Focused Corporate Bond

April 2022

Market Highlights

Corporate yield spreads ground tighter through mid-April on a flat/inverted yield curve, easing issuance (from record levels), and a steadying macro tone. The market took a step back thereafter, as a hawkish Fed spurred volatility and weighed on market sentiment, weakening all risk assets and causing credit yield spreads to widen into month-end. For the month, Canadian credit yield spreads widened by an average of 16 basis points, with lower beta, higher rated debt generally outperforming. The US high yield market saw the most acute spread widening, with spreads widening by an average of 54 bps with the lowest rated, less rate sensitive CCC-rated spreads gapping out by 87 bps.

Given underlying yield volatility and investor sentiment that credit curves had not steepened enough to compensate for the inversion of the 10-30's Government of Canada curve, long credit spreads underperformed. For the month, the corporate yield spread curve bear steepened as short, mid and long-term spreads widened by 15, 17 and 18 bps respectively. However, the rise of underlying Government of Canada yields was the largest driver of absolute performance as 2, 5, 10 and 30-year yields rose by 33, 34, 46, and 42 bps respectively during April. At month-end the market had priced in expectations of the Bank of Canada aggressively hiking by eight quarter points by year end.

After record corporate issuance in March, and amidst a backdrop of challenging liquidity, negative market sentiment, and earnings black-out for many corporate issuers, April supply was a measly $4.9B, marking the quietest April in nearly ten years. The year-to-date pace remains 15% ahead of last year however, as record bank issuance (due to prefunding, robust loan growth and acquisitions) offset a more than 40% decline for non-financials issuers.

From an industry perspective, defensive and higher-rated issues generally outperformed across the yield curve. Utilities (distribution and generation), infrastructure and grocers were top performers. High energy prices and positive rating actions aided integrated energy producer issues. On the back of recent underperformance, real estate issuers saw renewed interest on hopes that a return to a more normalized environment would benefit credit metrics.

With reduced secondary market liquidity, investors looked to benchmark liquid issues to act as a corporate proxy for rebalancing purposes. Consequently, liquid domestic bank senior bail-in debt underperformed smaller issues in legacy deposit notes, non-DSIB senior bank debt and subordinated non-viability contingent capital bonds. In a similar vein, telecom and pipelines lagged similarly rated issues as liquidity needs overshadowed favorable industry fundamentals.

Outlook & Strategy

Tightening monetary policy, geopolitical risks and ongoing COVID issues have hurt risk sentiment. Reactions have been most acute in the speculative grade markets which have seen risk premiums rise and issuance struggle on lower demand, particularly for issuers with weak business profiles and longer maturities, where term premiums are low. In the Canadian market, which is dominated by investment grade credits, leverage metrics and debt servicing metrics, even for the lowest rated credits, are healthy and refinancing risk is not a near-term threat.

Given the macro backdrop and event risks, we anticipate that credit markets will remain in a cautious reach for yield environment. During a tightening cycle, corporate credit spreads typically narrow and credit curves steepen due to an improving macroeconomic backdrop. However, corporate yields may prove more volatile this tightening cycle given the plethora of risks. We expect to see less momentum driven trade and greater differentiation of spread performance amongst lower rated, higher-beta and illiquid credits. The portfolio has good liquidity and is well positioned to capitalize on relative value and yield enhancement opportunities.

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