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US debt issuers unfazed by rate rise risk

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When the “taper tantrum” unleashed by the Federal Reserve’s plans to trim its quantitative easing programme clobbered bond markets in 2013, corporate debt was one of the biggest losers.

Prices swooned and issuance shrivelled. But in the more recent bout of turmoil, the market has proven resilient.

While the average yield of Barclays Corporate Aggregate — a gauge of investment grade company debt — has edged up from a mid-April low of 2.83 per cent to just over 3 per cent, the 10-year US Treasury yield has climbed more, from 1.85 per cent a month ago to 2.25 per cent on Monday.

Riskier bonds have performed even better, despite mounting concerns over tortuous trading conditions and fund outflows. The average yield of non-investment grade corporate debt — often called high yield, or junk — has held relatively steady at about 6 per cent.

Corporate titans tap US bond market despite jitters

Significant US corporate bond deals over past month

FT graphic. Source Delogic

“Credit markets have been very well behaved,” notes Robert Michele, chief investment officer and head of fixed income at JPMorgan Asset Management. “Corporates have by far the strongest balance sheets and spreads are the highest there. Everything I look at points us to corporate bonds.”

Perhaps most strikingly, there has been a torrent of US corporate bond sales despite the market jitters, with more than $100bn of bonds issued already this month, according to data from Dealogic. Some of the recent bigger issuers include AbbVie, which sold $16.6bn of bonds to pay for the acquisition of Pharmacyclics; oil majorRoyal Dutch Shell, which raised $10bn earlier this month; and Apple and Qualcomm, which tapped markets for $18bn between them to fund stock buybacks.

That has taken total corporate issuance so far this year above $510bn, outpacing debt sales in the record-breaking years of 2012 and 2013, and over a fifth more than in the same period last year. Add in bank bond sales and the total rises above $750bn this year.

The favourable environment has also helped corporate treasurers to issue more longer term debt, locking in cheap funding for many years — sometimes decades. According to Dealogic the average maturity of US corporate bonds sold in 2015 has been 12 years, up from 11 years in 2014 and 10 years in 2010.

Some analysts argue that the ferocious volume of corporate bond sales — especially longer dated issuance — has exacerbated the sell-off in government debt, as investors have trimmed their Treasury portfolios to buy higher yielding but still relatively safe company debt. But so far there are few signs of the splurge weighing on the corporate market itself.

“The higher all-in yields have attracted investors who had remained on the sidelines,” says Ashish Shah, head of global credit at AB Global, an asset management group.

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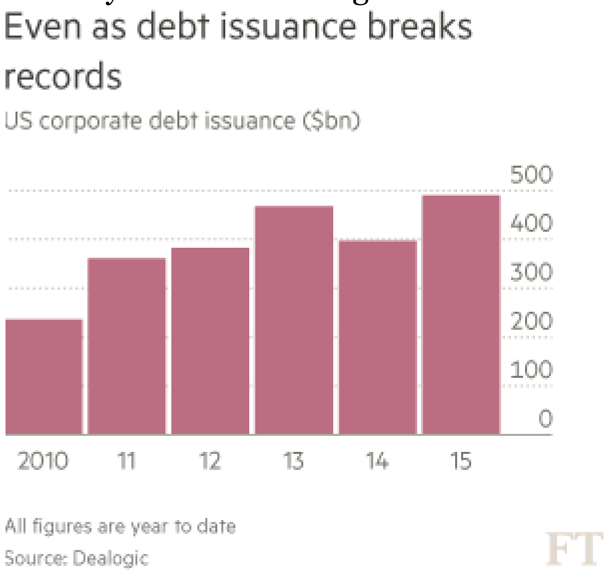
Nonetheless, the market’s solidity is not unshakeable. At some point the roaring high-grade corporate bond supply is likely to lead to investor indigestion. As average maturities lengthen, bonds become increasingly sensitive to interest rate changes and the Fed is still likely to lift US benchmark rates at some point this year.

The resilience of junk bonds is probably partly due to — rather than in spite of — the poor trading environment, according to Oleg Melentyev, head of US credit strategy at Deutsche Bank. He points out that when money managers suffer outflows they typically sell their more liquid securities, such as high-grade corporate bonds, before attempting to flog junk bonds that only trade intermittently.

That illiquidity will probably turn from boon to bane in a severe sell-off. The recent jitters fell short of the taper tantrum turmoil, when the 10-year Treasury yield rocketed by more than 100 basis points in little over a month, compared with this month’s 20bp move. “Credit will be able to deal with a lot of volatility. But there is a limit,” Mr Melentyev warns.

Still, the US corporate bond market looks sturdy for now. Companies are mostly in fine fettle, fund managers sit on healthy cash balances and money is gushing in from overseas investors turned off by even lower returns on offer in European or Japanese markets. Freshly printed bonds are generally performing well after issuance, a sign that the rally still has some legs.



With liquidity so poor, issuance has become increasingly important as a way for investors to put money to work, but bond sales will soon slow down for the summer, exacerbating the supply-demand mismatch that has underpinned the corporate bond market in recent years. “If you haven’t bought your bonds yet it might be too late now,” Mr Shah says.

Mr Michele is particularly upbeat on high-yield bonds. He predicts the average yield difference between junk and Treasury bonds, or the spread, will eventually narrow from about 468 basis points currently to 250bp, the level touched at the peak of the pre-financial crisis heyday in 2007.

”The time to worry about credit is not at the start of a hiking cycle but at the end,” he argues.