PARAMETRIC

TRANSCRIPT:

Preferred market update with Kevin Lynyak

Hello, folks. This is Kevin Lynyak, Fixed Income Portfolio Manager at Parametric. Today is Monday, November 6. Today we're gonna talk about corporate credit and why I think investment-grade corporate bonds belong in your portfolio.

In past cycles, corporate credit has been an early sign of potential economic stress to come. Widening credit spreads in com equity markets were referred to as the canary in the coal mine. That's why the Federal Reserve pays close attention to credit spread. And given all the fixed income volatility that we've seen so far this year, credit spreads have been fairly stable. Spreads are near long-term averages, which is essentially suggesting to me that it's a soft-landing or even a potential no-landing scenario for the economy this year.

Investment-grade credit has been one of the few fixed income sectors that has actually seen net inflows this year. We recently published a market memo, which you can find on the Parametric website, on why we think investment-grade corporate bonds are a solid place to invest moving forward.

And a couple of key reasons why that is. First of all, we see some of the highest yields that we've seen in investment-grade credit since 2009.

Secondly, debt cliffs, in our view, are manageable. Investment-grade companies use the very low interest rates that we saw back in 2020/2021 to fund long term. So as the newest Treasury has to issue more long-term Treasury bonds to fund the deficit, US investment-grade companies don't necessarily need to. They've already done that.

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And finally, the strong economic data that we've seen this year. Specifically, the GDP growth came in at 4.9% third quarter. I think this suggests a very strong fundamental background for corporate credit moving forward.

So a few reasons why we are constructive: valuations. We can discuss earnings and upgrades fundamentally. Valuations: investment-grade credit. Right now, the IG corporate market trades at right around 6%, with front end a little bit through 6%. And then, after the 7- to-10-year area starts to get a little bit steeper and north of 6%. But it's a fairly flat curve, but it is steep compared to where some other yield curves are, especially the US Treasury yield curve. This 6% level is a level that we haven't seen really since 2009.

A quick discussion on earnings. So earnings is roughly 80% of the S&P 500® reported. FactSet reports that a blended growth rate in earnings is a positive 3.7%. If that holds up, it'll be the first year-over-year positive earnings growth since the third quarter of 2022. While not all companies and sectors are created equal, a trough in earnings, I think, imports stable spreads.

And finally upgrades. In prior cycles, we were really worried about potential downgrades. Recall back to 2020, we saw around $250 billion of BBBs downgraded to junk. The last couple of years we've seen a much higher amount of upgrades versus downgrades. If you look at the data so far year-to-date, we've seen $614 billion of debt has been upgraded and $157 billion of IG debt has been downgraded. So, a lot more net upgrades than downgrades. And I think what this is is the rating agencies just taking notice of the strong fundamentals that are going on with corporate America, but also with how strict the management teams are managing their balance sheets.

And I think this is one of the most well-telegraphed recessions moving forward, and essentially corporate management teams are husbanding cash. They're not doing excessive stock buybacks. They're not doing excessive mergers, especially with bond yields at higher levels. The rating agencies have picked up on this.

We've seen around $150 billion upgraded from BBB to A, and I think this is just the rating agencies taking notice of the conservative management teams out there and how they're handling the balances. And I think this puts us in a very solid position as we move forward.

At Parametric, we believe that the Fed is now done for the cycle, and we think this is a good time to step out of cash. And certainly we think you should consider investment-grade corporate bonds in your overall fixed income asset allocation.

Thank you.

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