

Investment Grade Corporate

Marketing communication | As of 30 Sep 2024

- **During the third quarter, the Investment Grade Corporate strategy underperformed on a gross and net of fees basis.**
- **Security selection was the primary contributor to performance.**
- **Duration positioning was the primary detractor from performance.**

Market review

U.S. and global economies continued to expand during the third quarter, although more signs of a slowdown emerged. Second-quarter U.S. gross domestic product (GDP) growth came in stronger than expected at a solid 3.0% pace versus the prior year, while full-year growth is tracking just slightly below that rate. Monthly U.S. job creation moderated significantly during the quarter versus the first half of the year, causing unemployment to rise above 4%; however, layoffs and outright job losses remained rare. At the same time, U.S. consumption continued to expand at a healthy pace as illustrated by robust retail sales, while the housing market showed early signs of rebounding. In Europe, overall growth continued to improve versus 2023's sluggishness, with consumption and net exports improving modestly. However, China's economic growth remained weak causing the government to unleash a broad package of stimulus measures in September.

Amid further signs of moderating U.S. inflation and the weakening labor market, Fed policymakers made a supersized 50-basis-point rate cut at their September meeting. Following the meeting, however, Chair Powell asserted that a more aggressive pace shouldn't be expected going forward. U.S. Treasury yields dropped significantly across the yield curve, after rising in the first half of the year. The bellwether 10-year Treasury yield ended the quarter 55 basis points lower at 3.81%, while two-year rates fell by nearly twice as much. As a result, the two-to-10-year segment of the yield curve returned to an upward slope following an extended period of inversion, easing recession fears.

The investment grade corporate bond market experienced a major selloff at the beginning of August after weaker employment numbers drove spreads nearly 20 basis points wider in a matter of days. However, the selloff was short lived as spreads subsequently rallied to end August where they began. Over the full quarter, spreads fell a mere 4 basis points to end at 89 basis points, just above their tightest mark of the year. The Fed's first rate cut since 2020 helped drive investment grade corporate yields lower by 76 basis points over the quarter, ending at 4.72%. Despite the lower all-in yields, technical factors remained robust, supporting spreads and demand. New issue supply stayed above expectations capped by a record month of issuance in September. Investment grade corporates have seen \$1.17 trillion of new issue volume year to date, 24% higher than last year's pace. Investment grade corporates ended the quarter with a total return of 5.84% led by longer duration and higher rated bonds, outperforming Treasuries. (Source: Bloomberg index returns except where noted.)



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Investment Grade Corporate

Portfolio review

During the third quarter, the Investment Grade Corporate strategy underperformed its index, the Bloomberg U.S. Intermediate Investment Grade Corporate Index, on a gross and net of fees basis.

In the third quarter, the strategy's shorter-than-benchmark duration position was the largest detractor from performance as Treasury yields declined rapidly, driven by Fed rate cut expectations. Additionally, the strategy's up-in-quality positioning detracted from performance. Most of the accounts in the composite do not have exposure to BBB rated securities, which comprises ~48% of the index and outperformed during the third quarter. At the index level, BBB rated corporates returned 4.74%, while A returned 4.65%, AA 4.15% and AAA 3.85%. The strategy benefitted from security selection within the utility sector. The strategy's positioning in high quality electric names benefitted performance, while its positioning in capital goods was a detractor from performance. Over the course of the quarter, we extended duration from a Walmart bond into a Home Depot bond and also extending duration in Citi bonds. Lastly, we reinvested coupons into an Enterprise Products bond.

Heavy supply from the first two quarters of the year continued in the third quarter, capped by a record amount

of issuance for September. Technicals continue to be the primary driver of the investment grade corporate market this year and we expect this trend to continue. Risks to this outlook include deteriorating economic conditions or a worsening labor market. We anticipate spreads will remain range-bound in the near term, with the potential to stay tight barring an economic shock. While the risk-off tone in early August reflected concerns about a slowing economy, the subsequent rally underscored the resilience of demand for investment grade corporates. Although yields have fallen from recent peaks, we expect continued heavy demand for the asset class as the market anticipates further yield declines. Additionally, the upcoming presidential election and geopolitical developments could introduce more volatility into the market.

We continue to favor positioning that emphasizes higher credit quality and liquidity. We prefer defensive sectors such as utilities and consumer non-cyclicals because they generate consistent cash flows, even during periods of economic uncertainty. Despite recent outperformance, we also prefer U.S. money center banks as they remain well-capitalized. Conversely, we intend to maintain the strategy's underweight to economically sensitive sectors such as basic industry and transportation.

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Glossary

The **Bloomberg U.S. Intermediate Investment Grade Corporate Index** is a broad based benchmark that measures the investment grade, fixed-rate, taxable corporate bond market. It includes USD-denominated securities publicly issued by U.S. and non-U.S. industrial, utility and financial issuers that have between 1 and up to, but not including, 10 years to maturity. **It is not possible to invest directly in an index.** Clients should consult their financial professional regarding unknown financial terms and concepts.

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