FIXED INCOME: A RETURN TO NORMALCY

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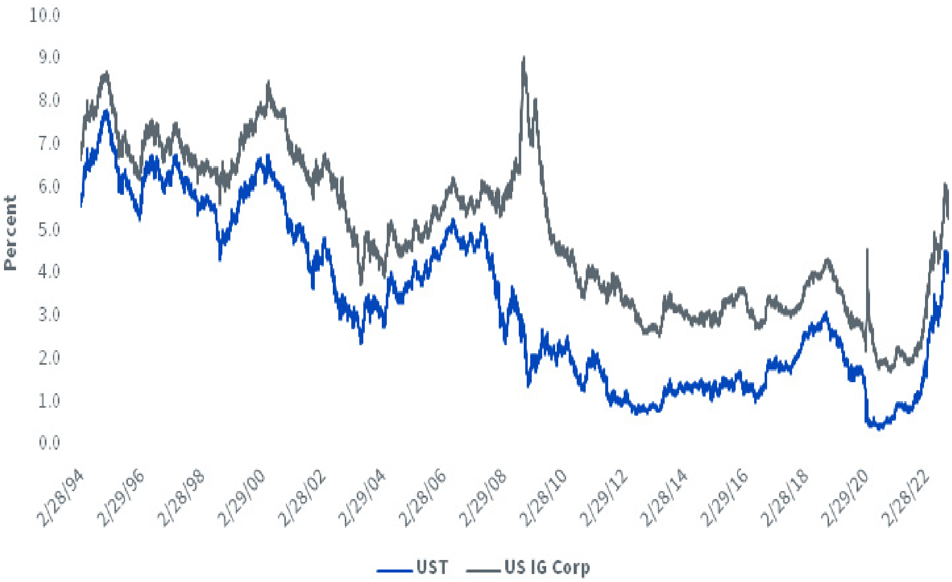
While 2022 was arguably one of the worst, if not actually *the* worst, years for the U.S. bond market in modern history, a silver lining has emerged. Indeed, with yield levels surging across the asset class spectrum, one could conclude that a semblance of 'normalcy' has returned to the fixed income arena.

Up until this year, the one major question I was always asked was: Where can I find yield in the bond market? To be sure, with U.S. rates being dragged down by zero interest rate (ZIRP) central bank policies, negative sovereign debt yields abroad and a lack of inflation, to name a few key factors, investors had been left with historically low yield levels, a new normal for the bond market.

UST & U.S. IG Corporate: Yield to Worst



Source: Bloomberg, as of 12/1/22. UST is U.S. Treasury, IG is investment grade.

U.S. High Yield: Yield to Worst

Source: Bloomberg, as of 12/1/22.

As we are about to embark on a new calendar year, the fixed income landscape has changed dramatically. As I mentioned in a prior blog post, I would argue that the historically low yield levels of the last 10 to 15 years were "abby normal," to quote the movie *Young Frankenstein*, and that investors are now witnessing what normal looks like when central banks are no longer pursuing ZIRP and are actually tightening monetary policy *because of inflation*.

This new rate regimen has brought Treasuries (UST), investment-grade (IG) corporates and high-yield (HY) corporates all back to familiar pre-global financial crisis territory, arguably the genesis of the abnormal yield structure for the last decade or so (see graphs). For Treasuries, that means a yield to worst reading at or around 4%, and for U.S. IG corps, levels over the 5% threshold. Perhaps one of the more intriguing developments has been the rise in HY into the 8%–9% range. Compare these readings to where they were just a year ago: UST 1.12%, U.S. IG corps 2.29% and HY 4.74%.

Conclusion

From an investment backdrop, investors now have some definitive options within the fixed income arena. In fact, even though Fed Chairman Powell has signaled the potential for some slowing in the pace of rate hikes, perhaps as soon as next week's FOMC meeting, he also emphasized that rates could be heading higher for longer, with no apparent appetite to reverse course anytime soon. So, if I was asked the aforementioned question about where to find yield in the bond market now, my answer has now become a much easier one.

Indexes:

- Treasuries: Bloomberg U.S. AGG Treasury Yield to Worst
- IG Corps: Bloomberg U.S. AGG Corporate Yield to Worst
- High Yield: Bloomberg U.S. Corporate High Yield Yield to Worst

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DEFINITIONS

Bond market : The bond market—often called the debt market, fixed-income market, or credit market—is the collective name given to all trades and issues of debt securities. Governments typically issue bonds in order to raise capital to pay down debts or fund infrastructural improvements.

Yield : The income return on an investment. Refers to the interest or dividends received from a security that is typically expressed annually as a percentage of the market or face value.

Fixed income : An investment security that provides a return in the form of fixed periodic payments and the eventual return of principal at maturity.

Zero Interest Rate Policy (ZIRP) : A monetary policy where by interest rates, such as Fed Funds, are kept close to, or at zero.

Central bank : Refers to the the monetary authority of any country.

Sovereign Debt : Bonds issued by a national government in a foreign currency, in order to finance the issuing country's growth.

Inflation : Characterized by rising price levels.

Monetary policy : Actions of a central bank or other regulatory committee that determine the size and rate of growth of the money supply, which in turn affects interest rates.

Treasury : Debt obligation issued by the U.S. government with payments of principal and interest backed by the full faith and credit of the U.S. government.

Investment grade : An investment grade is a rating that signifies a municipal or corporate bond presents a relatively low risk of default.

High Yield : Sometimes referred to as "junk bonds," these securities have a higher risk of default than investment-grade securitie.

Yield to worst : The rate of return generated assuming a bond is redeemed by the issuer on the least desirable date for the investor.

Federal Reserve : The Federal Reserve System is the central banking system of the United States.

Federal Open Market Committee (FOMC) : The branch of the Federal Reserve Board that determines the direction of monetary policy.

Barclays Capital U.S. Treasury Bond Index : A market-capitalization weighted index that measures the performance of public obligations of the U.S. Treasury that have a remaining maturity of one year or more.

Barclays Capital U.S. Corporate Bond Index : The Index consists primarily of publicly issued U.S. corporate securities. The index includes both corporate and non-corporate sectors. The corporate sectors are industrial, utility and financial. To be included in the index an issuer must have debt with at least one year to final maturity, have at least $250 million par amount of debt outstanding and be rated investment grade by at least two rating agencies.

Bloomberg U.S. Corporate High Yield : Covers performance for United States high yield corporate bonds.