# Investment Grade Market Update

## SEPTEMBER 2021: OUTLOOK AND IMPLEMENTATION

| | September 2021 | YTD/YTD Change |
|---|---|---|
| **Total Returns** | -1.05% | -1.27% |
| **Excess Returns** | +0.26% | +1.89% |
| **Yield** | +0.14% | +0.39% |
| **Spread** | -3 | -12 |
| **Price** | -$1.65 | -$5.32 |

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

► It was the status quo for the Investment Grade Corporate market for much of September: steady demand, manageable net supply, stable fundamentals, and sideways spreads. As the month ended, rates jumped, supply chain and China property sector risks came to the forefront, and earnings estimates began declining. While this wobble could prove transitory, it is difficult to be bullish on a long duration asset class with spreads near 15-year lows.

### Fundamentals

- Second quarter sales and earnings rose 26% and 92% year-over-year, respectively. Easy comparison notwithstanding, earnings beat estimates by 16%, one of the largest quarterly beats on record. As we look to the back half of the year, consensus estimates project revenue growth in the low double-digits with earnings growth in the mid-20s. Estimates moved lower by 0.9% during the month of September – the largest monthly decrease since June 2020.
- With earnings rebounding, leverage ratios have returned to pre-Covid levels, albeit still elevated by historical standards. Per JP Morgan, debt outstanding was down 3% year-over-year as of 6/30 and per Morgan Stanley, 58% of IG rated companies had lower debt balances than a year ago.
- Year-to-date, S&P reports 25 rising stars versus 13 fallen angels. Moody's reports 22 rising stars and six fallen angels. Within investment grade, upgrade/downgrade activity has been more balanced.

### Technicals

- The market saw gross and net supply of $184 billion and $79 billion, respectively, both in-line with expectations and the five-year average. Supply skewed heavily towards financials (56% of net supply vs 10-year average of 27%) and BBB issuers (54% of net supply vs 44% average).
- Large deals during the month included Walmart ($7 billion – repay debt), Nestle ($5 billion - GCP), TD Bank ($4.5 billion - GCP), and Charter ($4 billion - GCP).
- Modestly positive fund flows into corporate funds continued in August. Fund flows for aggregated products have been solidly positive all year.
- The Federal Reserve completed the unwind of its corporate bond portfolio as of September 1st. Their portfolio of IG bonds and ETFs totaled $14 billion at its peak.

### Valuations

- Spreads tightened 3 bps in September to 83 bps and have been range bound between 80-90 since mid-April
- The compression theme is evident in the year-to-date period, with BBBs trading 36 bps wide of A-rated credit, versus a five-year average of 58 bps. This is a new post-crisis low.
- A late September surge in rates pushed yields back above 2%. Yields are 95 bps below the five-year average.

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*At S&P, a fallen angel is when a credit is downgraded from Investment Grade (BBB- or higher) to High Yield (BB+ or lower). A rising star is when a credit is upgraded from High Yield (BB+ or lower) to Investment Grade (BBB- or higher). At Moody's a fallen angel is when a credit is downgraded from Investment Grade (Baa3 or higher) to High Yield (Ba1 or lower). A rising star is when a credit is upgraded from High Yield (Ba1 or lower) to Investment Grade (Baa3 or higher).

**The Bloomberg 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 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.

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**Investing is subject to risk, including the risk of possible loss of principal.**

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