

## OCTOBER 2021: OUTLOOK AND IMPLEMENTATION

	October 2021	YTD/YTD Change
<b>Total Returns</b>	0.25%	-1.02%
<b>Excess Returns</b>	0.00%	1.90%
<b>Yield</b>	+0.09%	+0.48%
<b>Spread</b>	+3 bps	-8 bps
<b>Price</b>	-\$0.16	-\$5.48

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

- ▶ The market's late September/early October wobble was stabilized by a robust round of earnings and a move lower in rates. Supply was heavy while flows were uneven, but we are now entering a seasonally favorable portion of the calendar (low supply). Spreads have barely budged over the past six months, and it is hard to foresee that changing in the final two months of the year.

### Fundamentals

- With nearly 90% of constituents reporting, third quarter sales and earnings growth for the S&P 500 stands at 19% and 41% year-over-year, respectively. Earnings are beating estimates by nearly 10%, a high magnitude by historical levels.
- We are surprised by the resiliency of these firms with the backdrop of supply chain constraints. Earnings growth estimates for Q4 and 2022 have not declined and companies are not providing negative guidance at a rate that is out of line with historical averages.
- 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 June 30; per Morgan Stanley, 58% of IG rated companies had lower debt balances than a year ago.
- Year-to-date, S&P reports 31 rising stars versus 14 fallen angels. Moody's reports 30 rising stars and six fallen angels. Within investment grade, upgrade/downgrade activity has been more balanced.

### Technicals

- Gross and net supply of \$143 billion and \$68 billion, respectively, put both ahead of the five-year average and ahead of expectations.
- Large deals during the month included AerCap (\$21 billion – Buy GE Air Leasing Portfolio), Goldman Sachs (\$9 billion), Thermo-Fisher (\$6.1 billion – PPD Acquisition), Morgan Stanley (\$5 billion), and TMSC Arizona (\$4.5 billion – Capex).
- The monster AerCap deal proceeds will head to General Electric where we expect it to be used to repay debt – making that a debt neutral transaction. The large bank issues were driven by increasing deposit balances, which impacts banks' leverage ratios and requires more long-term capital.
- Flows oscillated between positive and negative weeks in October as investors faced rising yields in the first two weeks of the month, which renewed pessimism on total return expectations.

### Valuations

- Spreads widened 4 bps in October to 87 bps and have been range-bound between 80-90 bps 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.

# Investment Grade Market Update

- Banking (issuance), communications (competition increasing) and technology (supply chain) underperformed during the month while COVID-sensitive industries outperformed (transports, finance companies, energy).
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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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