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Investors Betting Strongest Junk-Bond Rally in Years Has Legs

The Wall Street Journal- Sam Goldfarb
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An uptick in earnings among riskier U.S. companies is bolstering investor confidence that an epic rally in junk bonds can last a little longer.

After six straight quarters of year-over-year declines, earnings of low-rated companies increased 14% in the second quarter and 72% in the third quarter, according to Bank of America Merrill Lynch. At the same time, defaults slowed following a wave of bankruptcies in the energy sector.

Because of those factors, some investors and analysts say junk bonds— issued by companies that are often small and burdened by debt—could do much better than might be expected after such a strong year.

“From my vantage point, fundamentals are the most important thing” and “they’ve modestly improved,” said Michael Contopoulos, head of high-yield strategy at Bank of America, noting stronger earnings and steady oil prices have reduced risks.

The average junk bond yield was 5.86% Thursday, a two-year low but above the sub-5% levels it reached in 2014. Despite the low yields, many investors still view junk bonds as attractive at a time when the 10-year Treasury note yield is below 2.5% and stock valuations are widely seen as inflated.

Among the many junk-rated companies that had better earnings was Sprint Corp., which reported a 17% increase in adjusted earnings before interest, taxes, depreciation and amortization in the quarter ended Sept. 30 from a year earlier. Its 7.625% bonds due 2025 last traded at around 107 cents on the dollar, up from 75 cents on the dollar in June, **according to MarketAxess**.

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