The Evolution of the Corporate Bond Market

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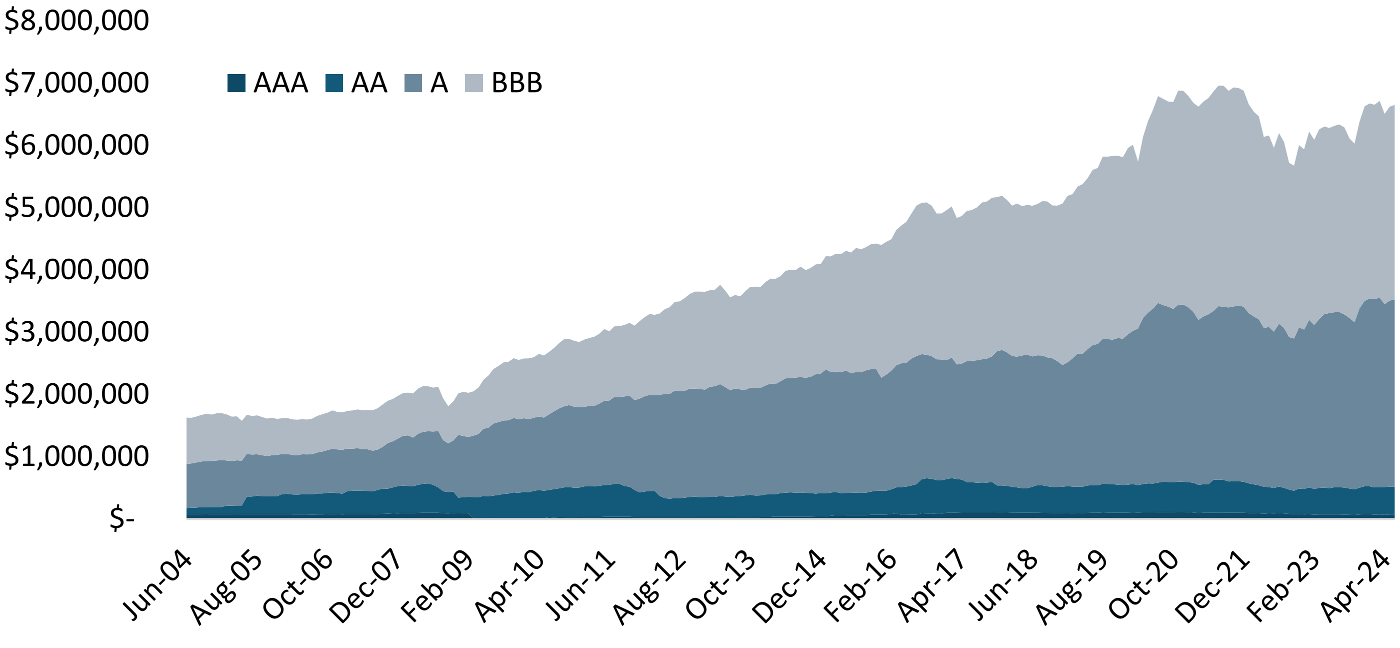
Over the past 20 years, the corporate bond market has experienced a significant evolution driven by economic cycles, regulatory shifts, and changing investor demand. From the recovery following the early 2000s dot-com bubble through the global financial crisis, which spurred central bank interventions that resulted in low interest rates and record bond issuance and refinancing – the last two decades have seen a surge in demand for corporate bonds. Indeed, compared to 20 years ago, the investment grade (IG) corporate bond market grew by 308%, to reach a total market value of $6.6 trillion as of June 30, 2024. High yield (HY) corporate bonds grew by 131%, to reach a total market value of $1.3 trillion over the same period.

A common narrative around the corporate bond market is that investment grade corporate bonds have become lower quality over time, while high yield bonds have become higher quality. We looked at the ratings profile of the IG and HY universes to address those consensus narratives. We found that the IG universe has become lower quality in terms of ratings over the past 20 years, but only mildly, with a higher weight of AA, A, and BBB bonds coming at the expense of a shrinking AAA portion. High yield, on the other hand, can hardly be considered "junk" anymore as the universe has seen a significant shift higher in the portion of its highest quality tier, BB.

In the last two decades, the IG corporate market has grown by $5 trillion (to $6.6 trillion from $1.6 trillion in 2004), which is equal to the rate of 7.3% per annum. After the Great Financial Crisis, the AAA tier of the IG corporate bond market collapsed and has continued to remain a tiny part of the universe. Conversely, the AA, A, and BBB ratings tiers grew significantly, by $346 billion, $2.3 trillion, and $2.4 trillion, respectively.

Market Value by Rating of IG Corporate Bonds

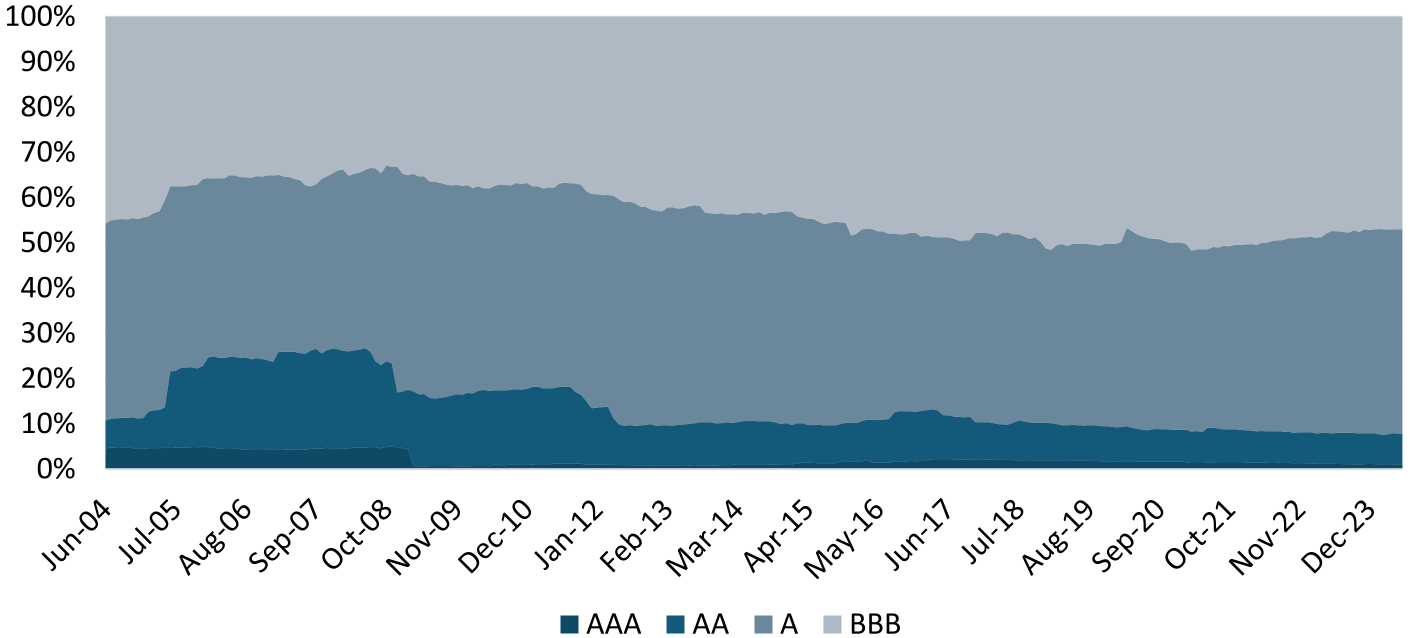
Source: Sage, Bloomberg



Outside of the AAA portion, the ratings composition as a percentage of the total IG market hasn't changed drastically from 20 years ago. For example, the BBB-rated bonds comprised 45.7% of the total IG corporate bond universe in 2004, and they make up 47.0% today. The AA and A parts of the market also grew as a share of the IG universe at the expense of AAA-rated bonds, which are currently 1.1% of the universe, down from 4.6% in 2004.

IG Corporate Bonds – Percent of Market Value by Rating

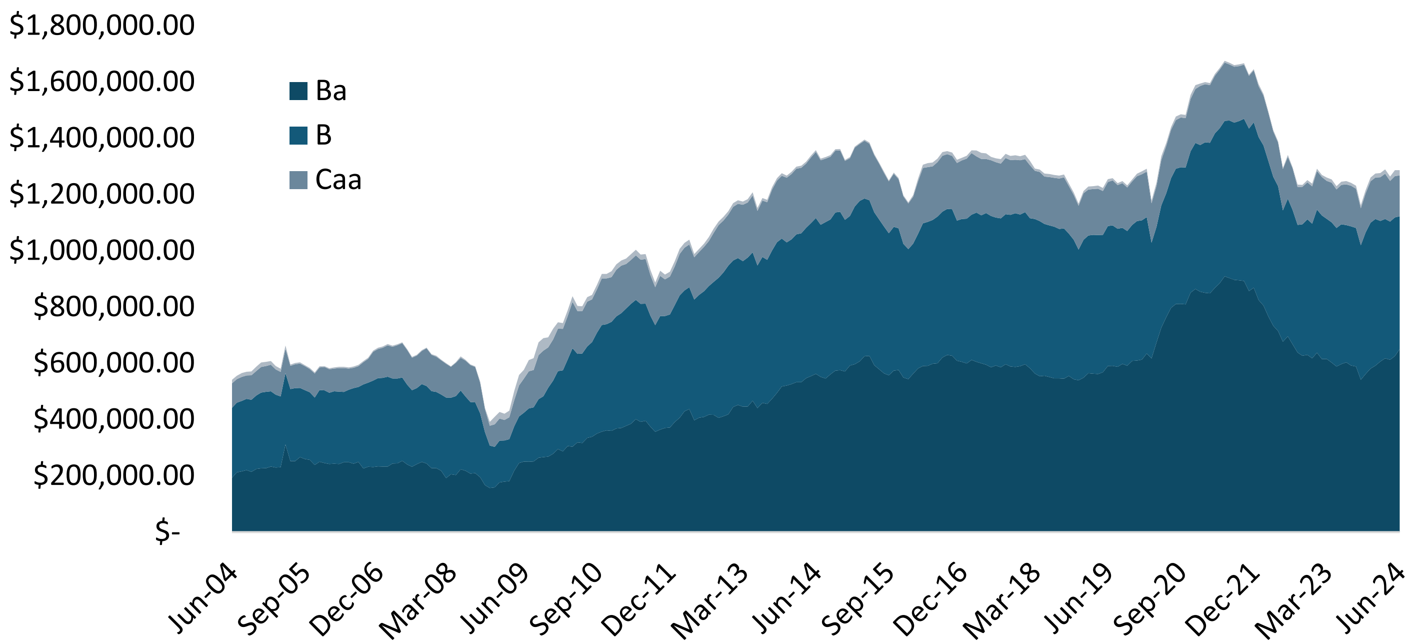
Source: Sage, Bloomberg



The high yield bond market has seen more drastic changes. Over the last 20 years, the HY corporate market has grown by $730 billion (to $1.3 trillion from $556 billion in 2004), or 4.3% per annum. BB saw the bulk of growth in HY over this time, expanding by $457 billion to $650 billion.

Market Value by Rating of HY Corporate Bonds

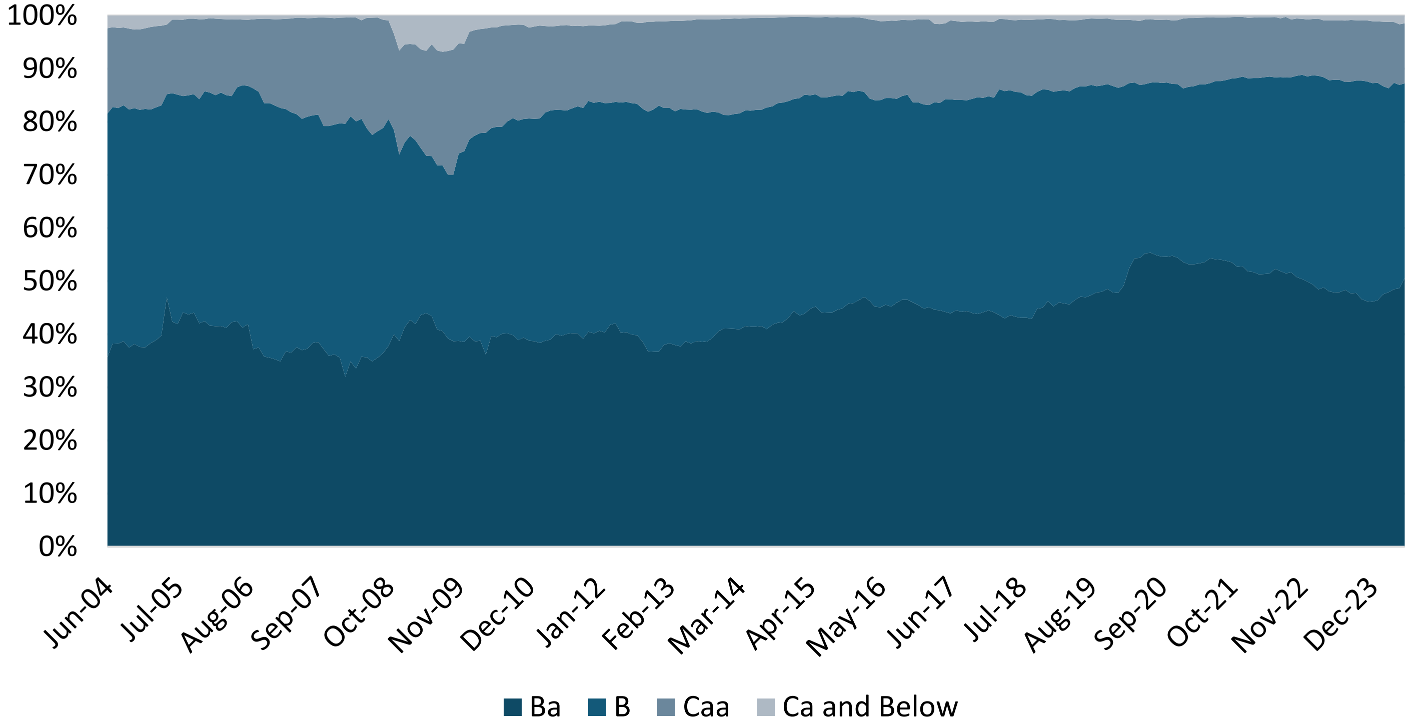
Source: Sage, Bloomberg



The BB-rated bonds grew at a faster pace than the lower-quality strata of the high yield market, and they currently comprise 50.6% of the HY universe today, up from 34.7% 20 years ago.

HY Corporate Bonds – Percent of Market Value by Rating

Source: Sage, Bloomberg



The significant growth in both the IG and HY markets over the past two decades has provided investors with diversification opportunities within the corporate bond market. And while the high yield market has grown at a slower pace than its IG counterpart, the HY market has seen an increase in the quality of its offerings, with the percentage of BB-rated bonds growing significantly. This suggests that the "junk" status traditionally associated with HY bonds has diminished. For active fixed income managers like Sage, this development offers attractive security selection opportunities for portfolios that can accommodate high-quality, high-yield bonds.