46	4.34%	15.04	9.91	1.71
Financial	3.27%	4.83%	2.98%	87	$104.51	3.72%	7.87	5.94	0.67

Source: Bloomberg Barclay's Indices

Preferred securities have a year-to-date total return of 10.19% and a trailing-12 month total return of 5.94%, according to data from Bank of America Merrill Lynch Indices. Leveraged loans have a total return this year of 3.70% and a trailing-12 month total return of 5.26%, according to the same indices.

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High yield spreads ended the week at 334 bps over comparable Treasury yields while the yield level was 5.43%. High yield spreads began the year at 398 bps over which has resulted in tightening of 64 bps year-to-date while yields have fallen from 6.01% at the onset of 2017 resulting in yields down 58 bps. High yield corporate bonds have a total return of 7.40% year-to-date and 8.36% over the trailing 12-months, according to data from the Bloomberg Barclay's Indices.

High Yield Corporate Bond Total Return and Statistical Data – 10/27/17

	TR-12	YTD	Yield	Spread	Price	Coupon	Mat	Dur	Con
High Yield	**8.36%**	**7.40%**	**5.43%**	**334**	**$101.79**	**6.42%**	**6.26**	**3.76**	**(0.30)**
Ba	**7.02%**	**7.19%**	**4.07%**	**200**	**$105.17**	**5.62%**	**6.84**	**4.32**	**(0.13)**
B	**7.95%**	**6.66%**	**5.28%**	**323**	**$102.49**	**6.63%**	**6.11**	**3.42**	**(0.52)**
Caa	**12.81%**	**9.46%**	**8.42%**	**634**	**$94.58**	**7.82%**	**5.10**	**3.06**	**(0.27)**
Ca-D	**21.48%**	**14.76%**	**24.33%**	**2,053**	**$66.62**	**8.69%**	**3.43**	**2.74**	**0.10**
Ba/B	**5.83%**	**5.09%**	**4.65%**	**259**	**$103.87**	**6.11%**	**6.49**	**3.89**	**(0.32)**
Industrials	**8.18%**	**7.15%**	**5.53%**	**343**	**$101.38**	**6.45%**	**6.29**	**3.73**	**(0.32)**
Energy	**9.29%**	**6.13%**	**6.73%**	**425**	**$98.21**	**6.45%**	**6.62**	**4.22**	**(0.12)**
Retailers	**1.07%**	**1.78%**	**8.04%**	**569**	**$93.00**	**6.51%**	**6.62**	**3.76**	**(0.19)**
Utilities	**9.39%**	**10.95%**	5.34%	**309**	**$103.01**	**6.51%**	**6.47**	**3.57**	**(0.60)**
Financial	**9.92%**	**8.76%**	**4.50%**	**248**	**$104.17**	**6.12%**	**5.88**	**4.02**	**(0.10)**

Source: Bloomberg Barclay's Indices

Sources:

Bloomberg: Bond News
Bloomberg Barclay's Indices
CreditSights: Monday Morning Meeting Notes. Is Powell The Pick? October 30, 2017.

For more information please contact your Financial Advisor.

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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