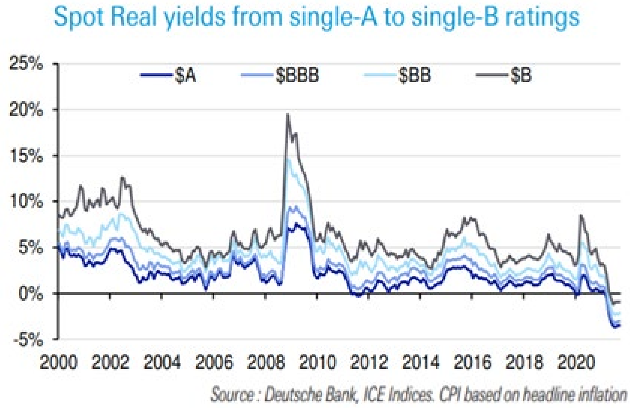
Fixed Income – Spread Rather Thin

Just prior to the arrival of Omicron, bond market spreads were hitting levels we had not seen for many decades. Real yields on investment grade debt fell into negative territory when inflation rose last year, but in October we saw single-B debt also go negative. To have a negative risk premium on single-A debt has occurred in the past because of the incredibly low probability of default. Debt rated B, on the other hand, has almost a 30% chance of default according to S&P Global Ratings Research. Investing in debt with a yield below current inflation that has a 30% chance of default should be the very definition of a bubble in my opinion. While concerns over a repeat of lockdowns will likely drive non-investment grade debt to higher yields, it is difficult to believe those yields will be sustainable for very long.



Technical – Charting the Fed

This chart shows just how powerful a role monetary policy can play with the equity and fixed income markets. Since the Great Recession in 2008 when the Fed went to extraordinary measures to support the U.S. economy, there have been six identifiable Fed programs with varying results. QE was generally greeted with a market rally for equities and bond prices, while tapering and quantitative tightening (QT) caused markets to trade mostly flat. The COVID QE was by far the largest and most expansive and was accompanied by fiscal stimulus as well, sending equities to highs in the face of unprecedented economic turmoil. With the new variant of the virus appearing more virulent than prior strains, we will need to see if Central Banks have the will to continue growing their balance sheets and flooding the markets with excess liquidity which leads to risk asset appreciation.