

27 October 2022



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People my age and up will remember that for all of us (or since 1930, when Pluto was first discovered), the solar system consisted of nine planets. Then in 2006 a monumental event happened when the International Astronomical Union downgraded Pluto to 'dwarf planet' status. This essentially meant that from that day on, our solar system would consist of eight planets only, and Pluto wasn't one of them anymore.

It has been 16 years since that event, a rounding error in the context of a planetary life cycle, but a whole lot in the investment world. This is approximately how long it took for the investment grade credit index (based on the Bloomberg US Corporate Bond index) to again look that attractive relative to the stock market.

IG index Yield vs S&P Earnings Yield



Source: Bloomberg

As of October 2022, the Yield to Worst (YTW) on the IG index exceeds 6%! This is more than three times its yield just a year ago. Furthermore, the IG index has only very briefly had a yield of more than 6% in the past 16 years, and the last time was pre-2010. Last, and most interesting we reckon, is the fact that 2022 marks the first time in around 16 years when the difference between the yields of the IG index and the earnings yield of the S&P 500 index is once again positive!

IG Yield to Worst - S&P Earnings Yield (%)



Source: Bloomberg

We believe that aside from the all-in attractiveness of investment grade, this has significant implications for asset allocation decisions globally. It offers a rare opportunity for investors to move up the capital structure and pick up yield while doing so. Naturally, the equity earnings yield is subject to the actual earnings coming through as expected (and is thereby subject to change), whereas a bond yield is pretty much guaranteed (bar a default). This degree of certainty would appeal to even the more conservative income-oriented strategies, while still leaving plenty of upside room for growth too. We believe that this trade-off would make a lot of sense in an economic environment where consensus expectations about global growth are fairly negative. All in, it is another reason why we have turned more positive on investment grade credit on a 12-month horizon.

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AdTrax: 5067817.1. | Exp Date: 31 October 2024