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Slide continues for junk bond ETFs

Government bond sell-off and falling oil price reverberate across credit markets

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Two of the largest junk bond exchange traded funds suffered their fifth straight day of losses on Monday, as last week's sell-off in government bonds and the drop in oil prices reverberate across credit markets.

The slide has knocked the biggest high-yield bond ETF — BlackRock's $16bn iShares HYG — 1.6 per cent since it touched a record peak of $87.42 on October 24. The five-day decline is the ETF's longest losing streak since May. State Street's $11bn high-yield ETF — known by the ticker JNK — has slipped 1.7 per cent over the same period.

The pair's losses come after global government bond markets were rattled by rising inflation expectations last week. Yields on benchmark 10-year Treasuries, which rise as the bond price falls, climbed to the highest level since May on Thursday.

Oil prices have also fallen as the world's largest oil producing countries struggle to agree terms on a deal to reduce production. Brent crude dropped a further 2.8 per cent to $48.30 a barrel on Monday.

"The recent pullback in the larger high-yield ETFs such as HYG and JNK, while in part perhaps due to the sell-off in oil, is primarily the result of concern with rising rates rather than credit, with people increasingly wary of exposure to longer duration assets," said John Dixon, a high-yield bond trader at Clearview Trading.

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Some ETFs that invest in shorter dated or floating rate assets have seen some inflows in recent weeks. Powershares senior loan ETF (BKLN) saw inflows of $200m last week.

HYG saw outflows of almost $1bn on Friday, according to Bloomberg data, the largest one-day flow for the ETF. HYG and JNK are no stranger to big daily flows as investors often move money between ETFs and the underlying bond market, using the ETF as a placeholder for funds until bonds can be acquired. JNK saw $182m leave the fund on Friday.

BlackRock iShares investment grade bond index also saw outflows of $785m on Thursday and $543m on Friday, according to Bloomberg data.

Analysts said it may also show some investors seeking to take profits ahead of the potential for price volatility around the US election.

"Speculators, who are more influential in the ETFs, are probably focusing on the near-term risk of heightened volatility related to the presidential election," said Marty Fridson, chief investment officer at Lehmann, Livian, Fridson Advisors.

The underlying bond market has seen a more muted reaction, with the yield, which moves inversely to price, on Bank of America Merrill Lynch's high-yield index rising from 5.98 per cent on October 20 to 6.18 per cent on Friday.

Moody's, a rating agency expects the default rate for junk-rated US companies to tick up to 6 per cent toward the end of the year before falling back to 4.1 per cent by September 2017.

"The ETF is somewhat more volatile than the Baml index," said Mr Fridson. "HYG trades every day but most of the issues in the Baml index don't. So there may be some bona fide volatility that's picked up by the ETF but not by the index."