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# Morningstar Corporate Credit Research Highlights

## Corporate Bond Markets Drift Higher

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### Morningstar Credit Ratings, LLC

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### Credit Market Insights

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### Credit Market Insights

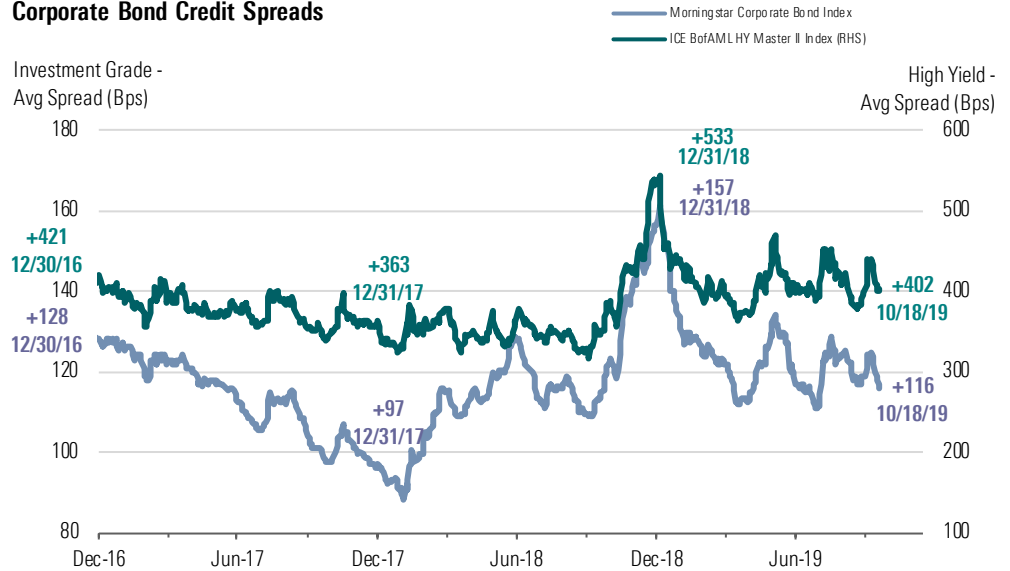
#### Corporate Bond Markets Drift Higher

Markets drifted higher last week as stocks rose and credit spreads tightened, but both markets gave back some of the gains on Friday. The pullback was in reaction to weak economic data released from China, which renewed concerns the United States might not be able to fend off contagion from global economic malaise throughout Asia and Europe. The concern was further reinforced by weak economic readings in the U.S. as both the retail sales and industrial production reports were below economists' expectations.

In the U.S. Treasury bond market, the yield curve steepened. The yield on the 2-year Treasury bond declined 2 basis points to 1.57% as investors priced in a higher probability that the Fed will cut the federal funds rate later this month; whereas, the yield on the 10-year rose 2 basis points to 1.75%. The spread between the 2-year and 10-year widened to 18 basis points, the highest this spread has registered since July and near its average level over the past 52 weeks. According to CME FedWatch Tool, the market implied probability the Fed will begin Halloween early on Oct. 30 with a treat (rate cut) rose to 89%. This is a substantial increase compared with as recently as one month ago when the probability of a 25-basis point rate cut to a range of 1.50% to 1.75% was only 28%.

In the corporate bond market, the market action was relatively subdued as the main focus was on digesting third-quarter earnings reports, which thus far have been generally uneventful. On a week-over-week basis, the Morningstar Corporate Bond Index tightened 4 basis points to +116 and in the high-yield market, the ICE BofAML High-Yield Master II Index tightened 8 basis points tighter to +402.

### Corporate Bond Credit Spreads



Source: Morningstar, Inc., ICE BofAML Global Indexes. Data as of 10/18/2019.

Following the liquidity drought in the repurchase market last month, fixed-income traders are continuing to keep a close eye on this market. The cost for dealers to finance their inventory had quickly normalized once the Federal Reserve stepped in and provided the market with both overnight and term repo facilities. In addition, in order to create more reserves in the banking system, the Fed also began permanent open-market operations last week. However, the repo market does not appear to have fully healed as it remains reliant on this continued support from the Federal Reserve. For example, on Friday, banks submitted \$56.5 billion of collateral securities for the overnight repo facility and offered to sell \$36 billion of Treasury bills against the \$7.5 billion the Fed offered to purchase.

Global asset markets followed a similar story as the U.S. with only a few outliers. For example, the Chinese equity market fell 1.20% last week. All of the loss occurred on Friday following China's GDP report, which indicated its economic growth rate has been sequentially slowing. Chinese GDP slowed to 6.0% in the third quarter from 6.2% in the second quarter and 6.4% in the first quarter. The Chinese economy is expected to face further pressure for the remainder of this year and into 2020. China's construction boom has been cooling, global demand for its exports are slowing, and higher food inflation will take a bite out of domestic consumption.

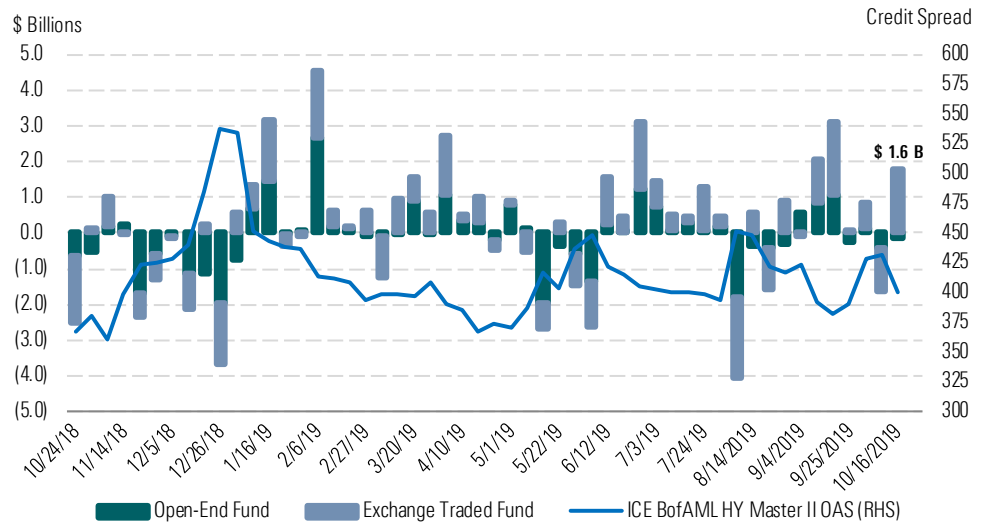
The United Kingdom's equity market also declined last week, dropping 1.33% as investors decided to take some risk off the table before heading into the weekend. In a historic Saturday session of parliament, Prime Minister Boris Johnson was unable to secure enough votes to pass the most recently negotiated agreement with the European Union in order to leave the trading bloc. As required by U.K. law, he has formally requested another extension from the EU; however, Johnson still wants to move ahead and force the U.K. to leave the union at the end of the month, even without a trade agreement in place. Following the original request seeking an extension, Johnson followed up with another request

asking that the EU deny the extension request. It is expected the EU will grant another extension until February 2020. This entire process has been mired in political gridlock. If the U.K. is finally successful exiting the EU at that point, it will have taken four years since the U.K. originally voted to leave the EU.

**Surging High-Yield Inflows Driven by Exchange-Traded Funds**

For the week ended Oct. 16, inflows into the high-yield asset class surged by \$1.6 billion; however, this increase was driven entirely by \$1.7 billion of net new unit creation across the high-yield exchange-traded funds, or ETFs, which was partially offset by \$0.1 billion of withdrawals among the open-end high-yield mutual funds. Year-to-date inflows of \$20.1 billion are heavily weighted toward the high-yield ETFs, which account for \$15.0 billion of the inflows as only \$5.1 billion of inflows are accounted for by the open-end mutual funds.

**Estimated Weekly High-Yield Bond Fund Flows and High Yield Credit Spreads**



Source: Morningstar, Inc. and ICE BofAML Global Indexes.

**Exhibit 1** Morningstar Corporate Bond Index Sector Summary

Sector	Average Rating	Number of Issues	Modified Duration	Spread (bps)	MTD Spread Chg (bps)	YTD Spread Chg (bps)	MTD Total Return (%)	YTD Total Return (%)
<b>TOTAL</b>	<b>A-</b>	<b>5,375</b>	<b>7.3</b>	<b>116</b>	<b>(3)</b>	<b>(40)</b>	<b>(0.06)</b>	<b>12.84</b>
<b>FINANCIAL</b>	<b>A-</b>	<b>1,459</b>	<b>5.6</b>	<b>97</b>	<b>(2)</b>	<b>(44)</b>	<b>0.11</b>	<b>10.69</b>
Bank	A-	849	4.9	96	(2)	(47)	0.20	10.16
Finance	A-	259	5.3	91	(3)	(45)	0.12	10.39
Insurance	A	236	9.0	108	(2)	(30)	(0.30)	13.69
REITs	BBB+	106	6.7	107	(6)	(42)	0.13	11.60
<b>INDUSTRIAL</b>	<b>A-</b>	<b>3,177</b>	<b>8.0</b>	<b>122</b>	<b>(3)</b>	<b>(40)</b>	<b>(0.09)</b>	<b>13.83</b>
Basic Industries	BBB	274	7.7	164	(2)	(34)	(0.04)	13.83
Consumer Products	BBB+	351	8.3	121	(2)	(39)	(0.18)	14.95
Energy	A-	399	7.6	161	3	(36)	(0.16)	13.43
Healthcare	A-	444	8.4	103	(4)	(33)	(0.08)	13.06
Manufacturing	A-	509	6.4	113	(2)	(48)	(0.09)	11.92
Media	BBB+	174	9.3	133	(7)	(45)	0.02	16.35
Retail	A-	212	8.4	106	(5)	(38)	(0.06)	13.27
Technology	A	376	7.5	91	(5)	(36)	0.00	12.73
Telecom	BBB+	159	9.9	138	(6)	(53)	(0.11)	18.49
Transportation	BBB+	201	9.1	123	(4)	(33)	(0.36)	13.92
<b>UTILITY</b>	<b>BBB+</b>	<b>682</b>	<b>9.0</b>	<b>143</b>	<b>(2)</b>	<b>(43)</b>	<b>(0.40)</b>	<b>14.36</b>
Electric Utilities	A-	379	9.8	123	(4)	(47)	(0.27)	15.01
Gas Pipelines	BBB	283	7.9	168	1	(40)	(0.55)	13.64

**Rating Bucket**

AAA Bucket		121	7.7	46	(2)	(13)	(0.15)	10.38
AA Bucket		492	6.5	60	(1)	(26)	(0.08)	9.65
A Bucket		1,957	7.4	88	(3)	(36)	(0.10)	11.74
BBB Bucket		2,805	7.5	151	(3)	(53)	(0.03)	14.44

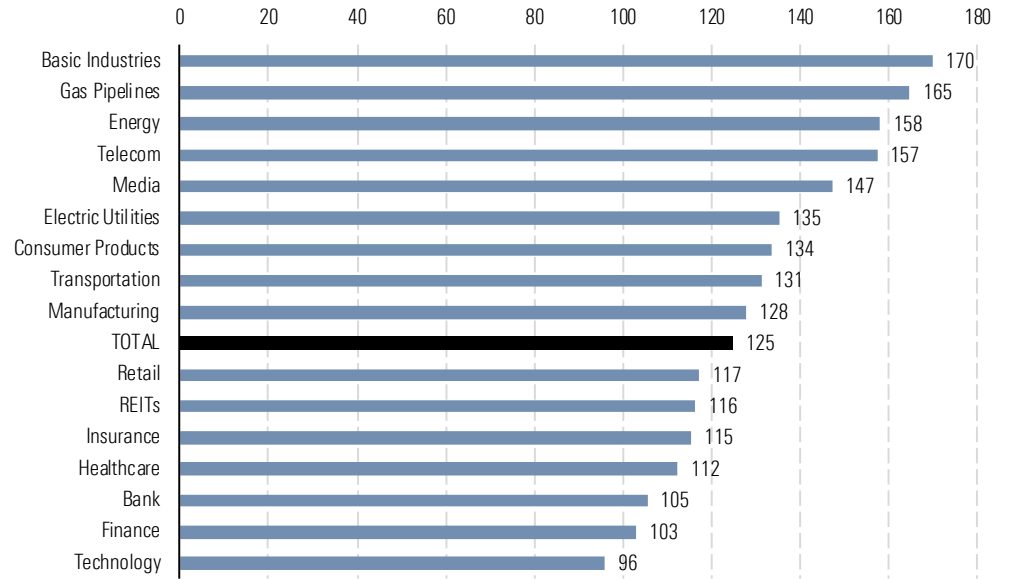
**Term Bucket**

1-4	A-	1,718	2.2	64	(0)	(37)	0.26	5.56
4-7	A-	1,233	4.7	100	(4)	(55)	0.28	10.65
7-10	BBB+	859	7.0	128	(3)	(51)	0.09	14.24
10PLUS	A-	1,565	14.1	170	(4)	(39)	(0.67)	21.93

Data as of 10/18/2019

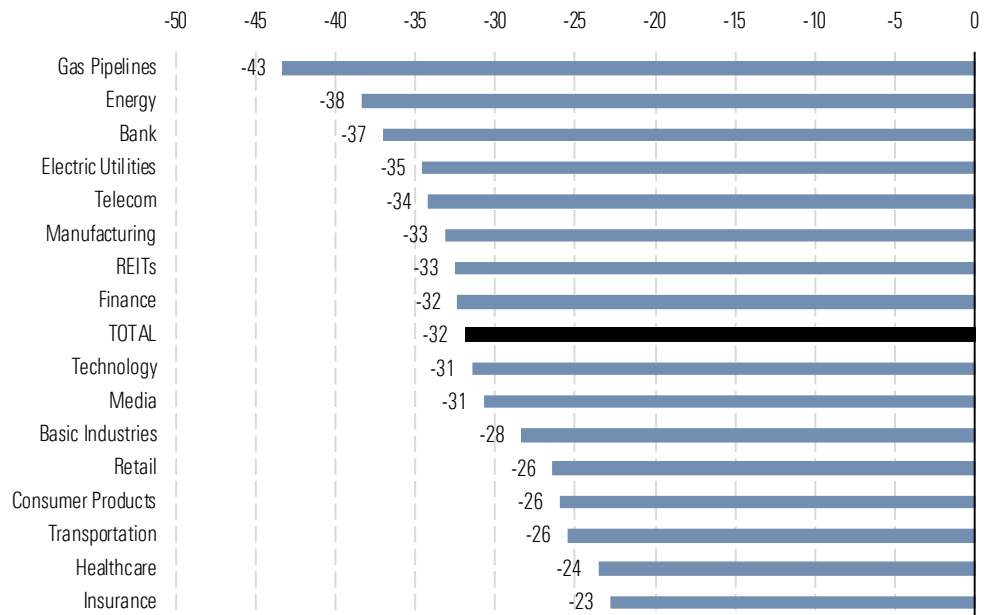
Source: Morningstar, Inc.

**Exhibit 2** Morningstar Corporate Bond Index Spread by Sector



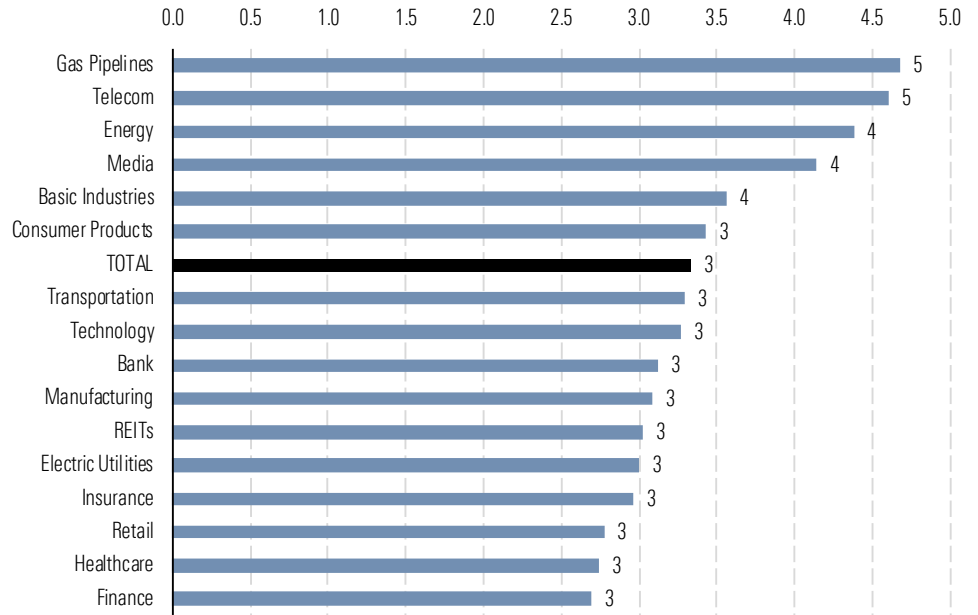
Source: Morningstar, Inc.

**Exhibit 3** Morningstar Corporate Bond Index YTD Spread Change



Source: Morningstar, Inc.

**Exhibit 4** Morningstar Corporate Bond Index YTD Return



Source: Morningstar, Inc.

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