Market Volatility Creates Opportunities

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With an escalation of trade tensions and growing concerns about slowing global growth, volatility across capital markets has increased. Central banks are under increased pressure to respond with additional accommodation, and futures markets in the U.S. are pricing in a near 50-50 probability of a 50 basis point (bp) reduction in the Federal Reserve's (Fed) target rate at the September Federal Open Market Committee meeting.

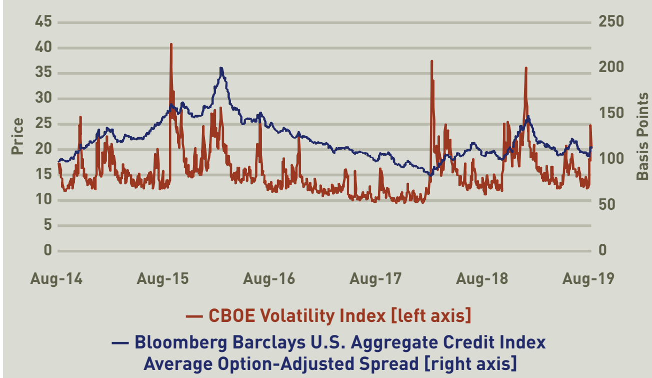
The U.S. Treasury market has rallied by more than 30 bps during August, while the inversion between the 3-month bill and 10-year note increased to around 30 bps. Meanwhile, equities have pulled back from all-time highs, and volatility, as measured by the CBOE Volatility Index (VIX), is spiking. However, while corporate credit spreads are about 10 bps wider in August, they remain near the mean level of the trailing 1- and 3-year periods. As shown in Chart 1, it typically takes a prolonged period of elevated equity market volatility to produce a more considerable spread widening event.

We think it's important to note, the yield-to-worst on the Bloomberg Barclays Corporate Index is now below 3%—more than 100 bps lower year-to-date—which is approaching the level immediately prior to the 2016 U.S. presidential election. The decline in global yields is even more pronounced, with the German bund below -50 bps and more than $14 trillion in global debt yielding less than zero. According to ICE Data Indices, U.S. corporate bonds account for approximately 50% of outstanding debt worldwide, but almost 90% of the index yield!

With continued strong demand from global investors, we believe this presents a unique dynamic for issuers to access extremely attractive all-in funding costs. For example, Occidental Petroleum Corporation (OXY) was in the market on August 6 to finance its pending acquisition of Anadarko Petroleum Corporation. The transaction is valued at more than $55 billion, and with this incremental debt financing, OXY's single-A ratings (in place since mid-2005) will fall to mid-to-low BBB. While pricing improved significantly due to strong investor demand, OXY still offered material concessions relative to secondary bonds. In total, OXY was able to place more than $10 billion in fixed-rate term debt, with an average maturity of almost eight years and an average coupon of 3.1%. OXY is just one example of a recent trend developing in the U.S. corporate bond market.

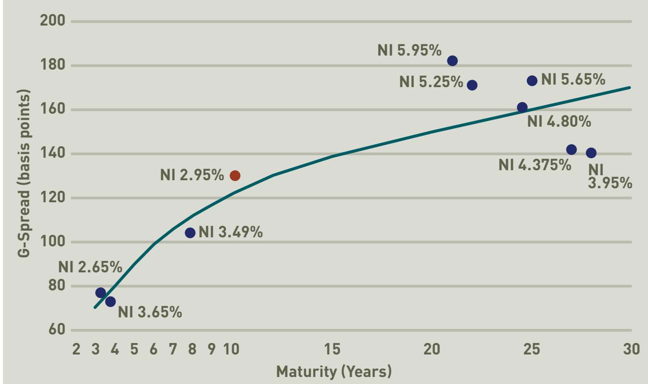
With issuers emphasizing attractive funding on an all-in yield basis and investor demands for concessions given the more volatile market, we are seeing select opportunities to invest in corporate bonds at comparatively attractive levels. As shown in Chart 2, pricing on a new NiSource Inc. 10-year bond on August 7 was approximately 10 bps higher than interpolated levels from existing secondary issues and approximately 25 bps higher than a comparable maturity issue.

Chart 1



Source: Bloomberg L.P.

Chart 2



Source: Bloomberg L.P.

In more "risk-on" environments, primary market deals can price at or through levels on comparable secondary offerings—a technical we call the "the new issue compression." We never want to be price-takers, and our Fundamentals-Valuations-Technicals framework enforces discipline as we evaluate opportunities to source attractive investment opportunities for our clients.

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Indexes

The **CBOE Market Volatility Index** is a real-time market index that represents the market's expectation of 30-day forward-looking volatility. Derived from the price inputs of the S&P 500 index options, it provides a measure of market risk and investors' sentiments.

The **Bloomberg Barclays Aggregate Credit Index Option Adjusted Spread (OAS)** calculates spreads between the computed OAS of the Bloomberg Barclays Aggregate Credit index and a spot Treasury curve. An OAS index is constructed using each constituent bond's OAS, weighted by market capitalization.

The **Bloomberg Barclays U.S. Corporate Bond Index** is an unmanaged market-value-weighted index of investment-grade corporate fixed-rate debt issues with maturities of one year or more.

G-spread, also called nominal spread, is the difference between yield on Treasury Bonds and yield on corporate bonds of same maturity.

Important Disclosures