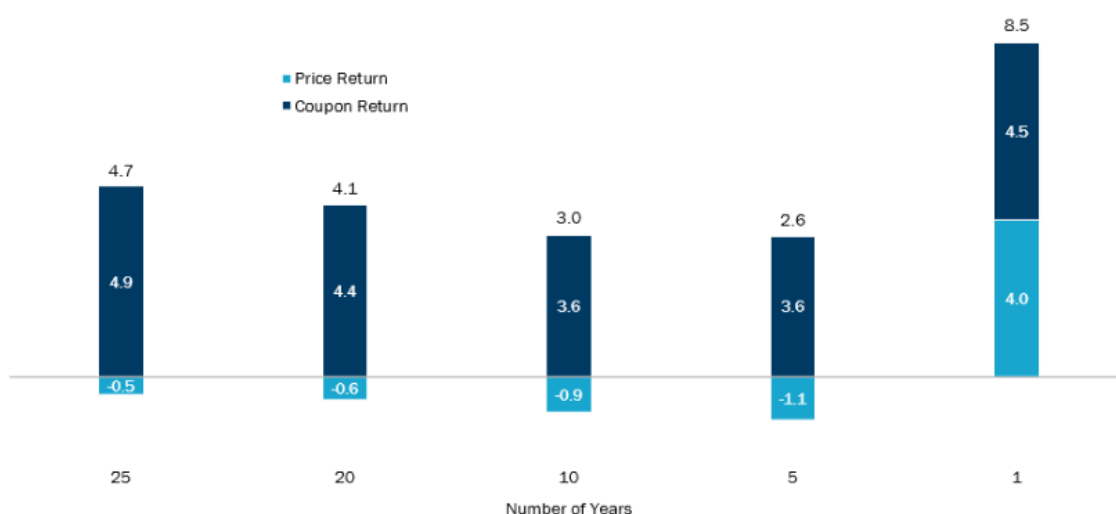


Fixating on Income

Looking back over the last 25 years, more than 90% of returns for investment grade credit come from the income component, rather than the price component¹. With the market now reevaluating its view of when the Federal Reserve will start its interest rate easing cycle and by how much, it is worth remembering that returns in investment grade credit have historically been driven by income, and not price returns. We believe that US investment grade remains an attractive value proposition even if rates stay elevated. Generally, investors buy investment grade for income and not the price return. In our view an investor would be better served by owning a variety of other fixed income products if their return focus is premised on the change in the path of interest rates.

INCOME DRIVES RETURNS



Data as of December 31, 2023
Source: Bloomberg

IG yields against history

Currently, the yield on the Bloomberg US Corporate Index is around 5.3%, down from its near-term peak of 6.5% achieved late last year. The yield (also known as the income component of a bond) is still elevated when looking back over the last 20 years. We recognize credit spreads are toward the lower of the recent range, but, we still hold the view that credit investors are being fairly compensated for taking the incremental risk of owning investment grade credit over similar duration Treasury products.

Fundamentals are robust

The Q4 2023 earnings season showed investment grade credit continues to perform well. Net income increased 5% year-on-year and revenue growth was 7%. Net profit margins were generally flat at 10%, on average. Leverage metrics remain intact with gross leverage at 2.5x.

² We're not too concerned about the impact of higher for longer interest rates on the IG market, not least as the interest coverage rate is 11x. Plus, the average coupon on the Bloomberg US Corporate Index is 4.09% and average maturity is 10.7 years. With GDP growth of 1.6% expected in 2024, we think overall revenue growth of over 5% should be expected.

All told, we think investors can continue to count on earning income from owning investment grade. Any price returns from lower interest rates would just be an added benefit.

1. Source: Bloomberg
2. Source: Bank of America

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The following indices may be referred to in this document: Bloomberg US Corporate Bond Index

BLOOMBERG US CORPORATE BOND INDEX

The Bloomberg US Corporate Bond Index measures the investment grade, fixed-rate, taxable corporate bond market. It includes USD denominated securities publicly issued by US and non-US industrial, utility and financial issuers..

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