Midyear 2024: the compelling case for credit continues

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As we predicted at the start of the year, investment grade credit has performed well, on an absolute and a relative basis.

The 1st half of 2024

After an exceptionally strong 2023, gains have continued at a moderated pace. Canadian investment grade credit is better by 12 bps. Investor risk appetite has been broad-based, also reflected in the strong performance of equities and the corporate bonds of lower rated borrowers.

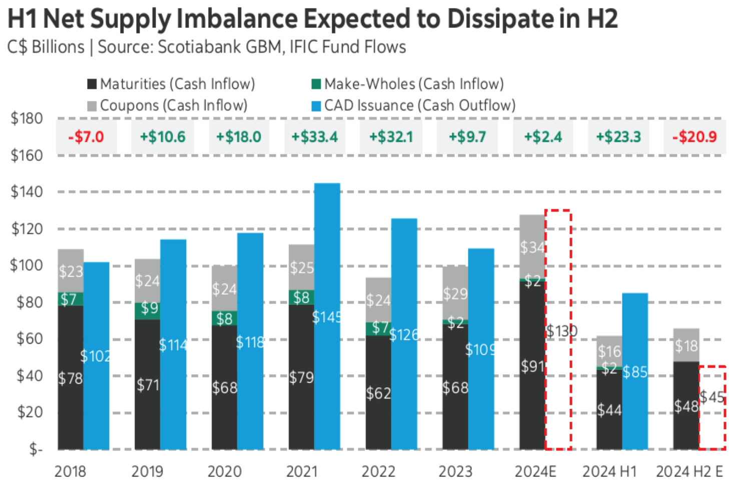
Corporate fundamentals remain robust. U.S. corporate profits have grown by 35% since 2019. Liquid assets on corporate balance sheets continue to rise, which could help provide a buffer for issuers if the economy slows and profits decline. According to the Federal Reserve, non-financial corporate businesses had roughly $7.9 trillion in liquid assets at the end of the first quarter, a record high. The ratio of liquid assets to short-term liabilities is just shy of 100%. In aggregate, corporations have almost $1 in liquid assets for every $1 of upcoming short-term liabilities, one more supporting factor should the economy slow.

Gross issuance has been particularly strong to start the year; however, most of the new borrowing was to refinance existing debt, as attractive credit conditions have encouraged borrowers to replace near-term maturities and allowed them to reduce interest costs. The composition of supply has also been technically positive, as Bank Bail-In - by far the largest sector in Canadian investment Grade credit - 2024 supply as a percentage of total supply is the lowest on record. This trend towards more non-financial issuance is positive for the credit market, especially in light of the considerable market inflows seen thus far in 2024.

The Rest of 2024

Although valuations have compressed meaningfully in recent months, yields remain historically attractive and fundamentals mostly remain firm. This environment is supportive of continued investor inflows, which is a positive technical tailwind for credit markets.

In fact, investor inflows are expected to outpace new supply, as pictured below. If that materializes it will further support Canadian credit markets.



In Canada spreads remain approximately 20 bps wider than the 2021 tights. Other global credit markets are at or flirting with those 2021 tights. Our view is that while tight credit spreads may not allow for outsized returns, we expect the combination of attractive running yields and a constructive economic backdrop to provide a compelling narrow range of expected returns clustered around current running yields.

As always, there are uncertainties going into the second half of 2024 including the outcome of the U.S. election, changing patterns in immigration, household formation and consumer preferences, and significant geo-political events, to name a few.

With this in mind, we remain hyper-focused on the liquidity of our portfolios, allowing for further de-risking should the positive momentum change. We believe that credit will continue to fare well compared to other asset classes, and that our Funds will again prove to provide a *better fixed income solution.*