Bloomberg

Trump trade pushes US junk yields to 2-year lows

Rally across riskier assets reflects how relaxed investors are over Fed rate rises

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By: Eric Platt

Appetite for US corporate bonds has pulled yields for the riskiest tiers of debt to the lowest level in nearly two years, as investors hold faith that the economic plans of Donald Trump will deliver faster economic growth and buoy corporate profits.

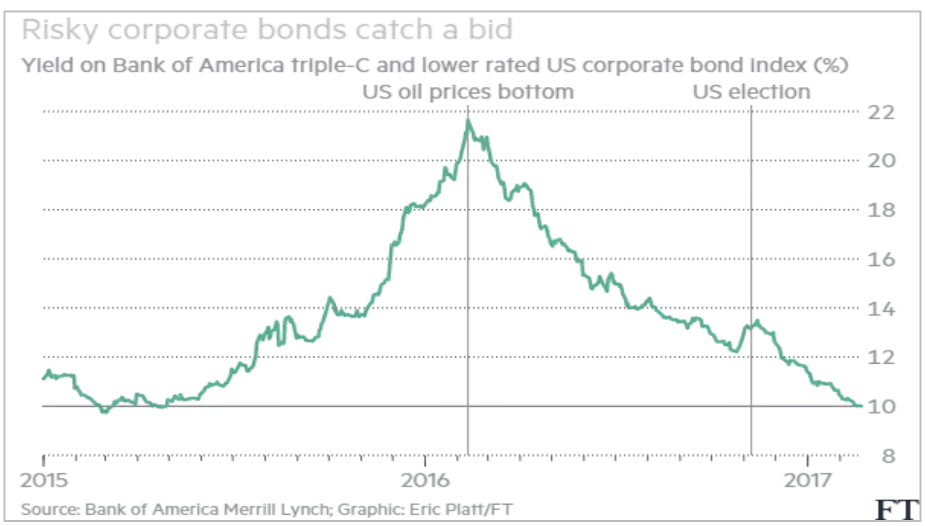
Yields on triple-C-rated US corporate debt fell to 10 per cent this week for the first time since April 2015, according to data from Bank of America Merrill Lynch. Yields on the debt, which is sold by companies with ratings deep in junk territory, fall as bond prices rise.

The sharp drop in the premium that money managers are demanding to own junk debt comes as US equities advance to fresh records, with the S&P 500 index up almost 6 per cent this year, closing at a fresh high on Tuesday.

Evidence of the increasing appetite for risk also underlines how investors have become more relaxed at the prospect of the Federal Reserve raising interest rates further.

“There is a degree of comfort taking on credit risk considering regulatory and tax changes . . . as growth in the US probably turned the corner before the election,” said Henry Peabody, a portfolio manager with Eaton Vance.

“But the market is pricing in a lot of positive news without factoring in questions about geopolitics, policy and the pace of reforms. There is a degree of picking up quarters in front of the steam roller. At some point when rates do move higher, spreads will react negatively.”



More than $11bn has poured into high-yield corporate bond funds in the US since the election, according to flows tracked by EPFR, the US fund monitor.

Those purchases have eclipsed the roughly $7bn that has gone into higher rated investment grade corporate debt.

Earlier this month, the average price of a bond within Bank of America's triple-C and lower US index eclipsed 90 cents on the dollar. That was the first time triple-C debt had surpassed that level since March 2015.

The drop in yields accompanies a global search for income, as roughly $9.8tn of sovereign and corporate debt trades with a yield below zero.

While that figure has fallen from a peak of nearly $14tn last September, the higher yields offered on bonds sold by lowly rated US companies have proven enticing.

The rally across riskier assets is likely to face a test next week when Mr Trump delivers the State of the Union address, which will be an opportunity for the administration to give more details on plans to cut corporate tax rates and step up spending on infrastructure.

"The turn in fiscal policy is likely to sustain the top line and earnings over the next two years, together with a slight recovery in companies' pricing power," analysts at French asset manager Amundi said of the outlook for companies in the US high-yield market.

An improving economic outlook will be enough to offset a bounce in refunding needs from the US high-yield sector over the next two years, according to Amundi, which estimates that 12 per cent of US high-yield and loan debt will mature this year and next.

Janet Yellen, Fed chair, signaled this month that the central bank would raise interest rates in 2017 with the unemployment rate at 4.8 per cent and inflationary pressures starting to strengthen after more than seven years of economic expansion.