RPIA
Global Fixed Income Experts

Credit Market Themes in 5 Charts

September 2022

These five charts highlight some of the themes and trends we are seeing in global credit markets. We believe identifying these trends and positioning our portfolios accordingly will enable us to capitalize on opportunities over the next few quarters.

CONTACT US FOR MORE INFORMATION

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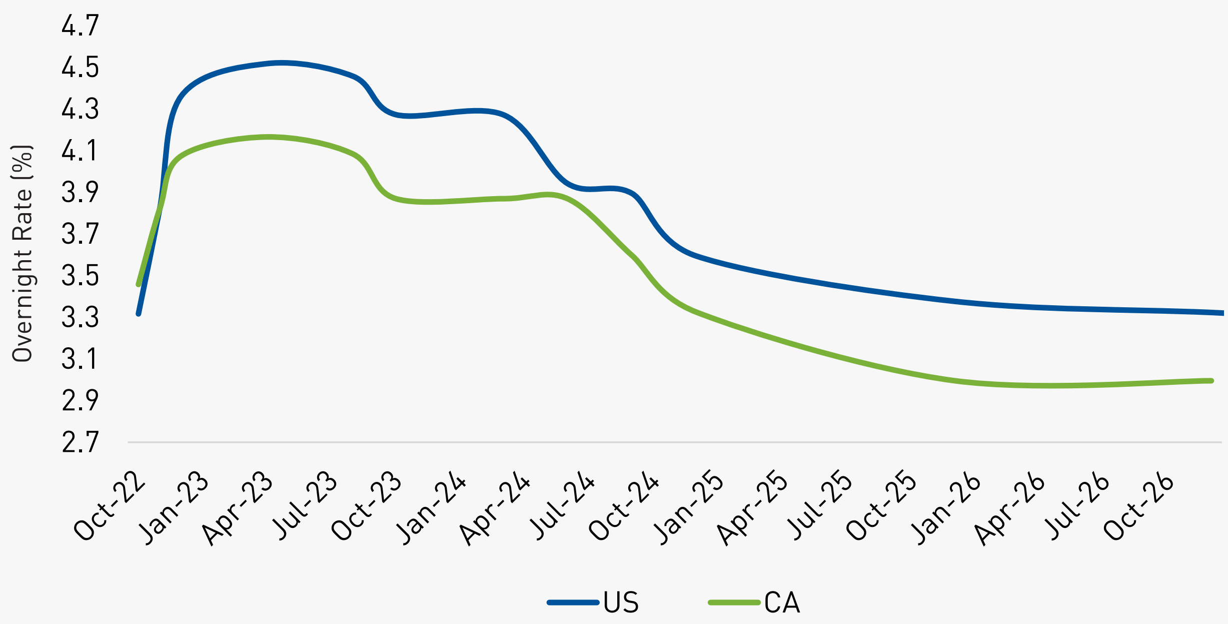
1 The Federal Reserve is Expected to Tighten Monetary Policy More This Year Before Easing Next Year

Both the Federal Reserve and the Bank of Canada are "front-loading" interest rate hikes with the goal of controlling inflation. The market is pricing in more hikes this year and expecting a terminal rate of around 4.5% in Q1. After that time, the overnight is expected to decline as economic activity slows. Many institutions are increasing their allocation to fixed income to capture these higher yield levels.

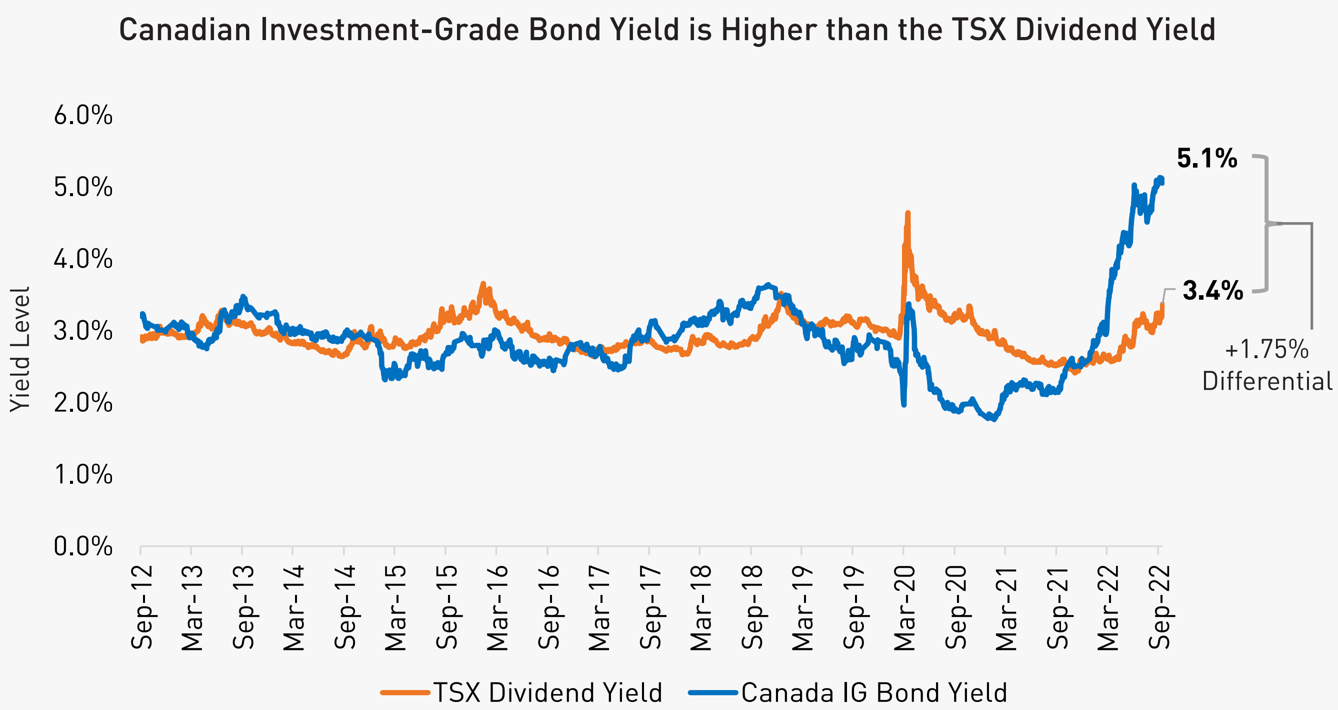
Federal Reserve is Expected to "Front-Load" Interest Rate Hikes



Data as of Sept. 26th, 2022. Source: Bloomberg.

2 Fixed Income Yields Look Attractive Versus Equity Dividend Yields

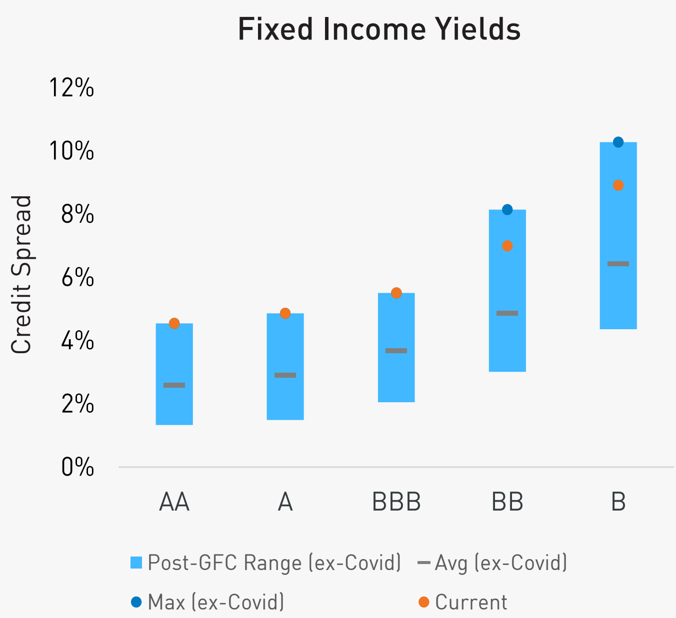
It is notable that investors can earn a higher yield in Canadian investment grade credit than they can from the dividend yield on stocks. At the same time, investors sit higher in the capital structure with more downside protection in the form of "pull to par."

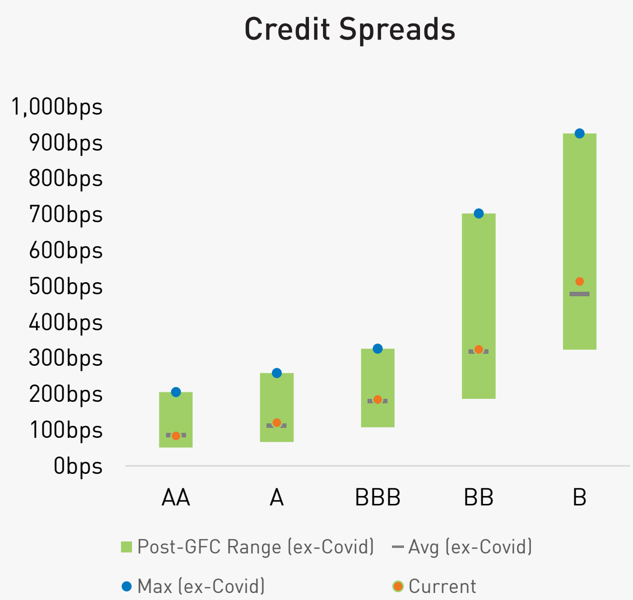


Source: Bloomberg. Canada IG = ICE BofA Canada Corporate Index. As of Sept. 23rd, 2022.

3 Yields are Very Attractive by Historical Standards – Driven Primarily by Increases in the Risk-Free Rate

Fixed income yields are very attractive by historical standards – particularly for investment grade rating segments. However, these yields are being driven primarily by increases in the risk-free rate. Credit spreads are "OK" but not particularly attractive by post-Global Financial Crisis standards, especially if we are entering a recession.



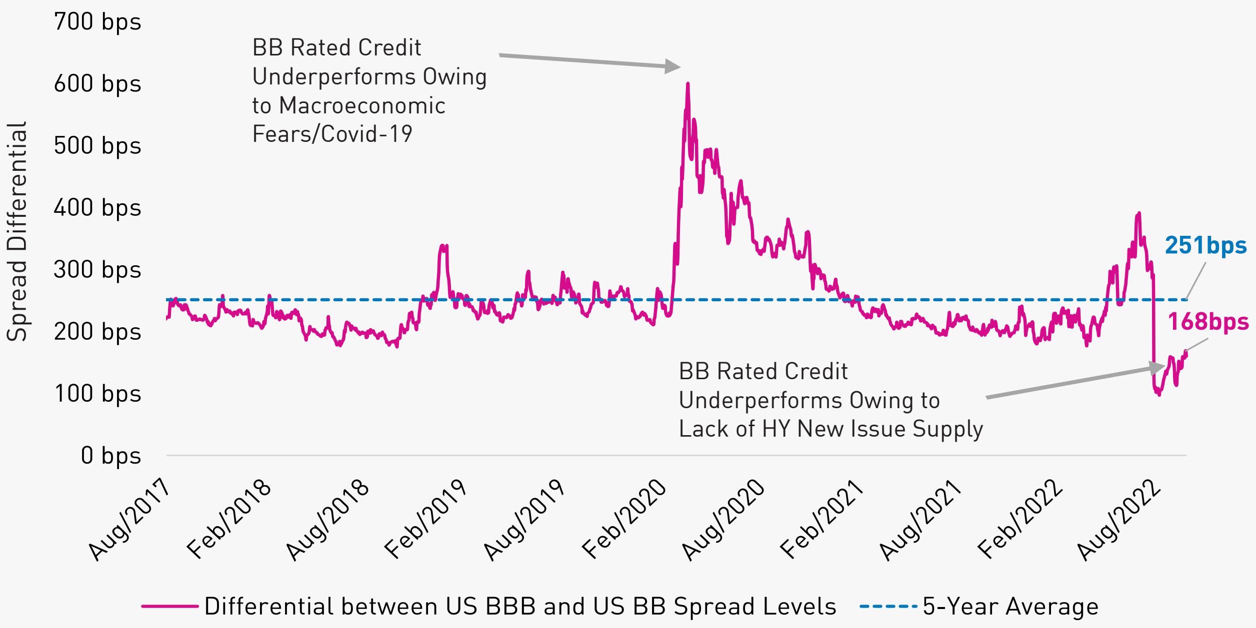


Source: ICE BofA.
Data as of Sep. 16th, 2022.
Post-GFC Range (ex. Covid) data ranges from Jan. 2011 – Sep. 16th, 2022, and excludes data ranging from Mar. – May 2020.

4 We Believe the Differential Between BBB and BB is Too Narrow

The differential between BBB-rated and BB-rated securities has averaged 251 bps over the last five years. In 2020 the additional compensation earned from the drop in credit quality spiked to almost 600 bps. Owing to High Yield inflows and a lack of new issuance, this differential has compressed dramatically in recent months. At this juncture, we generally prefer BBB to BB exposure in our portfolios.

The BBB-BB Differential is Currently Much Lower Than Its 5-Year Historical Average

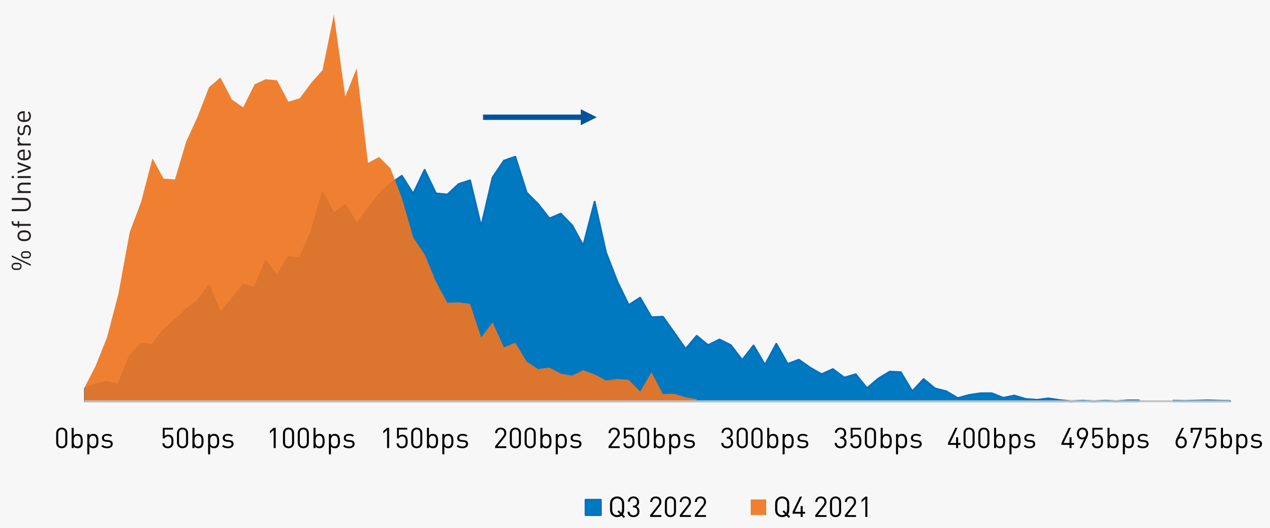


Source: ICE BofAML. Data as of Sept. 30th, 2022. U.S. Inv. Grade Index = ICE BofA BBB US Corporate Index; U.S. High Yield Index = ICE BofA BB US Corporate Index.

5 More Dispersion Means Better Opportunities for Security Selection

Since the start of 2022, credit spreads have widened across the board. There has also been a decompression in credit spreads, such that the range of credit spreads for the investment grade universe has widened. This presents more opportunities for relative value investing in fixed income.

U.S. Investment Grade Distribution by Credit Spread Level



Source: Bloomberg. Data as of Sept. 29th, 2022. Index = Bloomberg US Corporate Total Return Index.

Opportunity in Uncertainty: The Role of Active Management

Investors find themselves facing elevated inflation, rising interest rates, and a looming recession. Tightening financial conditions, volatile yield levels, and greater dispersion in credit spreads all speak to the changing paradigm in financial markets.

Institutions face new and unique challenges in this ever-changing market environment. We believe active management can deliver real value to clients in such an environment.

Please contact us if you would like to discuss how Active Credit strategies could help your organization achieve your risk and return objectives.

Important Information