Chart of the Day

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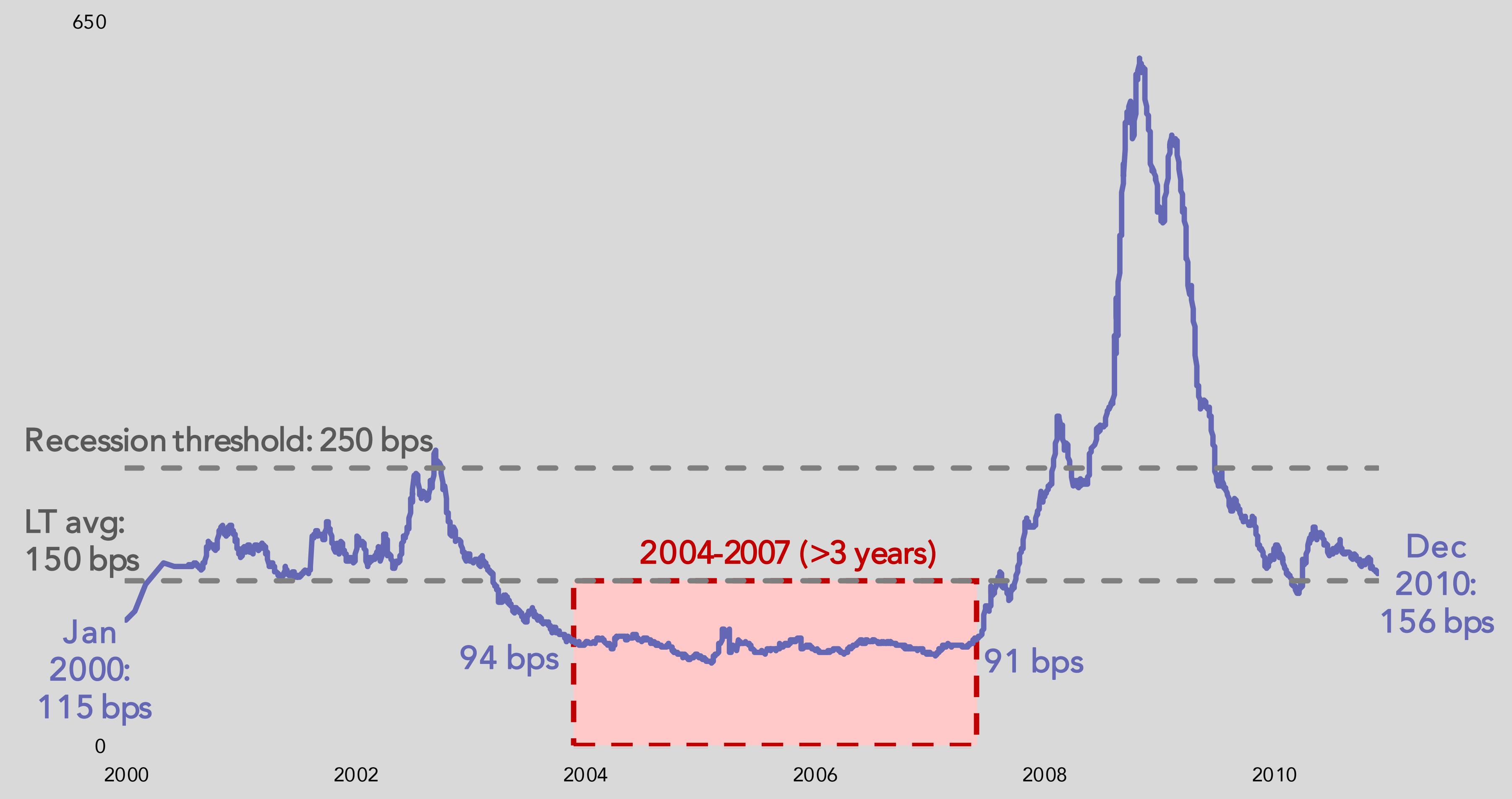
Corporate credit spreads do not like volatility, and typically gap sharply wider in the event of sizable exogenous events (bank crisis, oil price shocks, recession, credit cycle turn). Historically, spreads can more than double in a short time period when such events occur. However, when "the stars align", USD corporate credit spreads can also stay below long-term averages for multi-year periods.

Despite the elevated risk environment, numerous important drivers have converged in a manner that suggests credit spreads could possibly stay below LT averages longer than anticipated, including: (1) "soft landing" for the US economy; **(2)** expected Fed policy easing; **(3)** MMF outflows as Fed eases rates and slows the pace of QT; **(4)** strong corporate credit market fundamentals; and **(5)** structural technical demand for yield.

With investors focused more on all-in-yield than credit spreads, and the timing and magnitude of Fed easing pushing further out, spreads can indeed stay lower for longer than expected, so long as the soft landing endures and tail risks remain contained. USD IG and HY credit spreads at 87 and 298 bps today are well below their long term averages of 150 bps and 525 bps, respectively. However, history demonstrates that they can sustain a tight trading range for longer (absent a sudden turn in the economy or unexpected tail risk).

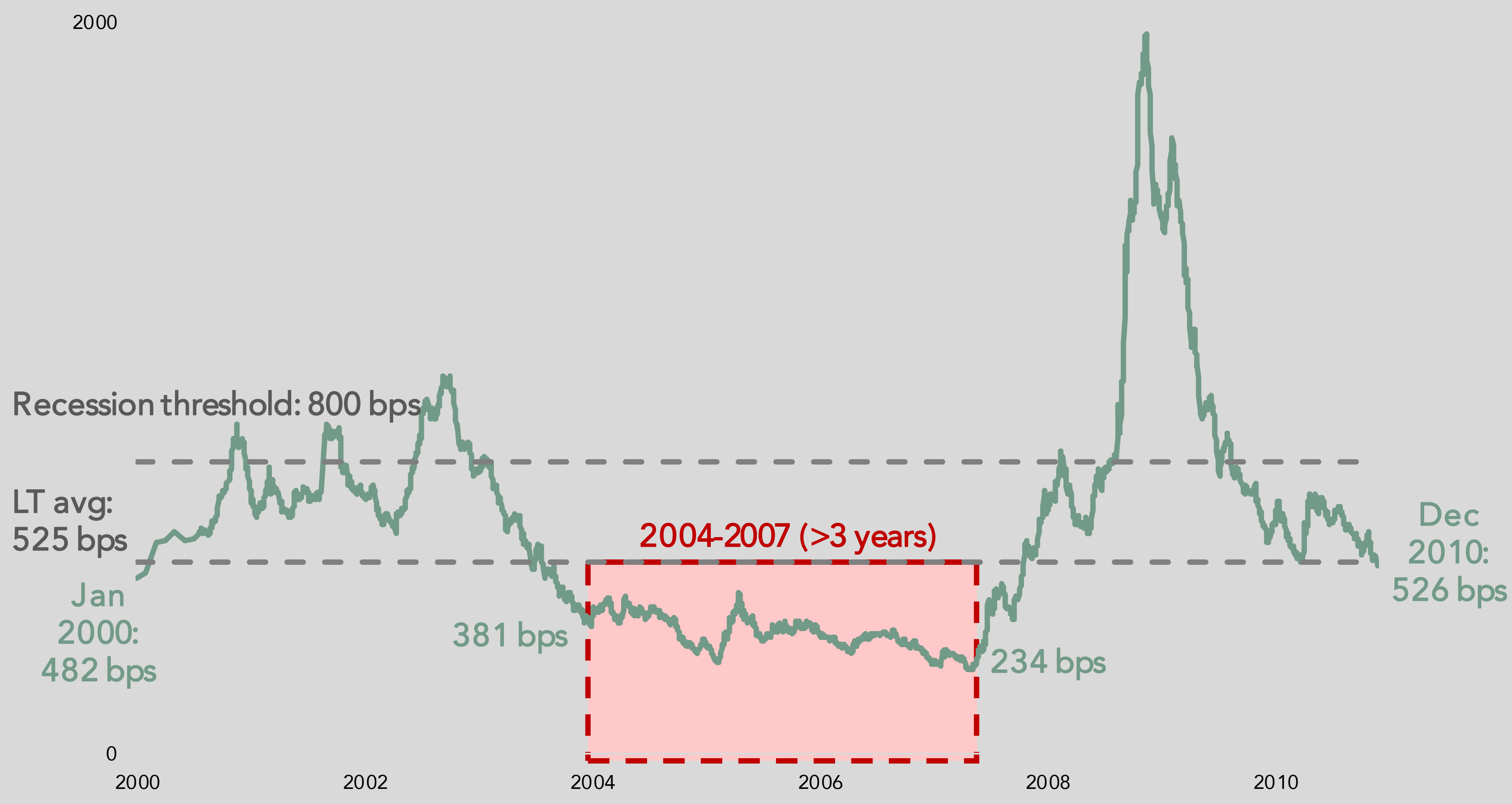
In the period from 2004 - 2007, USD IG corporate credit spreads traded between 80-100 bps for more than three years, well below both their LT average of 150 bps and historic recession threshold of 250 bps.

USD IG OAS



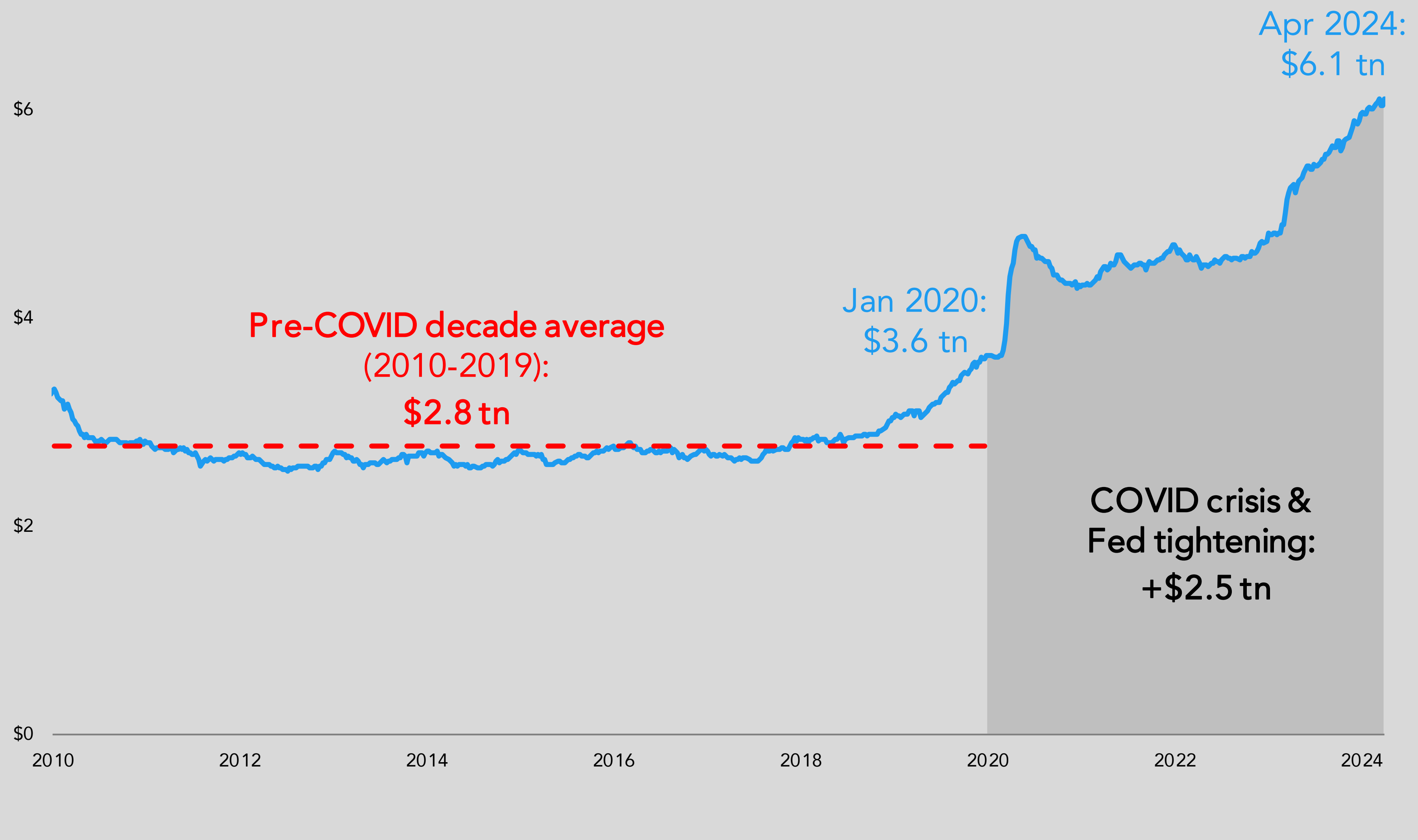
In the period from 2004 - 2007, USD HY corporate credit spreads traded between 250-350 bps for more than three years, well below both their LT average of 525 bps and historic recession threshold of 800 bps.

USD HY OAS



Unlike stocks, which have moved higher in "anticipation" of Fed rate cuts, Money Market Fund (MMF) outflows are likely to wait until the "actual" Fed rate cuts occur. Once the Fed begins to cut rates and slow the pace of QT in 2H 2023, we expect some substantive portion of MMF outflows to flow into USD corporate credit, providing additional support for tighter spreads.

US money market funds total assets, USD tn



Source: (1-3) Bloomberg. Data as of April 9, 2024.

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"Macro stability isn't everything, but without it, you have nothing."