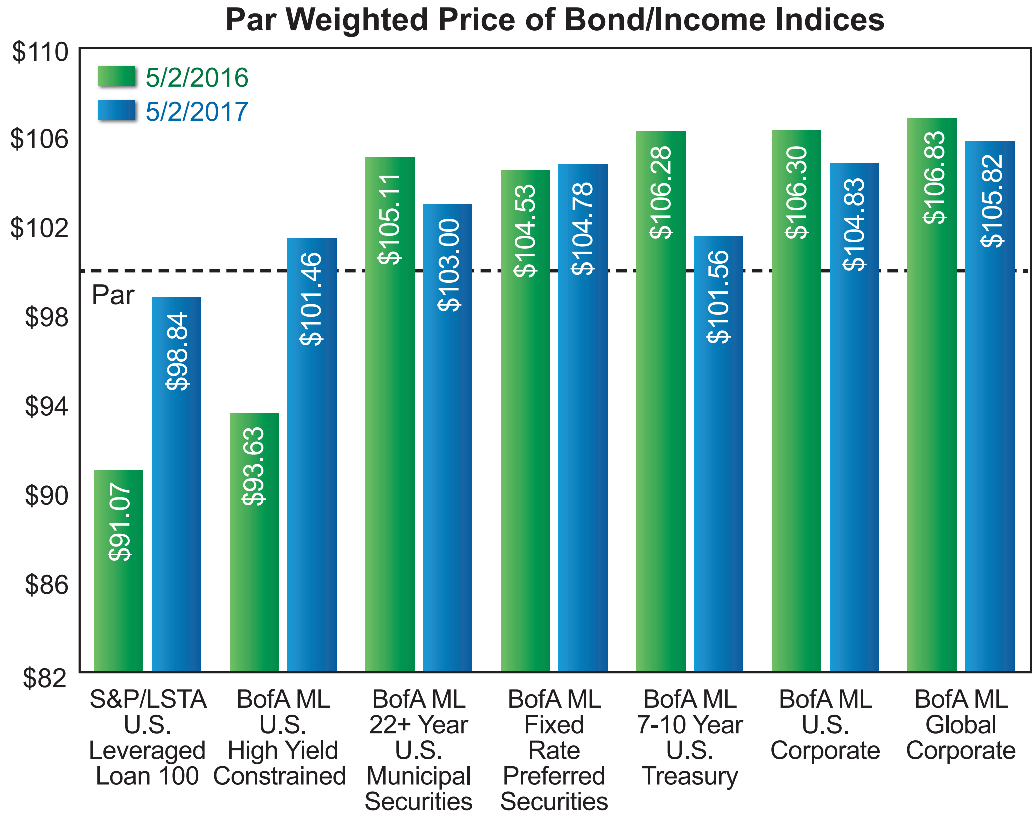
A Snapshot of Bond Valuations



Sources: Bloomberg, BofA Merrill Lynch. Past performance is no guarantee of future results.

View from the Observation Deck

1. Today's blog post is one we do on an ongoing basis so that investors can monitor fluctuations in bond prices relative to changes in interest rates and the global economy.
2. The yield on the benchmark 10-year Treasury note rose from 1.87% (5/2/16) to 2.28% (5/2/17), or an increase of 41 basis points, according to Bloomberg. It was as low as 1.36% (7/8/16) and as high as 2.63% (3/13/17) over that 12-month period.
3. Leveraged loans (senior loans) and high yield corporate bonds, both of which carry speculative-grade ratings, posted significant price gains for the 12-month period ended 5/2/17 (see chart).
4. The income distributed by leveraged loans floats with the direction of short-term interest rates. Loans are typically indexed to a benchmark, such as the 3-month LIBOR (London Interbank Offered Rate).
5. The 3-month LIBOR rate rose from 0.63% (5/3/16) to 1.17% (5/2/16), or an increase of 54 basis points, according to Bloomberg. Rates may be headed higher in the U.S. as well. The Federal Reserve last raised the federal funds rate by 25 basis points on 3/15/17. We believe that the Fed is prepared to raise rates again, perhaps at its Federal Open Market Committee meeting in June (14th-15th).
6. With respect to high yield corporate bonds, Moody's reported that the U.S. speculative-grade default rate stood at 4.7% in March 2017. It sees the U.S. rate falling to 3.0% by December 2017. The recovery in energy/commodities over the past 12 months contributed to the price gain posted by the BofA ML U.S. High Yield Constrained Index, in our opinion.
7. Despite rising interest rates, investors continue to pour large amounts of capital into bond mutual funds. Bond funds reported net inflows totaling $74.33 billion in Q1'17, up from net inflows totaling $17.36 billion in Q1'16, according to Investment Company Institute. In 2016, net inflows totaled $106.65 billion.

This chart is for illustrative purposes only and not indicative of any actual investment. The illustration excludes the effects of taxes and brokerage commissions or other expenses incurred when investing. Investors cannot invest directly in an index. The BofA Merrill Lynch 22+ Year U.S. Municipal Securities Index tracks the performance of U.S. dollar denominated investment grade tax-exempt debt publicly issued by U.S. states and territories, and their political subdivisions, in the U.S. domestic market. The BofA Merrill Lynch Fixed Rate Preferred Securities Index tracks the performance of investment grade fixed rate U.S. dollar denominated preferred securities issued in the U.S. domestic market. The S&P/LSTA U.S. Leveraged Loan 100 Index is a market value-weighted index designed to measure the performance of the largest segment of the U.S. syndicated leveraged loan market. The BofA Merrill Lynch 7-10 Year U.S. Treasury Index tracks the performance of U.S. dollar denominated sovereign debt publicly issued by the U.S. government in its domestic market. The BofA Merrill Lynch U.S. High Yield Constrained Index tracks the performance of U.S. dollar denominated below investment grade corporate debt publicly issued in the U.S. domestic market. The BofA Merrill Lynch U.S. Corporate Index tracks the performance of U.S. dollar denominated investment grade corporate debt publicly issued in the U.S. domestic market. The BofA Merrill Lynch Global Corporate Index tracks the performance of investment grade corporate debt publicly issued in the major domestic and Eurobond markets. LIBOR, or ICE LIBOR, is a benchmark rate that some of the world's leading banks charge each other for short-term loans. It stands for Intercontinental Exchange London Interbank Offered Rate and serves as the first step to calculating interest rates on various loans throughout the world.