INCOME RESEARCH + MANAGEMENT

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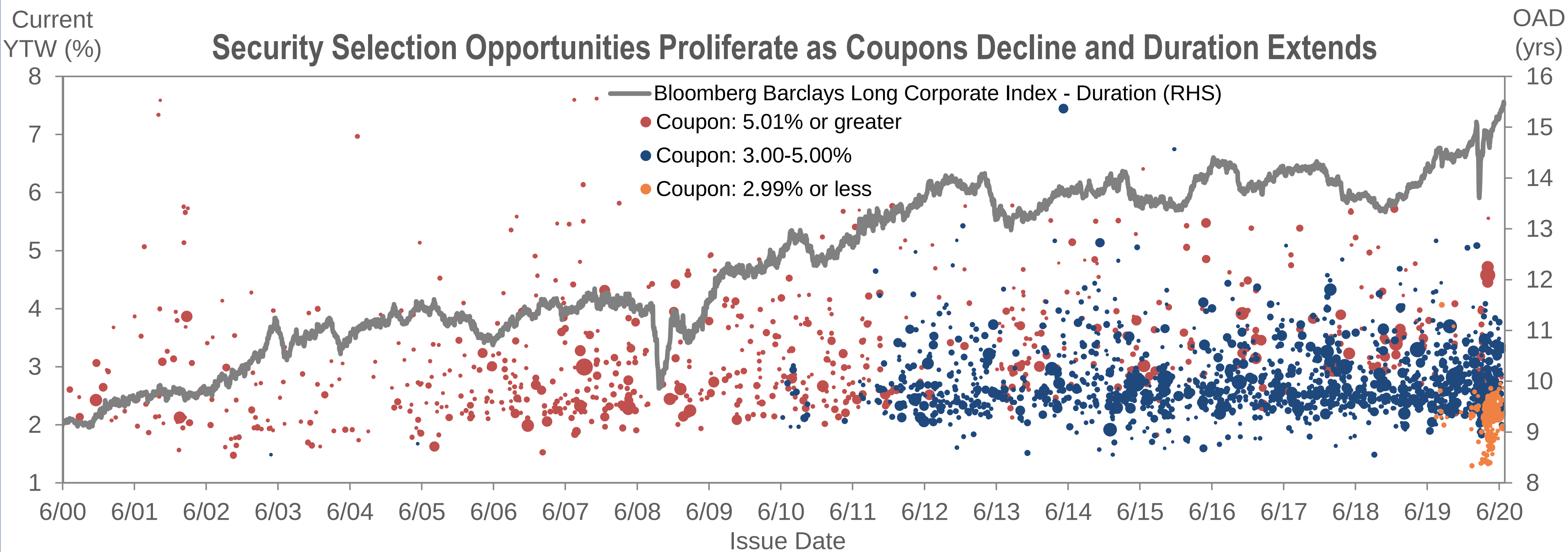
Security Selection Opportunities Proliferate as Coupons Decline and Duration Extends



- Coupons on newly issued long bonds are hitting record lows, as the average coupon of the index fell below 4.75% after starting the decade over 6.5%; issuers such as Alphabet and Praxair priced long-duration bonds with coupons 2% or below this month.
- Higher coupon long bonds are typically less liquid than the more-recently issued, lower coupon bonds that often trade with relatively tighter spreads; however, we have seen that liquidity premium diminish since the spread rally that began in late March.
- Consistent with most spread rallies, the most liquid issuers outperformed first, followed by lower-quality issuers and longer-duration bonds, as investors searched for ways to pick-up additional yield. Off-the-run bonds are beginning to catch up, with some +10% coupon bonds starting to trade more often.
- We believe corporates, with both higher and lower coupons, have a place in portfolios; higher coupons can offer more spread, but are typically less liquid and have higher downside risk in credit weakening environments given higher dollar prices. Lower coupons may offer less spread but are generally more liquid, more positively convex, and the low dollar price provides a ceiling on future spread widening, especially in challenged credit environments.