Investment-Grade Corporate Bonds

Focus on Liquid, Higher Quality Bonds

We expect spreads to widen from here.

In the first half of the year, tight spreads were offset by historically attractive all-in yields. However, the average yield on the Bloomberg U.S. Investment-Grade Corporate Bond Index for the trailing-two years is now 5.4 percent vs 5.2 percent as of Aug. 8, 2024, thus becoming less attractive all in. That said, with recent spread widening, spreads make up a larger portion of the total yield and are closer to long-term medians. Looking forward, we expect spreads to stay range bound or drift wider as a result of weakening growth. In this changing environment, focus on credit risk premium will be increasingly important.

Sector Commentary

- Complacency remains high given positive ratings, higher quality index composition, and favorable primary market dynamics.
- In the first half of 2024, $448 billion of investment-grade bonds were upgraded vs. $88 billion downgraded, with most of those downgrades remaining investment grade.
- Index composition continues to improve, with the share of BBB- bonds falling to 9.8 percent, an eight-year low. Meanwhile, the share of A-rated debt has increased to 45.3 percent, the highest level since 2011. We expect the upgrade/downgrade ratio, currently at a 15-year high, to start to normalize in the second half.
- The $860 billion in first half gross primary issuance represents the second largest first-half issuance ever. However, we expect second half issuance to be tamer on a gross and net basis with nearly $400 million in maturities coming due and $200 billion in coupon payments to bondholders.

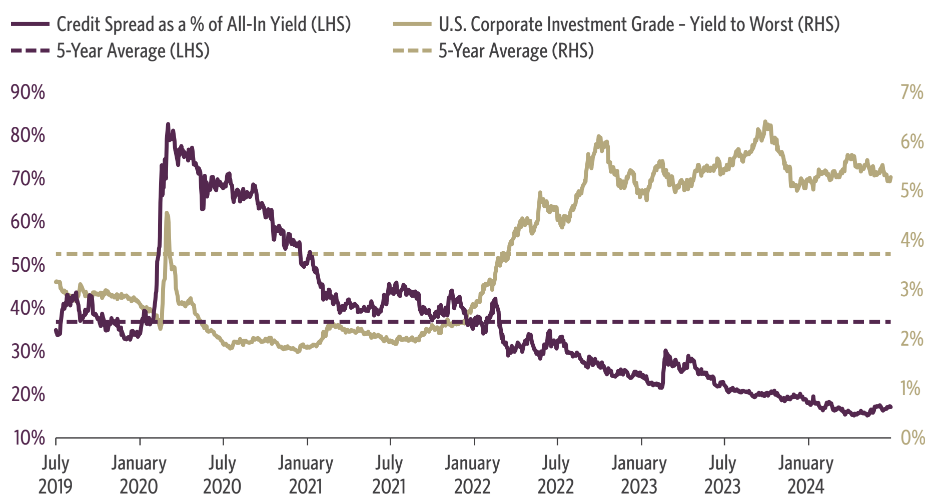
Investment Themes

- We continue to favor banks over industrials as sufficient capital positions and positive regulatory stress test results alleviated concern around the need for increased funding in the near term.
- We see the current environment as an opportunity to rotate into high current dividend/coupon preferred and hybrid securities while reducing exposure to short-dated call structures trading at or near par.
- Credit curves steepened during the second quarter but investors matching longer liabilities may find value in adding exposure as the rate curve bear steepened, adding incremental yield to 20+ year corporate securities.
- Our compression trade of BBB vs A-rated corporates performed well in the first half. Our focus in the third quarter is on more liquid, higher quality securities, which historically perform well in spread widening environments.

By Justin Takata

The average yield on the Bloomberg U.S. Investment-Grade Corporate Bond Index for the trailing-two years is now 5.4 percent vs 5.2 percent as of Aug. 8, thus becoming less attractive all in. That said, with recent spread widening, spreads make up a larger portion of the total yield and are closer to long-term medians.

All-In Yields Are Becoming Less Attractive, Although Spreads Have Recently Widened



Source: Guggenheim Investments, Bloomberg. Data as of 7.19.2024.

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Investing involves risk, including the possible loss of principal. In general, the value of a fixed-income security falls when interest rates rise and rises when interest rates fall. Longer term bonds are more sensitive to interest rate changes and subject to greater volatility than those with shorter maturities. During periods of declining rates, the interest rates on floating rate securities generally reset downward and their value is unlikely to rise to the same extent as comparable fixed rate securities. High yield and unrated debt securities are at a greater risk of default than investment grade bonds and may be less liquid, which may increase volatility. Investors in asset-backed securities, including mortgage-backed securities and collateralized loan obligations ("CLOs"), generally receive payments that are part interest and part return of principal. These payments may vary based on the rate loans are repaid. Some asset-backed securities may have structures that make their reaction to interest rates and other factors difficult to predict, making their prices volatile and they are subject to liquidity and valuation risk. CLOs bear similar risks to investing in loans directly, such as credit, interest rate, counterparty, prepayment, liquidity, and valuation risks. Loans are often below investment grade, may be unrated, and typically offer a fixed or floating interest rate.

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GPIM 62344