Morningstar Corporate Credit Research Highlights

Volume of new corporate bond issuance breaks weekly record

Morningstar Credit Ratings, LLC
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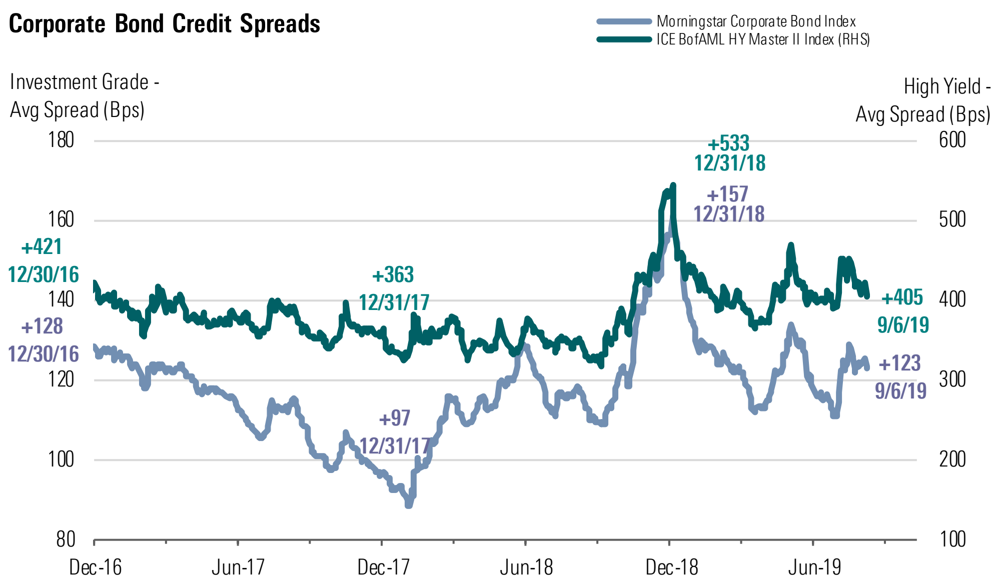
Credit Market Insights

Volume of New Corporate Bond Issuance Breaks Weekly Record

Following the typical seasonal lull in August, the beginning of September is usually very active as the window to the new issue market reopens and issuers look to tap the capital markets for their funding needs. However, not only was new issue activity strong last week, volumes were off the charts. According to Bloomberg, $74 billion worth of new investment-grade bonds were sold last week, setting a record for the amount of issuance sold in a week. Comparatively, last week's volume is almost the same amount as that sold during August.

Even in the face of the record-breaking volumes of new corporate debt being brought to market, corporate credit spreads held steady, and in many cases tightened slightly. In the investment grade market, on a week-over-week basis, the Morningstar Corporate Bond Index tightened 1 basis points to 123 and in the high yield market, the ICE BofAML High-Yield Master II Index tightened 4 basis points to +405.

Corporate Bond Credit Spreads



Source: Morningstar, Inc., ICE BofAML Global Indexes. Data as of 9/6/2019.

Of the new issues brought to market, Bloomberg reported that new issue concessions were in the single-digits and in some cases the new issue spread was priced inside existing bond levels. One would typically expect that with so many new issues being priced that new issue concessions would need to be especially generous to attract investor attention and that the market levels of credit spreads would widen as the market digests such a large dollar volume of bonds. However, there was a strong appetite for corporate bonds that easily absorbed the new issues.

There are multiple factors that helped drive the underlying strength in the corporate bond market. For example, the markets appetite for re-allocating investments into risk assets was prompted by the report that the U.S. and China had agreed to resume trade talks in early October. Once this made the headlines, the equity markets immediately surged. Economic metrics released last week were mixed, but generally interpreted by the market that the economy would continue to expand slowly, but at a slow enough rate that the Fed would continue to ease monetary policy to ensure that the slow growth trend does not slip into contraction. At the end of the week, China announced it was cutting its required reserve ratio in its banking system. This cut will reportedly have the effect of opening up an additional $126 billion of liquidity in the Chinese banking system. For the week, the S&P500 rose 1.79% and is trading less than 2% from its all-time closing high. The risk-on sentiment was not limited to the U.S. and the positive contagion spread across global markets. In Europe, the German DAX rose 2.11%, the French CAC rose 2.25%, and even with the U.K. mired in its Brexit drama, the FTSE rose 1.04%. China's Shanghai Index was the clear winner, rising 4.37% last week.

Another factor that continues to support the U.S. corporate bond market is its relative attractiveness to foreign bonds. With most European sovereign debt trading at negative yielding levels that guarantee a loss if held to maturity, global bond investors have increasingly looked to U.S. fixed income securities to generate a positive return. We have noted multiple times over the past few years, and even more often recently, the heightened demand from European and Japanese investors for U.S. dollar-denominated fixed-income securities as reported by bond traders.

Finally, the markets are continuing to price in a very high probability that the Federal Reserve will continue to provide additional monetary stimulus to shore up the U.S. economy. According to the CME FedWatch Tool, the market implied probability that the Fed will cut rates by 25 basis points on Sept. 18 to a range of 1.75% to 2.00% is 91% and the probability the Fed will leave rates unchanged is only 9%. Following the September meeting, the markets expect that the Fed will continue to cut rates further by the end of the year. The current market implied probabilities that the federal funds rate will end the year at a range of 1.50% to 1.75% is 47% and the probability that the rate will be even lower at between 1.25% and 1.50% is 34%.

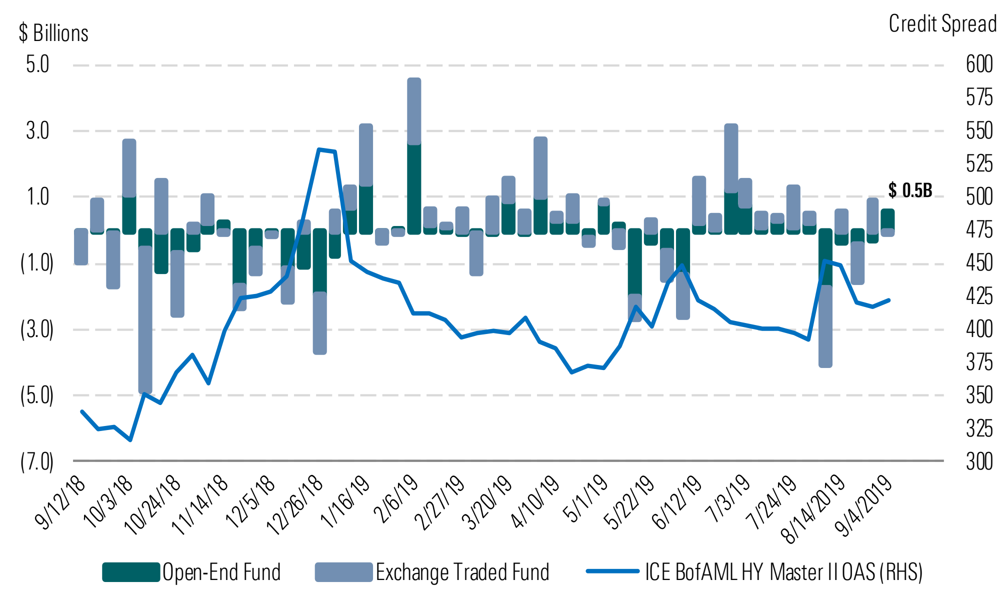
As investors bid up the prices of risk assets, the demand for U.S. Treasury bonds faltered and the decline in Treasury bond prices pushed up yields a bit. In the shorter end of the curve, the interest rate on both the 2- and 5-year bonds rose by 4 basis points to 1.54% and 1.43%, respectively, the 10-year interest rate rose 6 basis points to 1.56% and in the longest end of the curve, the yield on the 30-year rose 7 basis points to end the week at 2.03%. The slight steepening across the yield curve was enough to push the spread between the 2-year and 10-year back into positive territory. The spread between the 2s10s has been closely watched by the markets as an inversion between these two points on the curve has historically been a precursor to economic recessions.

Similar to the U.S. markets, as the European stock markets surged higher, interest rates across most of Europe also rose last week. The yield on the 10-year German bond rose 6 basis points to a negative 0.64%, the Swiss 10-year rose 10 basis points to a negative 0.92%, and the U.K.'s 10-year rose 3 basis points to 0.51%. Most German and Swiss bonds were trading at their historically most negative yields the prior week.

Individual Investors Return to High-Yield Market

Net inflows into the high-yield sector were $0.5 billion last week. The increase was driven by $0.6 billion deposits into the open-end high yield mutual funds as exchange-traded funds (ETFs) experienced $0.1 billion of net unit redemption last week. Historically, the change in open-end funds has been attributed to individual investors, whereas the movement among the ETFs is considered a proxy for institutional investors. Year to date, there has been a total of $14.2 billion of net inflows into the high-yield asset class. Most of the inflows have been driven by $10.4 billion of net unit creation across the highyield ETFs as the open-end funds have only received $3.8 billion of new investments.

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



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

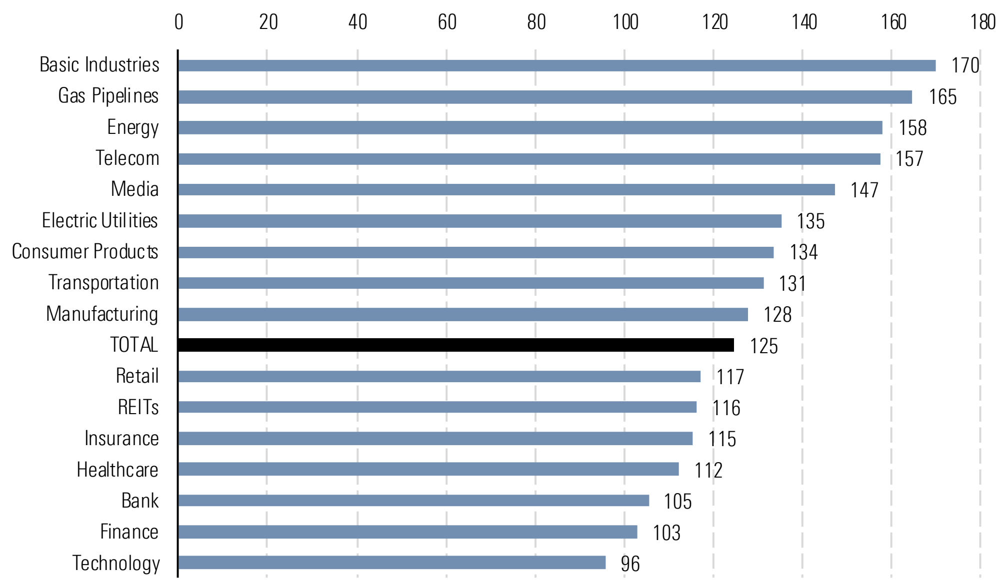
Exhibit 1 Morningstar Corporate Bond Index Sector Summary

Sector	Average Rating	Number of Issues	Modified Duration	Spread (bps)	MTD Spread Chg (bps)	YTD Spread Chg (bps)	MTD Total Return (%)	YTD Total Return (%)
TOTAL	**A-**	**5,338**	**7.4**	**123**	**(1)**	**(34)**	**(0.23)**	**13.32**
FINANCIAL	**A-**	**1,457**	**5.6**	**101**	**(0)**	**(40)**	**(0.18)**	**10.95**
Bank	A-	859	4.9	100	(1)	(42)	(0.11)	10.28
Finance	A-	258	5.3	96	1	(39)	(0.14)	10.56
Insurance	A	230	9.1	113	1	(25)	(0.53)	14.74
REITs	BBB+	101	6.3	110	(2)	(39)	(0.33)	11.93
INDUSTRIAL	**A-**	**3,148**	**8.1**	**131**	**(1)**	**(31)**	**(0.25)**	**14.32**
Basic Industries	BBB	270	7.8	169	(2)	(29)	(0.11)	14.40
Consumer Products	BBB+	342	8.3	128	(0)	(31)	(0.39)	15.48
Energy	A-	400	7.7	168	(5)	(28)	(0.16)	13.69
Healthcare	A-	443	8.4	111	1	(24)	(0.34)	13.69
Manufacturing	A-	499	6.5	122	(1)	(39)	(0.12)	12.16
Media	BBB+	176	9.3	145	(1)	(33)	(0.30)	16.83
Retail	A-	212	8.5	115	0	(29)	(0.30)	13.90
Technology	A	373	7.5	102	(0)	(25)	(0.32)	12.96
Telecom	BBB+	157	10.1	147	(2)	(44)	(0.19)	19.37
Transportation	BBB+	199	9.3	127	(1)	(30)	(0.30)	15.33
UTILITY	**BBB+**	**676**	**9.1**	**148**	**(1)**	**(38)**	**(0.23)**	**15.49**
Electric Utilities	A-	373	9.9	130	(2)	(40)	(0.34)	16.11
Gas Pipelines	BBB	283	8.0	170	(0)	(38)	(0.07)	14.78
Rating Bucket								
AAA Bucket		123	7.8	49	1	(9)	(0.38)	11.17
AA Bucket		492	6.4	64	0	(21)	(0.25)	10.13
A Bucket		1,957	7.4	94	(0)	(30)	(0.29)	12.37
BBB Bucket		2,766	7.5	160	(2)	(44)	(0.16)	14.79
Term Bucket								
1-4	A-	1,726	2.2	70	(1)	(31)	0.00	5.24
4-7	A-	1,232	4.8	109	0	(46)	(0.09)	10.53
7-10	BBB+	853	7.0	134	(1)	(45)	(0.24)	14.64
10PLUS	A-	1,527	14.3	178	(1)	(31)	(0.53)	23.81

Data as of 09/06/2019

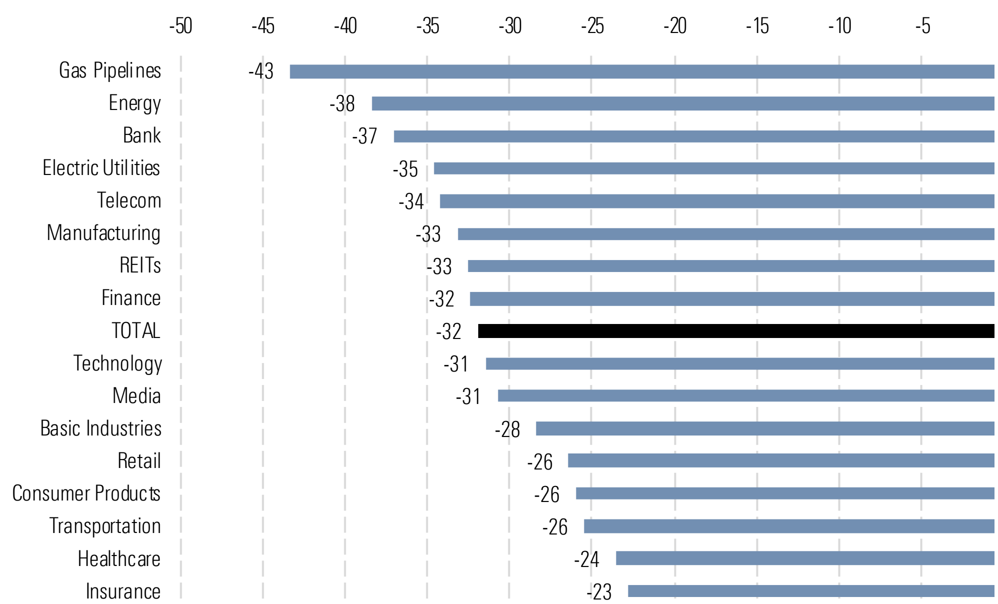
Source: Morningstar, Inc.

Exhibit 2 Morningstar Corporate Bond Index Spread by Sector



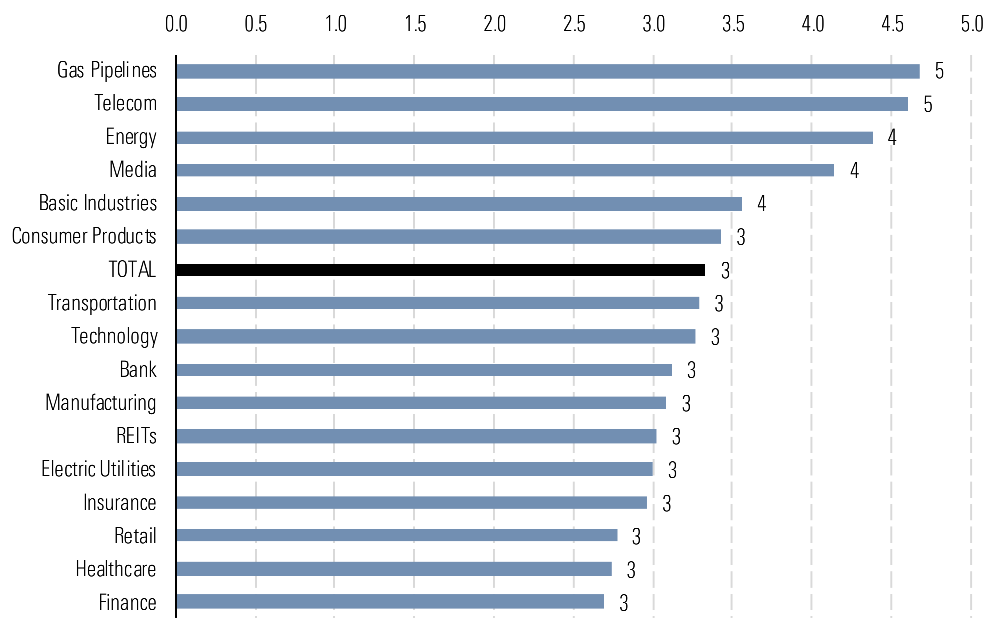
Source: Morningstar, Inc.

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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