

Market Commentary

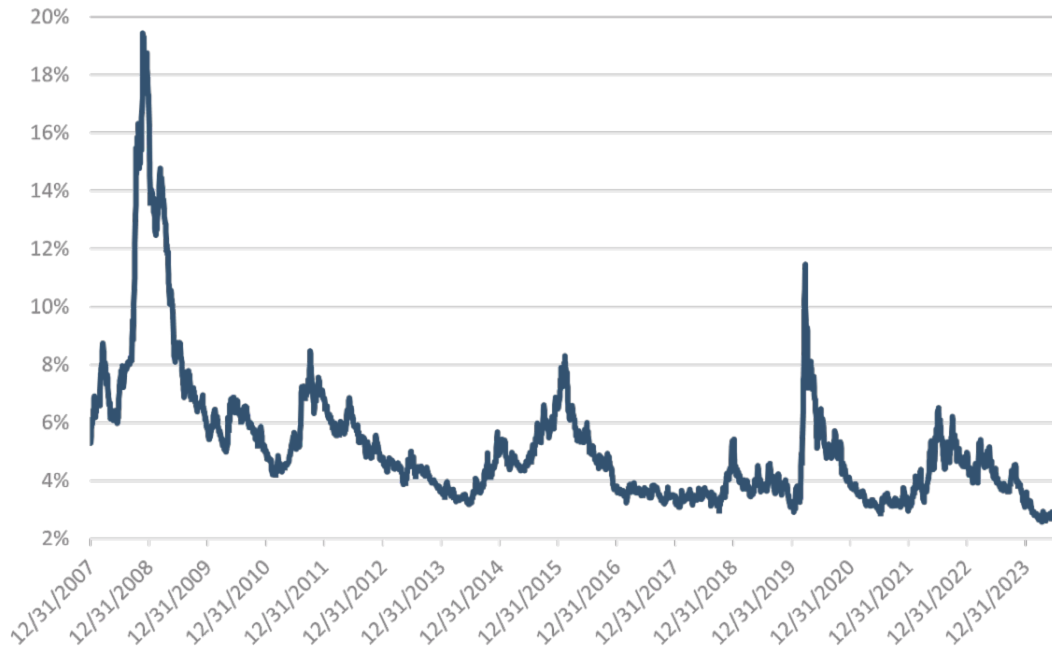
Buyer B-ware

Credit spreads reflect the additional yield earned from a security compared to like-duration Treasuries. In other words, it's the level of compensation investors need to assume a certain level of default risk over the risk-free alternative. Historically, investment-grade bonds have paid investors 150 basis points over Treasuries, while high-yield bonds have traded at more than three times that amount at 520 basis points. When credit spreads widen out, it's a sign that perceived risk in the market has increased, causing investors to demand a higher return on capital. On the other hand, tighter spreads indicate confidence in fundamentals and capital market activity. Today's spreads of roughly 90 basis points for investment-grade bonds and 300 basis points for high-yield bonds point to the latter scenario.

Today, what's particularly interesting is the level of credit spread associated with the riskiest group of the liquid bond market. Last week, the Bloomberg B US High Yield Index's credit spread hit a 16-year low at just 258 basis points over Treasuries (yield to worst of 7.3%). Credit spreads are currently narrow across the board, but extreme tightness for this specific group of companies points to another dynamic: the direct and growing competition from private credit managers (i.e., sponsored back corporate lending). As capital continues to flow into the space, borrowers are shopping between banks (syndicated public loan market) and private lenders to drive the most attractive pricing, covenants, and deal terms. Notably, borrowers that straddle both markets largely fall into the single B rating category, which helps explain the erosion of yield related to this segment of the market. It's an enviable position for borrowers but leaves little room for error. We've often emphasized the importance of 'picking your spots' in the large and highly diversified private credit universe. This pricing dynamic is just another example of why we're not ready to add this 'flavor' of debt to our private or public portfolios but continue to monitor the space for opportunities.

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Figure 1: Single-B Rated US Corporate Credit Spreads



Source: Mill Creek, Bloomberg.

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