Global Investment Grade Corporates: Let the Good Times Roll!

Major central banks easing policy, solid economic growth and moderating inflation should bode well for global investment grade corporate credit. So, is global investment grade corporate the sweet spot in fixed income? We think it might just be.

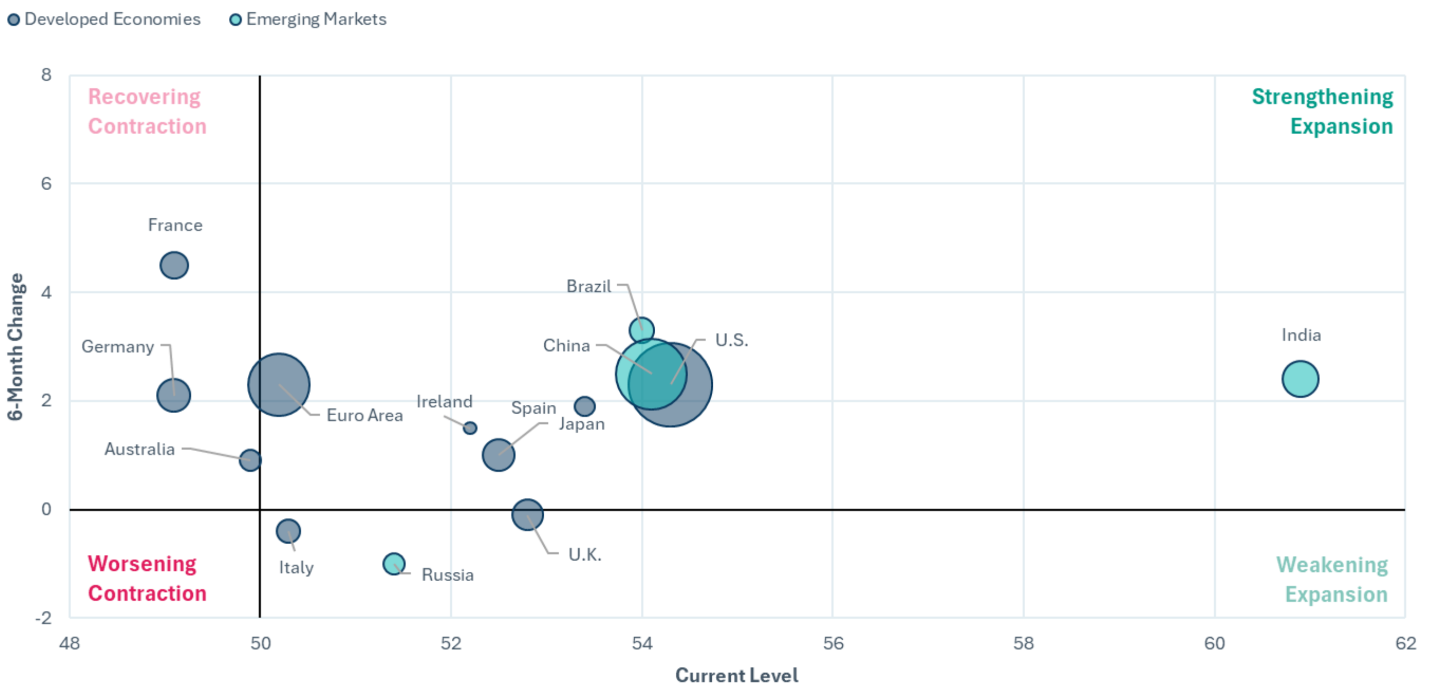
1. Global Economic Backdrop Supports Credit Markets

In our view, a soft landing is still the most probable outcome through the end of next year. We continue to expect above-trend GDP growth for the remainder of 2024 in the US, with the unemployment rate hovering slightly above 4% and inflation moderating. Looking further ahead, we see GDP growth at trend (~2%), with core inflation moderating at a faster pace toward the Fed's 2% target. The labor market may soften further but stabilize throughout next year, as low layoff activity will continue to keep a lid on the unemployment rate.

As the chart below indicates, growth remains in expansionary territory for most countries (top right) or is recovering, as is the case in Germany, France or Australia (top left).

Composite Global Purchasing Manager's Indices (PMI)

Current Level Versus 6-Month Change for Major Global Economies*



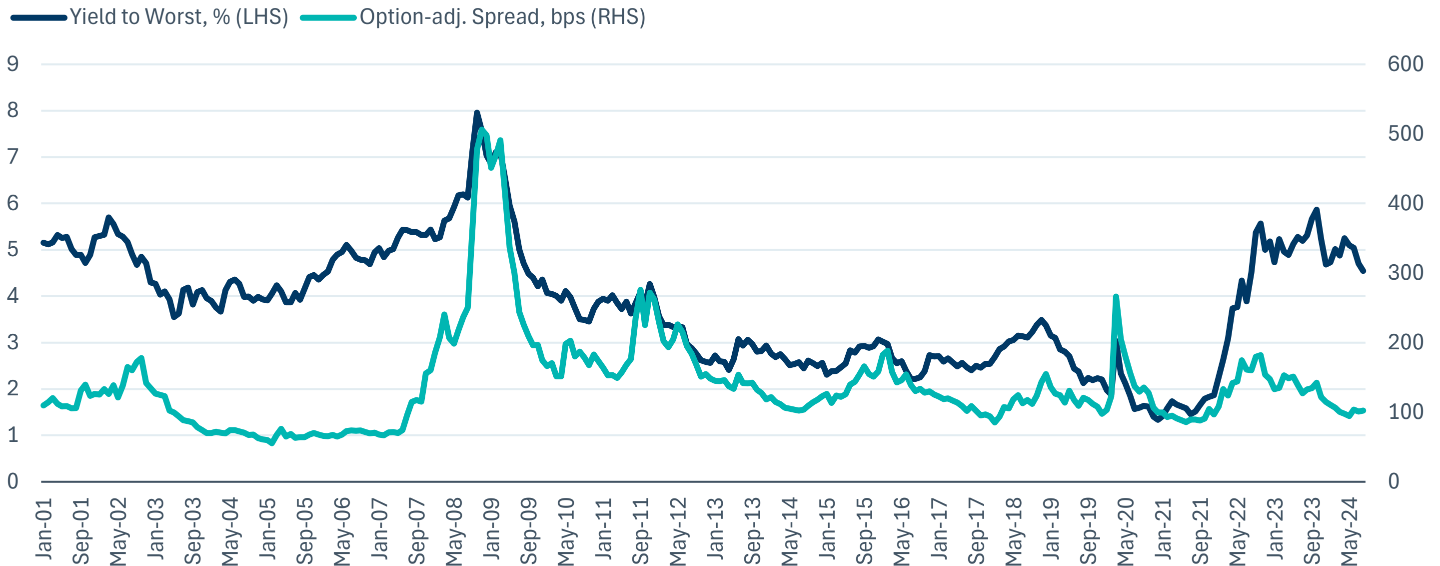
**Size of each point is scaled based on the share of nominal global GDP in U.S. dollars*

In line with a soft landing scenario, markets have currently priced in 200 basis points of rate cuts between now and early 2026 to a neural level considered to be in a range of 3% - 3.5% in the US. Elsewhere, central banks have also started to cut rates or rates have peaked, with cuts on the horizon.

2. All-in Yields Remain Compelling

All-in yields remain historically elevated despite spreads grinding tighter. The current yield-to-worst of 4.55% is in the 69th percentile, which means that over two thirds of the monthly yield observations since 2001 have been below the current level.

Historical Yield-to-Worst (in %, LHS) and Option-Adjusted Spreads (in bps, RHS)



Source: Bloomberg Global Aggregate Corporate Bond Index, monthly yield-to-worst and spread data from 31/1/2001 to 31/8/2024

We do acknowledge corporate credit spreads are currently tighter than their longer-term averages but they have been tighter in similar environments, for example from 2004 to mid-2007. Assuming global central banks can orchestrate a soft landing, we believe spreads can remain tight for an extended period of time.

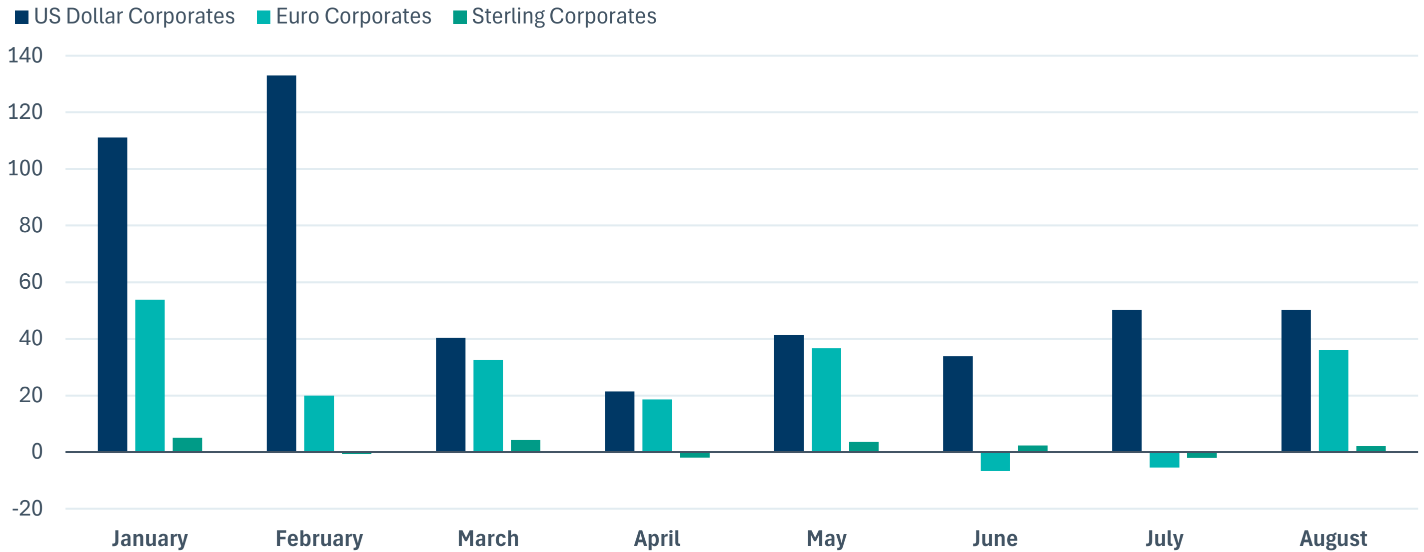
3. Corporate Fundamentals and Supply/Demand Dynamics are Supportive

Although corporate fundamentals are weakening from high levels, we expect corporate credit issuers to remain fundamentally in good shape. Issuers have termed out debt when interest rates were lower, thereby reducing their sensitivity to the economic and rates cycle. If our base case of a robust economy is right, we also expect corporates to benefit.

Demand/supply dynamics should also be supportive of the asset class going forward. New issuance was heavy in January and February of this year as issuers came to the market mostly to refinance rather than raise new debt. As the chart below indicates, net supply remained moderate thereafter. To us, that indicates that companies are keen to keep leverage at manageable levels and that they have well adapted to and been able to absorb higher financing costs. Going forward, we expect supply to moderate.

Investment Grade Corporate Credit

Net supply 2024, $/€/£ billion



Source: Barclays

What Are the Risks?

Although a recession is not our base case, the risks have increased. Should economic growth indeed crumble, we would expect global central banks to cut rates more aggressively relative to current market expectations. In such an environment, we would expect global government bond yields across the curve to fall and credit spreads to widen.

Is this really a bad scenario for investment grade credit? Not necessarily. In this scenario, the decline in government bond yields may mitigate or offset the losses from spread widening as the duration embedded in global corporate credit acts as a safety net. In addition, a starting yield of ~4.6% provides a cushion against capital losses: all-in corporate bond yields would have to rise by ~3/4% to offset the initial yield advantage (based on current duration of ~6 years for the Bloomberg Global Aggregate Corporate Index).

Summary

What's not to like about global investment grade credit?

Supportive Economic Backdrop	Attractive Valuations	Sound Corporate Fundamentals
Major central banks easing policy + solid economic growth + moderating inflation = Supportive environment for global investment grade credit	Current yield is above long-term average Spreads can remain tight if market is right about a soft landing In a recession, the embedded duration in corporate bonds may help protect capital.	Issuers termed out debt when interest rates were lower Expect issuers to benefit from a robust economy and soft landing especially in the US.

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