Investment Grade Market Update

MARCH 2021: OUTLOOK AND IMPLEMENTATION

	March 2021	YTD/YTD Change
Total Returns	-1.72%	-4.65%
Excess Returns	+0.29%	+0.95%
Yield	+0.27%	+0.58%
Spread	+1	-5
Price	-$2.44	-$6.74

Source: Bloomberg Barclays U.S. Corporate Investment Grade Bond Index
Past performance is not indicative of future results.

► Investment Grade returns continued to fall further behind competing asset classes in March as rates moved higher while spreads stagnated. We see pockets of opportunity in Investment Grade, but are cautious to take up exposure. While yields are up 58 bps YTD, they remain well below recent averages and overall spreads do not offer enough cushion to absorb further increases in rates. Flows are still behaving, but another round of rate volatility would likely change that.

Fundamentals

- Earnings beat analyst expectations by 23% in Q2, 19% in Q3, and 17% in Q4. Looking ahead to 2021, the consensus forecast sees 25% earnings growth for the S&P 500.
- Metrics have deteriorated with massive debt growth and EBITDA declines. Fortunately, issuers have largely avoided burning cash and are sitting on elevated liquidity in early 2021. Per JPM, the earnings payout ratio in Q4 2020 was 36%, the lowest it has been in seven years. Cash paid to shareholders in 2020 (15%) was 3x the decline in EBITDA (5%).
- After recording $200 billion of fallen angels in 2020, there has been just $2.8 billion of fallen angels thus far in 2021: TechnipFMC (Oil/Gas – $2.1B) and Hexcel (Aerospace – $700MM). There were no fallen angels in the month of March. We expect more rising stars than fallen angels in 2021.

Technicals

- Gross and net supply totaled $201 billion and $63 billion, respectively, both meaningfully ahead of their five-year averages. YTD gross and net supply fell behind last year's record pace by the end of the month and should continue to fall further behind as we lap last year's monster issuance in April and May.
- Large deals during the month included Verizon ($25B), Oracle ($15B), Siemens ($10B), and AT&T ($6B). Verizon and AT&T were funding spectrum purchases, Siemens was funding an acquisition, and Oracle was both refunding debt and prepping for shareholder returns. Oracle sacrificed its A- ratings for the transaction, a trend that has been ongoing over the past decade. This is another reason to favor BBBs.
- Flows remain positive for Corporate and Aggregate funds YTD despite the ugly total returns. They've slowed, but not stopped. Meanwhile, the largest IG ETF (LQD) has seen total fund assets shrink from $55 billion to $40 billion YTD.

Valuations

- Spreads have been range-bound thus far in 2021, between 90-100. The BBB/A relationship continues to compress as risk rallies. BBBs are 9 tighter YTD while As are 3 tighter. This relationship is at the low end of the historical range.
- Yields are up 58 bps YTD to 2.28%. It feels dramatic, though yields are still nearly 1% below the five-year average and 115 bps lower versus year-ago levels.

Paul Privitera

Director – Institutional

Paul.Privitera@Newfleet.com

Phone: (860) 839-0705

The Bloomberg Barclays U.S. Aggregate Bond Index is a broad-based benchmark that measures the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market, including Treasuries, government-related and corporate securities, MBS (agency fixed-rate and hybrid ARM pass-throughs), ABS, and CMBS. The index is unmanaged, its returns do not reflect any fees, expenses, or sales charges, and is not available for direct investment. **The Bloomberg Barclays U.S. Corporate Bond Index** is a component of the U.S. Aggregate Bond Index. It measures the investment grade, fixed-rate, taxable corporate bond market. It includes USD-denominated securities publicly issued by US and non-US industrial, utility and financial issuers.