Investment Grade Market Update

Newfleet ASSET MANAGEMENT
A Virtus Investment Partner

AUGUST 2022: OUTLOOK AND IMPLEMENTATION

	August 2022	YTD/YTD Change
Total Returns	-2.93%	-14.21%
Excess Returns	0.08%	-2.44%
Yield	+0.50%	+2.53%
Spread	-3bps	+48bps
Price	-$3.07	-$17.90

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

► With the Federal Reserve talking tough on inflation at Jackson Hole, the market reversed course and sent total returns towards the YTD lows. The summer rally ended in mid-August, with spreads and returns retracing 50% and 80% of the rally as of this writing. While the market appears shaky, we expect a high level of issuance in September that will only add to the pressure on index levels. We expect large new issue concessions and will look to opportunistically deploy capital into a cautious market.

Fundamentals

- Credit metrics fully retraced the pandemic-era weakening and are now moving sideways. We saw an acceleration of share repurchases in the second quarter, which began to eat into the cash piles that companies raised as a contingency during the pandemic. Fortunately, we have seen lower-rated BBB companies behaving in a more conservative manner. The value of investment grade ratings increased following the Fed actions from the last crisis.
- S&P 500 earnings are concluding with 75% of constituents beating earnings estimates – in line with the five-and-ten-year averages. Estimates for the back half of the year are falling as expected, now suggesting 6-7% growth, down from a peak of over 10%. Note that estimates usually beat by 4%, so if that trend held, we would be right back at 10% growth, which still seems optimistic given the macro backdrop.
- T-Mobile and DCP Midstream pushed rising star volumes to a new record (Kraft Heinz, Toll Brothers, Freeport McMoRan, Targa Resources, HCA). No new fallen angels in August, with Las Vegas Sands being the largest YTD.

Technicals

- Gross and net supply of $135 billion (the second highest all-time) and $79 billion (the third highest all-time), respectively, during August. This is nearly double the 10-year average for gross supply as issuers continued to pour into an open market. The investment grade market sticks out in this regard as YTD gross supply is just 7% lower year-over-year while high yield, for example, is running 75% below last year's levels. Large deals included: Meta ($10 billion – inaugural deal), Credit Suisse ($8.75 billion – two deals), Intel ($6.0 billion), and Apple ($5.5 billion).
- Flows were in positive territory for four of five weeks in August but were trending the wrong direction. Corporate-only funds have had modest inflows YTD while aggregate and total return strategies have had more substantial outflows. Per J.P. Morgan, the blended outflow figure from the three categories approximates $22 billion YTD (1.5% of AUM).

Valuations

- Spreads peaked at +160 in early July and rallied through the first half of August until reaching +130. The trend reversed mid-month with August spreads ending at +140, 3 basis points (bps) tighter on the month. Yields, however, were approaching their 13-year highs, ending the month at 4.83%.
- Underperformers in August included pharma (+5 bps) and health insurance (+5 bps) as the Inflation Reduction Act included a major change to drug pricing policy. Chemicals (+4 bps) underperformed as well due to heavier exposure to European power prices. Airlines (-43 bps), air lessors (-30 bps), tobacco (-20 bps), and gaming (-18 bps) outperformed.

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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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