# Focused Corporate Bond

January 2024

## Market Highlights

Investment grade credit spreads rallied to their best levels in two years as the soft-landing narrative and inflows to investment grade funds overshadowed record issuance and resurfacing US regional bank concerns. For the month, domestic investment grade credit spreads narrowed by an average of 6 basis points, with lower-rated, higher-beta debt generally outperforming across the credit curve. The positive momentum however, failed to migrate further down the credit quality scale as high yield spreads came under pressure from heavy supply, tight technical levels and eroding credit quality concerns.

In January, short, mid and long-term investment grade credit spreads narrowed by 8, 5 and 2 bps respectively. The bear steepening of the credit yield spread curve (long-term levels rose more than short-term) reflected a heavy government long-term supply schedule and some normalisation of the Government of Canada yield curve. Notably, record domestic issuance for January of $13.4B, did not act as a headwind for credit outperformance given robust demand (as evidenced by a lack of concessionary pricing) and well diversified issuance across several industries. Despite narrowing credit spreads, absolute returns were negatively impacted by higher Government of Canada yields as 2, 5, 10 and 30-year yields rose by 23, 23, 21 and 22 bps, respectively.

Across industries, lower-rated, higher-beta issuers in real estate, autos and hybrids outperformed on improved risk sentiment and well-received new issuance that repriced secondary issuer credit spread curves tighter. Insurance, domestic senior and subordinated bank debt, and securitisation (credit-card receivables) also outperformed, given reduced domestic issuance, higher yields and attractive relative value versus non-financials. Domestic bank debt, in particular, was not materially impacted by another flare-up over concerns of US regional bank commercial real estate exposure. Finally, affiliated pension debt (real-estate arms) outperformed on the back of strong operating and financial performance results. Alternatively, defensive, higher rated issues in utilities and infrastructure underperformed on increased risk appetite. Project finance and public private partnership issues also lagged as a result of illiquidity and long-term issuance profiles.

## Outlook & Strategy

We believe rates will remain volatile and that government yield curves and credit markets, as currently priced, are forecasting overly aggressive central bank easing cycles and both will likely need to adjust. The amount of easing priced into the US and Canadian yield curves implies deflation or recession or both by early next year, while credit markets are priced for much lower policy rates and a soft landing.

Amid this backdrop, investors will continue to cautiously look to credit as a source of attractive yield carry, particularly in the short-term area where the risk/reward opportunities are the most attractive, given the significant inversion of the yield curve and relative flat corporate yield spread curve. Speculative grade markets may be volatile as the threat of a recession periodically weigh on the market. In the Canadian market, which is dominated by investment grade credits, leverage, and debt servicing metrics, even for the lowest rated credits, are healthy and refinancing risk is not a near-term threat. The portfolio is defensively positioned with good liquidity to capitalize on relative value and yield enhancement opportunities.

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