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Vanguard, BlackRock Eye Munis and Junk as High-Grade Yields Drop.

- **Investment-grade company notes are yielding just 1.97%**
- **Fed's loose money policy pushes returns lower across markets**

Investment-grade corporate bond yields are so low that money managers like Vanguard Group and BlackRock Inc. are gravitating to taxable muni bonds, junk debt and other securities that can offer higher returns.

They can earn more than two percentage points of additional yield in some cases, by looking beyond their usual universe. That's enough to essentially double what they'd get on the average high-grade corporate bond. Their efforts underscore how the Federal Reserve's loose money policy and programs to support higher-quality company notes is forcing investors to look further afield for returns.

Vanguard is looking at taxable muni bonds, particularly longer-dated securities, according to Arvind Narayanan, senior portfolio manager on Vanguard's active investment-grade credit strategies. An uninsured taxable general obligation municipal bond maturing in 30 years, rated AAA, might yield around 2.5%, compared with an average yield of around 1.97% as of Wednesday for an investment-grade note maturing in about 12 years and rated closer to the bottom of the high-grade rating spectrum.

"To generate returns now, investors have to buy either longer-dated bonds or lower-rated credits," said Narayanan, whose firm managed about $6.3 trillion at the end of July. "We favor very specific stories that we believe can thrive in a slow and uneven economic recovery."

Yields are so low that high-grade investors are looking elsewhere
Taxable muni bonds can be a good example but it's important to scrutinize the credits because there has been so much of the debt sold recently, Narayanan said. Governments and public entities have sold more than $94 billion in debt subject to federal income taxes so far this year, according to data collected by Bloomberg, the most since 2010.

Money managers that buy junk bonds now are betting on a tricky market. The notes suffered their biggest loss on Monday since June 11, according to Bloomberg Barclays index data, as equities have sold off and Covid-19 concerns have flared up again. But issuance for the year also reached a record this week as companies look to refinance and money managers clamber for yield.

Western Asset Management Co. is looking at relatively high-rated junk bonds, focusing on companies with stronger businesses and manageable debt loads that can survive Covid-19, according to Kurt Halvorson, an investment-grade portfolio manager at the firm. The roughly $470 billion asset manager is also looking at battered industries like air travel, leisure, gaming and autos for bargains.

"Those are spots we're certainly willing to look at if we're being compensated for the risk that we're taking," Halvorson said. "You've got to ratchet up your due diligence and really dig into the balance sheets."

BMO Global Asset Management, which usually buys high-grade debt for a number of its portfolios, has also been digging into junk credits in industries outside of energy, such as cruises, airlines and retail. For example, Delta Air Lines Inc. notes due 2029, rated toward the top of the junk spectrum, were yielding about 5.9% on Wednesday, more than 2.5 percentage points above the yield on Southwest Airlines Co. notes due 2030, which are toward the bottom of the high-grade scale.

"We will go anywhere," said Scott Kimball, a portfolio manager at the firm, which manages about $100 billion of fixed-income assets.

Not all investment firms have much flexibility in that regard. Many money managers are limited by their agreements with their investors as to how much high-yield debt they can buy, for example.

Herd Risk

Even so, the difference between the default risk for a bond at the bottom of the investment-grade scale and the top of the high-yield range isn't necessarily the most important part of credit analysis in a Covid-19 world, said Rick Rieder, chief investment officer of global fixed income at BlackRock Inc.

"Today it doesn't matter what the rating is. I'd rather buy a BB company, health care or cable, some of the consumer oriented and housing than buy an energy company that's investment-grade," Rieder said at a conference last week. "It's all about the individual sector."

Asset-backed securities are also worth looking at, Rieder said, noting that yields there can still be respectable. BlackRock manages about $2.4 trillion of fixed-income assets.

Investors may be wise to look at other kinds of debt outside of the $6.7 trillion U.S. investment-grade corporate universe now, given how high valuations are, according to Erin Lyons, a credit strategist at CreditSights. If companies' credit profiles start to slide, or the market gets nervous about the lower rungs of investment-grade, there could be a selloff, she said.

"The risk is the herd moves in the opposite direction and you get a wave of selling," she said.

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