PCM
Peak Capital Management

Professional Investment Management

BLOG POST
Analyst Corner
Part 2
6/18/2020

Fixed Income – Junk Bond Tsunami

The chart below shows the dollar value of outstanding corporate debt in the U.S. categorized by S&P ratings on the debt. The most important classification is the BBB category that distinguishes between "Investment Grade" debt and "Non-Investment Grade" debt, also known as junk bonds. The Fed's financial repression of keeping interest rates near zero forces many yield investors, including large institutions, to overweight BBB bonds in their portfolio to receive higher yields. As we stare into the abyss of an unprecedented economic contraction, there are likely to be many debt downgrades as companies lose cash flow and earnings to service their debt. The smallest downgrade from BBB- will put those bonds into the junk category and result in forced selling for funds and pensions that are required to only hold investment-grade bonds and why the Fed is proactively stating they will buy junk bonds.

Technical – At a Tipping Point

Effective technical analysis requires looking at different time periods to see where indicators demonstrate a convergence of guidance. When multiple time periods are sending the same signal, confidence grows in the accuracy of the indicator. The red line shows the 65-week moving average on the S&P 500. This is a widely followed long-term technical indicator that signals secular bull or bear trends as opposed to shorter-term cyclical moves. You can see that in 2019 there were multiple occasions where the S&P pulled back to the 65-week moving average only to bounce higher, maintaining the bullish outlook. The recent recovery from the March lows has the S&P right at the 65-week moving average once again. If stocks can move above the trend line, and remain, it would signal a new bull market. A retreat from the trend line suggests the bear is not yet in hibernation.