Investment Grade Market Update

Newfleet ASSET MANAGEMENT
A Virtus Investment Partner

APRIL 2023: OUTLOOK AND IMPLEMENTATION

	Apr 2023	YTD/YTD Change
Total Returns	+0.77%	+4.29%
Excess Returns	+0.18%	+0.40%
Yield	-0.07%	-0.32%
Spread	-3	+5
Price	+$0.44	+$3.00

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

► Following a tumultuous March, the investment grade market returned to normalcy in April as financials, front-end bonds, and BBBs, previous underperformers, all outperformed during the month. The regional banking crisis that enveloped the market post-Silicon Valley Bank collapse largely subsided as emergency Fed lending declined throughout April and banks reported relatively stable deposits on their first quarter earnings releases. In early May, bank-related volatility has returned, so this crisis has not been put to rest. Financials, which trade close to their relative wides versus industrials, remain under intense focus and will be the driver of market performance from here.

Fundamentals

- Credit metrics are steady at healthy levels. We expect deterioration in 2023 as earnings are projected to decline, but we expect corporations to exhibit restrained behavior and preserve metrics broadly.

- Silicon Valley Bank failed on March 10, with Signature Bank taken over thereafter. Silicon Valley bonds represented 5 bps of the corporate investment grade (IG) bond index, and its failure marked the first default within the index since PG&E in 2019. Credit Suisse (27 bps of IG index) was quickly merged with UBS, with the Swiss National Bank VP noting that Credit Suisse would have failed without an emergency rescue. First Republic (1 bp of the IG index to begin the year) was seized and sold to J.P. Morgan simultaneously on May 1, marking the fourth bank failure of early 2023.

- With 80% of S&P 500 constituents reporting, 78% have beaten earnings expectations – a figure consistent with the five-year average beat/miss ratio. Earnings have come in ahead of fears and expectations: full year earnings, which had been declining steadily, have plateaued post-earnings reports.

- Surprisingly, upgrades outpaced downgrades again in April despite a wave of financial downgrades in the wake of the regional banking mini-crisis. Upgrades to mega-cap issuers included T-Mobile and Anheuser Busch.

Technicals

- After a record start to the year, supply slowed in March and remained cool through April with $106 billion of gross issuance − the lightest April since 2019. Year-to-date supply is currently down 4% year-over-year and on track to hit initial forecasts.

- Large issuers during the month included Bank of America ($8.5 billion), Morgan Stanley ($7.5 billion), and Wal-Mart ($5 billion).

- Mutual fund flows were positive throughout the month, while foreign flows remain muted given elevated hedging costs. Yield buyers have been active YTD (pension, insurance) and their impact is most visible on the long end of the curve.

Valuations

- Spreads and rates both moved slightly lower in April. The month was bifurcated, with tightening in the first two weeks and widening in the latter two weeks.

- Outperforming industries included: office REITS (-45 bps), gaming (-20 bps), homebuilding (-14 bps), and banking (-8 bps). Underperformers: packaging (+8 bps), wirelines (+7 bps), aerospace & defense (+5 bps), and communications (+5 bps). Essentially, the YTD performance began to reverse in April (and has since resumed in early May).

Newfleet Asset Management
One Financial Plaza
Hartford, Connecticut 06103
877-332-8172

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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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