



Unlocking opportunities in corporate credit

A case to go against the grain

Spread tightening has continued to ripple across the fixed-income markets, with high-yield index spreads below long-term averages. However, some parts of the asset class haven't tightened as quickly as others. What is driving this, and what is the investment opportunity?

BB- and B-rated credit spreads are near 10-year minimums, driven by investors buying into higher-yielding securities. However, spreads for the lower-rated CCC corporate bond cohort remain near their historical median.

The chart below shows the deviation of BB and B spreads from the rolling 10-year median versus CCC spreads. Over the past six months, spreads on BB- and B-rated debt have steadily tightened, while spreads on CCC-rated issuers have landed closer to the median.

Why?

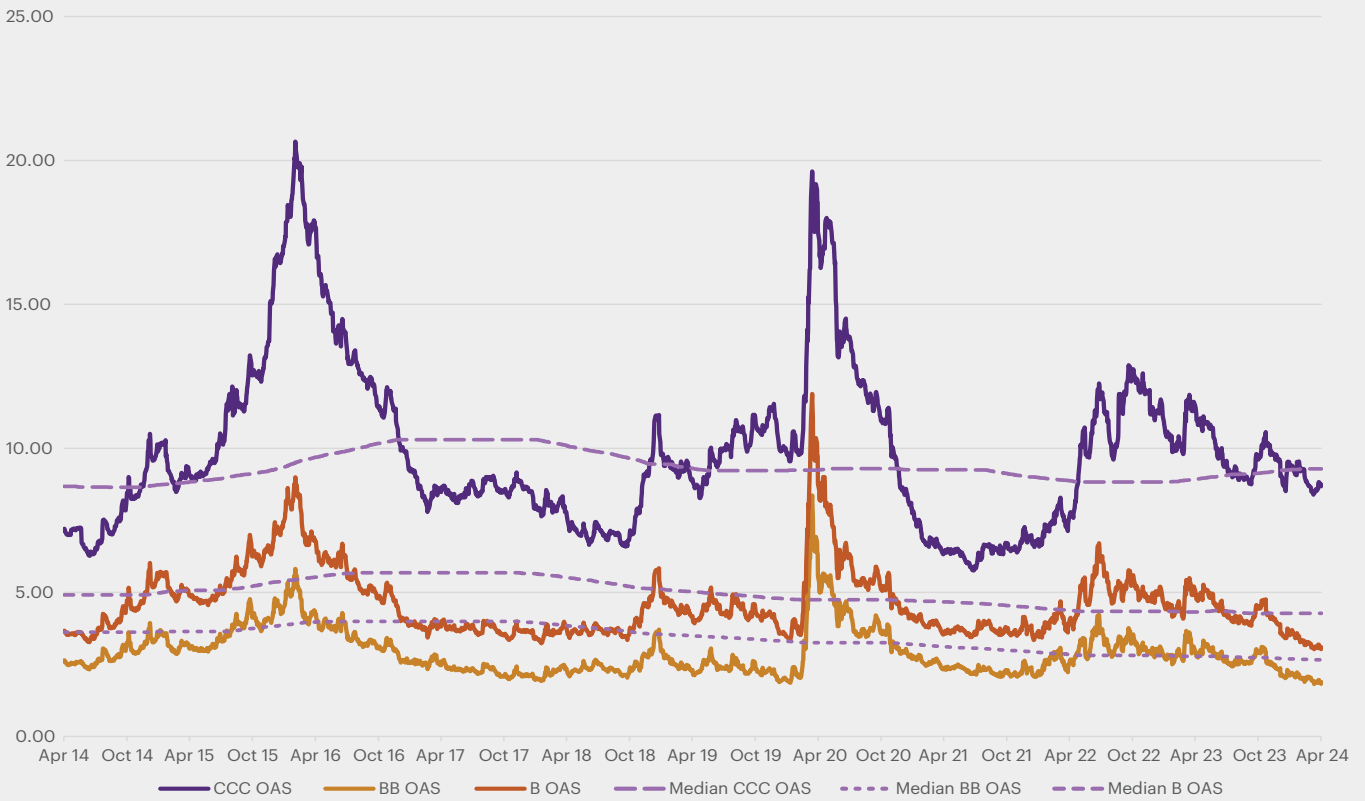
We believe part of the reason is the risk of a possible uptick in defaults. However, the continued strength of the U.S. economy and prospects for eventual rate cuts suggest the **default environment may be more benign than what is currently baked into spreads.**

How should this impact investment decisions?

Given this backdrop, it's **broad-market-like, high-yield exposure and focus on skilled active managers** who can capture better spreads and yields while avoiding the tighter parts of the market and vulnerable issuers.

Creative solutions in high-yield and leveraged loans can supplement traditional allocations to both stocks and investment-grade debt while adding diversification benefits. Investors willing to look past broad-based index metrics and allocations have the potential to be rewarded based on today's healthy yields when selecting skilled managers who invest away from the crowds.

Figure 1: Current and LTA spread by credit rating bucket



Notes: OAS = Option-Adjusted Spread

Source: ICE Data Indices, ICE BofA CCC & Lower US High Yield Index Option-Adjusted Spread, ICE BofA BB US High Yield Index Option-Adjusted Spread, ICE BofA Single-B US High Yield Index Option-Adjusted Spread

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