Investment Grade Market Update

APRIL 2022: OUTLOOK AND IMPLEMENTATION

	April 2022	YTD/YTD Change
Total Returns	-5.47%	-12.73%
Excess Returns	-1.40%	-2.68%
Yield	+0.71%	+1.98%
Spread	+19	+42
Price	-$5.82	-$15.26

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

► April was a tough month all the way through. Spreads and yields moved higher, with the latter now at 10-year highs. The asset class has lost nearly 13% YTD, which is in rarified territory—this marks the third worst period since 1970. Unlike other asset classes, the technical environment feels nonplussed by rates/returns, with a steady dose of supply and only modest outflows. Fundamentals, while improving, are backward-looking by nature, and investors are now hyper-focused on rate hikes and associated recessionary risks. Spreads are likewise in the zone that we would call "historically wide, save for recessions."

Fundamentals

- With 83% of constituents reporting, S&P 500 revenue and earnings growth for the first quarter are 14% and 7.5%, respectively. Earnings are ahead of initial expectations by 4%, with 79% of companies beating estimates – consistent with the five-year average beat/miss ratio.
- Earnings estimates for 2022 call for 5.5% growth in the second quarter with a ramp up to >10% earnings growth in the back half of the year. We are surprised that full-year estimates have climbed from 8% to >10%, given the macro uncertainty. Estimates got as high as 11% but are starting to slip. Unsurprisingly, energy estimates are up dramatically while consumer discretionary and industrial estimates have moved lower.
- Ratings trends are overwhelmingly positive, with Moody's and S&P together posting an upgrade/downgrade ratio of 4.7x. YTD, we have had a growing list of rising stars (Kraft Heinz, Toll Brothers, Freeport McMoRan, Targa Resources, MasTec), with just one small fallen angel (Steelcase).

Technicals

- The new issue market remained busy in April, with $134 billion of gross supply across 44 unique issuers. The largest deals included Amazon ($12.75 billion), Bank of America ($8.75 billion), JP Morgan ($8.5 billion), Morgan Stanley ($7 billion), Wells Fargo ($6.75 billion), and Vici ($5 billion – purchase of MGM Growth Properties). Huge banking issuance is a continuation of a theme from the first quarter and has contributed to the underperformance of G-SIB banks.
- Mutual funds have seen trickling outflows all year despite historically bad total returns. Corporate-only funds are surprisingly positive YTD, while aggregate and total return funds have seen outflows. Per JP Morgan, which blends these totals, YTD flows are functionally zero for the asset class.
- The big upcoming question is, what do foreign buyers do with rising hedging costs and positive yields in their home countries? Foreign buyers represent >25% of the holder base for investment grade corporate debt, and the U.S. market is no longer the only big liquid market with positive yields. Negative-yielding debt is down from $16 trillion at the peak to $2 trillion.

Valuations

- Spreads widened throughout April (+19 bps) and closed the month 10 bps shy of the YTD highs in mid-March. At +134 bps, spreads are 20 bps wide of the five-year average. Yields ended the month at 4.3%, which approximates the highest yields in the past decade.
- All sectors widened in April, with banking (+24 bps) and communications (+25 bps) the main underperformers. Utilities and insurance were relative outperformers, widening by 14 bps each.

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Paul Privitera

Director – Institutional

Paul.Privitera@Newfleet.com

Phone: (860) 839-0705

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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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