Bloomberg

# Bond Market's Storm Finally Hits Junk Debt as Buyers Flee ETFs

by Lisa Abramowicz
June 9, 2015 — 11:41 AM EDT

Suddenly, junk bonds have lost their luster.

After providing a haven from the global bond-market selloff, speculative-grade securities have now joined the rout, tumbling almost 1 percent since the end of May. Investors are starting to flee, yanking $1.5 billion from the two biggest high-yield bond exchange-traded funds over the past week, according to data compiled by Bloomberg.

This is a reversal in fate for bonds that had gained 4.8 percent in the first five months of 2015 and suggests that junk-bond investors will only tolerate rising benchmark yields for so long before they, too, bail.

"Price action was miserable across risk assets yesterday," Peter Tchir, head of macro credit strategy at Brean Capital LLC, wrote in a note Tuesday. "It was the first time since yields shot higher that credit markets felt weak."

Indeed, high-yield bonds were remarkably stable in May as German government bonds led the world's bond market down 0.5 percent, according to Bank of America Merrill Lynch index data. That same month, global junk notes gained 0.4 percent.

And in April, as global bonds fell 0.6 percent, speculative-grade securities handed buyers 1.6 percent.

Part of the risky debt's erstwhile resilience had to do with oil prices as the rebound in that market bolstered energy-company bonds that had been hammered at the end of 2014.

## Yield Cushion

Also, speculative-grade notes tend to have shorter maturities and fatter cushions of extra yield over benchmarks than higher-rated bonds, features that can protect the market in periods of rising rates and climbing inflation.

High-yield debt markets have "shown a degree of resiliency here to the shift in the inflation outlook," Jeffrey Rosenberg, a managing director at BlackRock Inc.'s, said in a Bloomberg radio interview Tuesday. "That resilience could be challenged if we follow up this bout of higher rates with a shift in” expectations for when the Federal Reserve will lift rates.

Case in point: BlackRock’s $14.3 billion high-yield bond ETF plunged 1.6 percent in the six days through Monday as $940.5 million exited the fund, Bloomberg data show. State Street Corp.’s $10.7 billion junk-debt ETF dropped 1.7 percent, with $571.7 million of withdrawals.

## Sentiment Gauge

While ETFs are a small slice of the junk-bond market, they’re usually a telling gauge of sentiment, and the outflows are significant compared with the $6.7 billion of total deposits into these funds so far in 2015, Bloomberg data show.

Government yields in Europe and the U.S. are rising in the face of improving economic data and signs inflation is picking up (or, in Europe’s case, that there’s any inflation at all.) Yields on 10-year Treasuries have surged past 2.4 percent, reaching the highest level since Oct. 6, from 1.8 percent in April.

And now the $2.2 trillion world junk-bond market is losing steam, at a time of growing questions about how long stocks can keep rallying. The debt tends to be a leading indicator, and its deterioration bodes poorly for stock investors, Tchir said.

While the selloff is short-lived enough that it may just prove a blip in a market propped up by central-bank stimulus, it may also portend broader pain ahead.