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Loan and bond investors trade short-term pain for long term-gain

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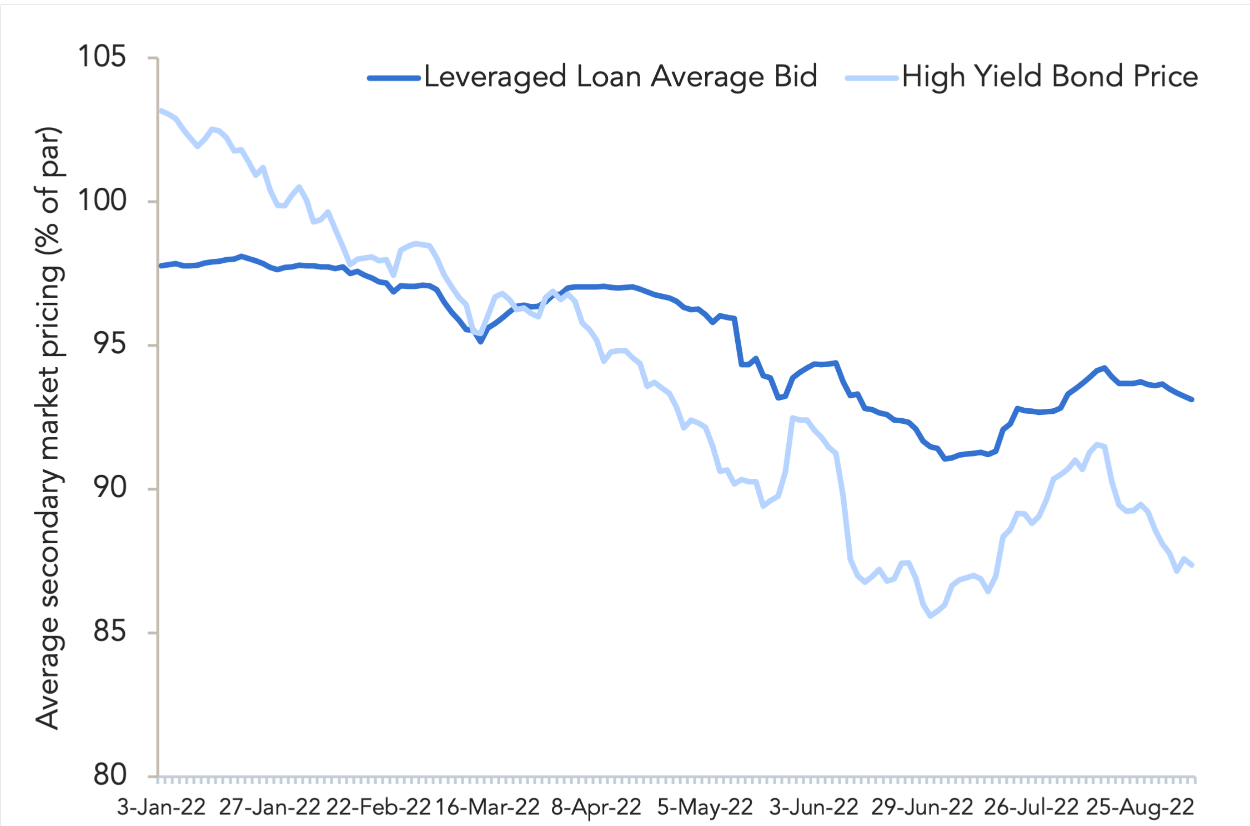

Source: Debtwire Par, Markit, ICE BofA US HY Index

Following a short-lived summer rally in the leveraged loan and high yield bond secondary markets, prices have once again been on the downswing. Leading up to fiery comments from Fed Chairman Jerome Powell at the Jackson Hole Economic Symposium on 26 August, and continuing into early September, loan and bond prices began to slip from recent highs, with loan bids declining to 93.12 from a 12 August high of 94.21, while secondary pricing on high yield bonds fell to 87.37 from 91.56 during the same time. While both figures remain above recent lows set in early July, the slide back down in pricing will prolong the pain for debt investors and issuers alike.

The trend mirrors that seen in the equity markets, where major indices have posted three consecutive weeks in the red following a brief summer rally. The Fed is expected to keep an aggressive stance towards fighting inflation, as key indicators continue to show the US economy moving along better than many analysts have expected. Just last week, the Bureau of Labor Statistics reported nonfarm payrolls rising, as unemployment also ticked up mildly and wages continued to rise. This is expected to support further rate hikes, as the US labor market has so far shrugged off the impacts of monetary tightening and has supported the idea of the Fed achieving a “soft landing” – reigning in inflation and cooling the economy, all while avoiding a full-blown recession.

All eyes will be on the Fed’s September policy meeting, where most investors are anticipating a third 75bps hike in the Federal Funds Rate. Leveraged loan and high yield bond investors can expect more swings in pricing ahead of any such moves, and prolonged volatility as the Fed is expected to hold rates at elevated levels until price stability is achieved, and inflation is brought back down towards the 2% mark.

(Past performance is no guarantee of future results.)