Daily Macro Insights: Credit spreads matter

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CREDIT MESSAGES: $10.6 trillion US corporate bond market is in good health, with decade low credit spreads, over the recently more volatile risk-free 10-year bond yield (chart), driven by rebounding GDP and investors 'reach for yield' with interest rates so low. Performance has been strong for both higher quality investment grade borrowers (VCIT) and riskier high yield (JNK). These ever-lower credit spreads are a key equity support, especially for small caps (IWM), and driving both high issuance and low default rates, even with record high corporate debt levels.

WHY IT MATTERS: Around 80% of US corporate finance is raised via the bond market, making its health crucial to the economy, and explaining Fed's strong support in the 2020 crisis. This is different elsewhere, such as Europe and China, where bank finance is much more important.

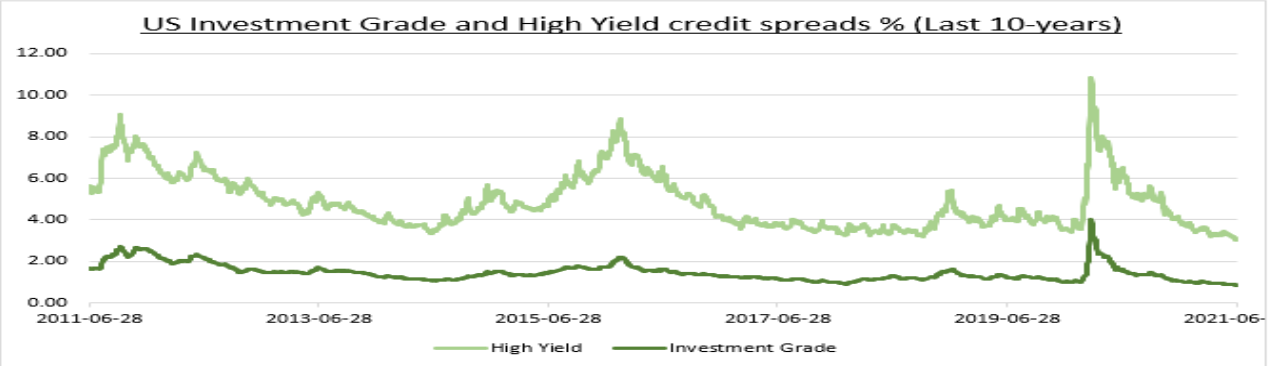
- **DEBT:** US corporate debt is high, equal to 84% of GDP, above household and financial sector debt and only lags the government. But corporate debt is higher in Europe and Japan (115%).

- **DEFAULTS:** The number of riskier high yield companies defaulting on their bonds YTD is -40% yoy and only 4.7% of total bonds, given the easy financing conditions and GDP rebound.

- **ISSUANCE:** New bond issuance is huge. Companies are taking advantage of these conditions to refinance, at $830 billion YTD, only slightly behind run-rate of 2020 all-time-high $1.8 trillion.

FOR EQUITIES: Company access to finance is crucial for equities, and open bond markets key to the current record low number of bankruptcies. High yield spreads are a barometer of riskier company health, and strongly correlated with small cap equities that share many characteristics.

TODAY: Markets growth 'scare', with lower bond yield, spreading Delta variant, and poor July seasonality, is likely short-lived, with growth secure and to be reminded by coming Q2 earnings.



Source: Fred, eToro calculations

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