

Global Credit Comment

US Credit: HY Skating on Thin Ice

Credit Strategy

Global

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Recent performance in Corporate Credit has been excellent with IG spreads tightening from 140 bps to 125 bps and HY spreads tightening from 564 bps to 494 bps since Feb 1st. However, since we published our outlook in December, both markets have essentially treaded water, with Treasury-hedged returns of 0.3% in IG & 0.61% in HY. What does the future hold for each market?

Our fundamental models are one way to get a handle on valuations, and we just have updated them for March. Please [click here](#) to get the latest updates. For IG, forecasted spreads in 6 months are expected to be around 110bps, implying a 12bp tightening from today's levels due to low leverage, high money supply growth, and easy bank lending standards. Corporate leverage may pick up later in the year per mid-to-late economic cycle dynamic as we have discussed recently¹, and the share of lower quality issuance is likely to fall from 2014 levels, helping to drive model valuations for spreads modestly higher in the mid-110s. With that said, the backdrop is still favorable. Institutional and retail flows into IG are much steadier than in HY and are being boosted due to cross-border flows from ECB QE. We also believe that short-term bouts of risk aversion will cause an increase in IG flows. This will help to support the market given the heavy supply expected this year. We would advise taking most risk in the long-end (Treasury-hedged) where valuations are juicy. This is particularly true for gas pipelines, due to valuations and cuts in capex-induced issuance, which we discussed here².

Our HY model however is not so sanguine and is flashing a yellow blending to red. Our 6-month ahead forecast for HY spreads is 590 bps on the back of a deflationary CPI print, less low quality issuance, and falling NYSE debit margin balances. Our model likely overstates the amount of spread widening by about 30-40bps that will occur given the deflationary CPI print of -0.3% in our model, which will reverse somewhat if oil prices stabilize. But the outright drop in NYSE debit margin balances over the last year is troubling. While directly an equity concept, we believe it proxies for trends in speculative risk-taking and financing of HY bonds. Drops of this magnitude are not common, and typically only occur after equity markets begin falling (Figure 3). The current Y/Y drop, albeit small, is a bit disconcerting given that equity markets remain supported. With debit margin balances near record highs relative to GDP, there is room for financing leverage to drop more, potentially signaling waning risk appetite and putting further downward pressure on asset prices.

Apart from our model, the technical backdrop for HY is also less promising. Supply is running hot this year, up 20% Y/Y and the forward calendar is growing, heavily boosted by Valeant's proposed \$9.6bn bond deal (which would be the 3rd largest deal on record). We expect near-term issuance to stay hot as favorable refinancing conditions and a fear on missing out on historically low yields prompts issuers to come to market. This dynamic could overwhelm demand, especially given that fund flows are beginning to tail off after a very strong January & February. (Continued on Page 2)

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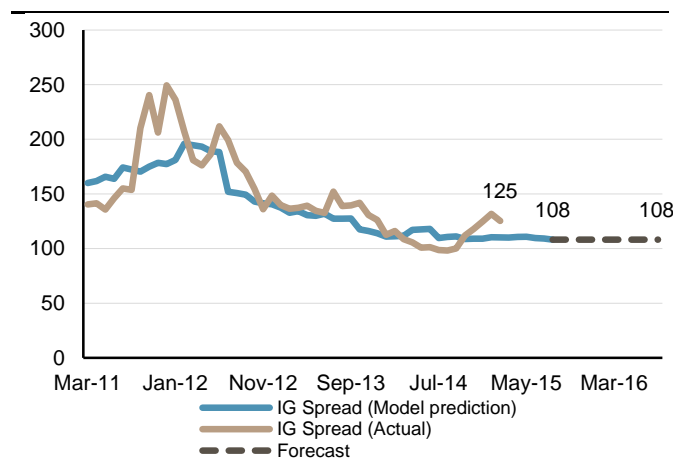
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¹ [The Global Outlook For Corporate Leverage, To watch a short video](#), S. Caprio, Mar 2015

² [US IG: Long-End and Energy Pipes: A perfect match2](#), S. Caprio, Feb 2015

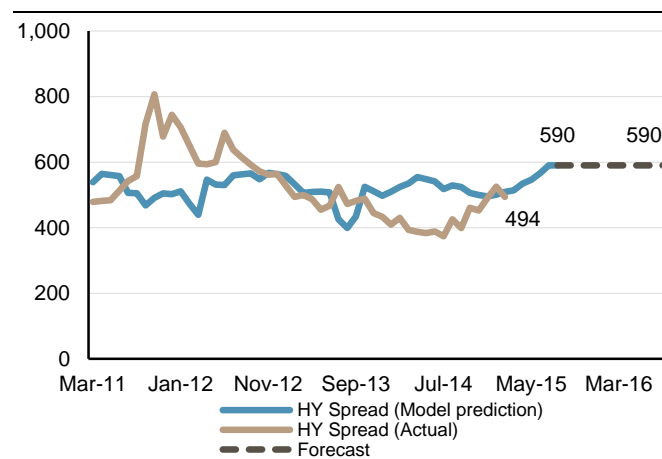
We estimate outflows of \$1.3bn over the last 5 days, all driven by more institutionally heavy ETF outflows. Retail mutual funds have remained modestly supportive. The pivot in flows has occurred with the turn in calendar, and while a driver is not easy to find, we think the persistent rise in Treasury yields is beginning to turn heads. Lastly, the prospect of Fed tightening has the potential to widen HY spreads, as the market re-prices, not due to deviations in the “lift-off” date of rate hikes, but with regard to the pace of tightening throughout the remainder of 2015. Given this, we would fade the recent rally in HY.

Figure 1: US IG spreads: 6-month forecast vs. actual



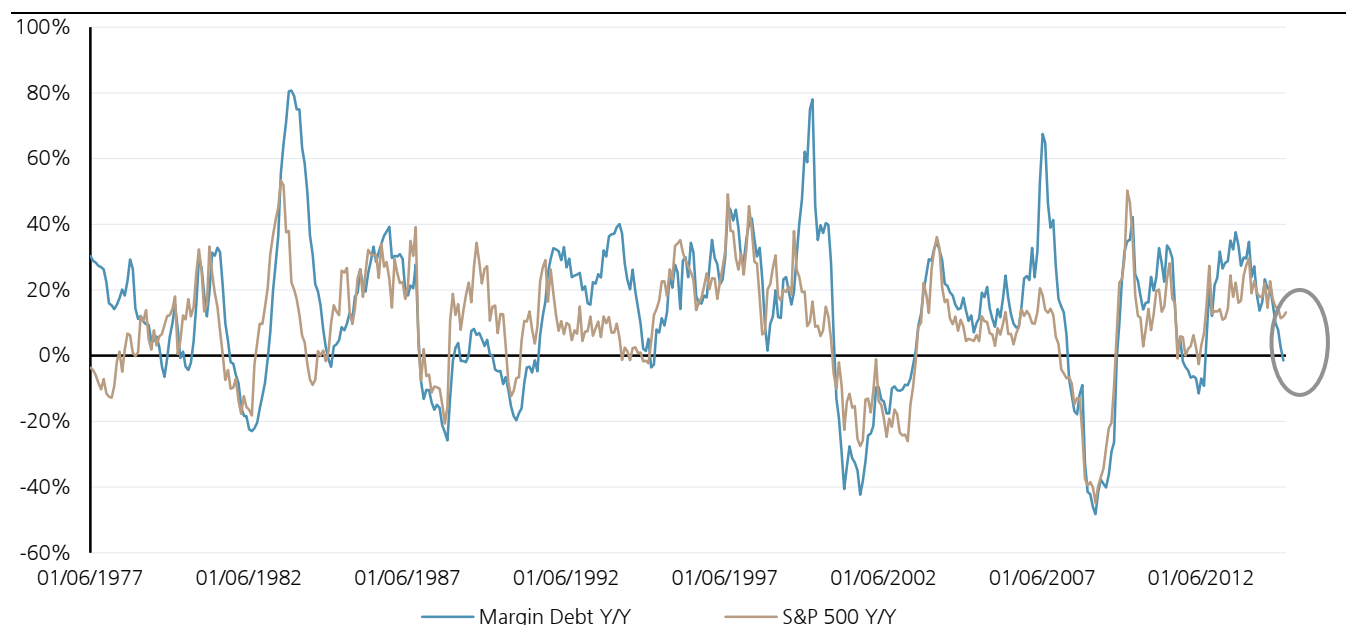
Source: UBS, Yieldbook, Moody's

Figure 2: US HY spreads: 6-month forecast vs. actual



Source: UBS, Yieldbook, Moody's

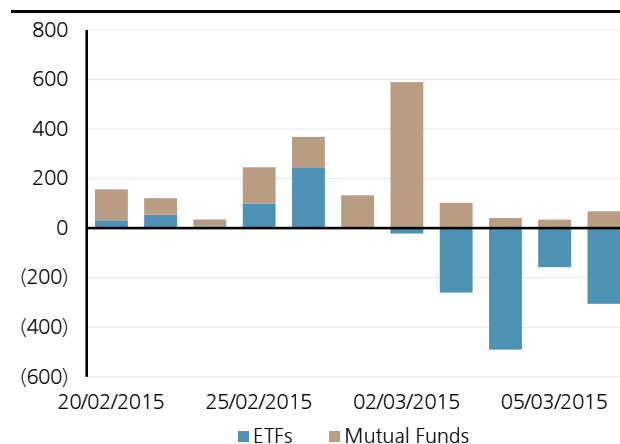
Figure 3: NYSE Margin Debt vs. S&P 500 (Y/Y chng)



Source: UBS, Bloomberg

Figure 4: US HY Forward Primary Market Calendar (\$bn)

Source: UBS, S&P LCD

Figure 5: HY Daily Fund Flows (\$mn)

Source: UBS, Bloomberg

US Daily Market Pulse

Primary Market Recap

US IG and HY issuance stood at \$14.6bn and \$1.6bn respectively. In IG, Zimmer Holdings came out with a \$7.65bn, seven-tranche deal and ING Bank NV sold \$2.35bn in a three-part deal. LL issuance stood at \$2.4bn. HY pipeline on LCD is estimated by S&P at \$26bn of which \$11.5bn is expected to be priced this week. LL pipeline on LCD is forecasted by S&P at \$13.1bn.

Secondary Market Recap

Credit indices widened (US BIG +2bps, US HYCP +17bps, CDX IG +1bps, CDX HY - \$0.3, LL unch). TRACE data showed \$785mn (1.14 Sell/Buy ratio) of client selling in IG and \$106mn (0.95 S/B ratio) of client buying in HY.

In IG, Energy (+2.7bps) underperformed and Senior Financials (-0.2bps) outperformed. All sectors widened in HY leading with Energy (+22.6bps).

For IG, client buying was prevalent only in the Materials sector (0.95 S/B ratio). Client selling was most concentrated in the Technology sector (1.4 S/B ratio), and across the curve, but majorly in the 7 -12 yr (1.2 S/B ratio) maturity bucket.

For HY, client buying was most prevalent in the Technology sector (0.8 S/B ratio), and in Ba1-Ba3 (0.9 S/B ratio) rated bonds. Client selling was most concentrated in the Energy sector (1 S/B ratio).

Figure 6: Things to watch

Time (EST)	Event	Survey	UBS Est.	Prior
7:00 AM	MBA Mortgage Applications	--	--	0.10%
10:00 AM	Quarterly Services Survey	--	--	--
2:00 PM	Federal Budget	-\$188B	-\$194B	_194B
4:30 PM	U.S. Fed Releases Results of Second Set of Stress Tests	--	--	--

Source: UBS, Bloomberg

Figure 7: Market Update

			Spreads (bp)				Yields (%)			
			Current	1d chg	1w chg	1m chg	Current	1d chg	1w chg	1m chg
US	Cash	US IG	125	2	1	-6	3.01	-0.04	0.00	0.06
		US Fin	108	2	2	-5	2.63	-0.03	0.01	0.06
		US Non Fin	134	2	0	-8	3.16	-0.04	0.00	0.06
		US HY	494	17	31	-14	6.31	0.13	0.33	0.00
	CDS	CDX IG	65	1	3	-1	-	-	-	-
		CDX HY (\$)	107.3	-0.3	-0.2	0.9	-	-	-	-
	Equities*	S&P 500	2,044	-1.7%	-3.0%	-1.2%	-	-	-	-
		VIX	17	10.8%	20.4%	-3.1%	-	-	-	-
	Treasury	10y UST	-	-	-	-	2.13	-0.06	0.01	0.13
EU	Cash	iBoxx € Corp	100	3	4	-5	1.02	-0.03	-0.05	-0.13
		iBoxx € Fin	109	3	2	-6	1.06	-0.03	-0.06	-0.13
		iBoxx € Non Fin	94	3	5	-5	1.00	-0.03	-0.04	-0.12
		iBoxx € HY	387	9	7	-30	3.78	0.05	0.02	-0.38
	CDS	iTraxx Main	50	1	0	-7	-	-	-	-
		iTraxx Crossover	262	5	-5	-50	-	-	-	-
		iTraxx Fin Snr	58	1	1	-9	-	-	-	-
		iTraxx Fin Sub	126	2	0	-16	-	-	-	-
	Equities*	€ Stoxx	3,567	-1.2%	0.5%	5.4%	-	-	-	-
	Treasury	10y Bund	-	-	-	-	0.23	-0.08	-0.13	-0.14
		10y UKT	-	-	-	-	1.80	-0.14	-0.05	0.13
	CDS	iTraxx Asia ex Japan IG	107	2	6	-1	-	-	-	-

Source: UBS, Bloomberg, Markit, Yieldbook; Data as of COB Y'day.

Figure 8: Credit Index Skew

10-Mar-2015		Skew*			
Index	Current	1d chg	1w chg	1m chg	
CDX IG	-4	0	1	2	
CDX HY (\$)	-\$0.5	\$0.1	-\$0.4	-\$0.7	
iTraxx Main	0	0	0	2	
iTraxx XO	-16	0	-8	-3	
Fin Snr	2	-1	0	0	
Fin Sub	4	-1	-3	1	
iTraxx Asia ex Japan IG	2	1	2	-1	

Source: UBS, Markit; *Skew=Index-Intrinsic;

Figure 9: CDS Sector Movements

09-Mar-2015	CDX IG					CDX HY					iTraxx MAIN					iTraxx XO				
Sector Changes (bp)	#	Avg	1d	1wk	1m	#	Avg	1d	1wk	1m	#	Avg	1d	1wk	1m	#	Avg	1d	1wk	1m
Consumer Discretionary	32	56	0	-1	-3	36	381	3	9	-15	21	44	0	-1	-7	14	336	5	-5	-53
Consumer Staples	13	98	0	0	-4	6	212	3	4	5	19	62	0	-2	-10	6	456	3	-28	-79
Energy	9	198	1	-3	-18	6	1393	38	333	312	6	56	0	-1	-11	1	202	6	-15	-84
Financials	20	76	0	1	-7	13	338	3	1	-26	25	56	2	1	-10	2	263	-5	-21	-66
Health Care	10	31	0	0	-1	4	250	5	-14	-38	3	25	0	-1	-3	3	426	2	-7	-91
Industrials	16	31	0	-1	-2	7	235	3	7	-22	16	48	0	-1	-10	21	283	5	0	-48
Information Technology	7	75	0	-2	-6	11	223	2	5	-26	2	50	0	-3	-15	4	148	2	-8	-28
Materials	10	117	2	7	-10	10	296	5	17	-3	8	71	1	1	-19	11	365	7	6	-14
Telecommunication Services	2	53	0	-2	-5	4	316	4	11	-2	11	45	0	-1	-7	11	218	8	4	-48
Utilities	6	41	0	0	0	3	307	3	3	-15	14	54	0	-2	-9	2	619	13	51	-144
Total/Theoretical Sprd	125	68	0	0	-5	100	305	3	-14	-54	125	50	1	-1	-9	75	273	5	-2	-47

Source: UBS, Markit

Figure 10: Daily CDS Winners/Losers

WINNERS					LOSERS				
Issuer		1d chg	1wk chg	1m chg	Issuer		1d chg	1wk chg	1m chg
CDX (IG)					CDX (IG)				
Nabors Industries	368	-4	-8	-35	Transocean	705	+16	+12	+63
Time Warner Cable	63	-1	-8	-12	Teck Resources	276	+7	+16	-41
Weatherford Intl	307	-1	-18	-110	Barrick Gold	184	+6	+32	+15
Expedia	84	-1	-5	-11	Newmont Mining	139	+5	+24	+4
Pitney Bowes	85	-1	-6	-14	Freeport McMoran	272	+3	+5	-48
CDX (HY)					CDX (HY)				
Neiman Marcus Grp	134	-25	-21	-16	First Oil	6,100	+179	+1,922	+1,828
Boyd Gaming	337	-18	-8	-43	Toys R Us	1,554	+33	+61	-113
Sanmina Corp	220	-3	+6	+21	Parker Drilling Co	663	+33	+26	-61
Realogy	275	-2	+2	-20	AK Steel	951	+20	+88	+65
Kinder Morgan KS	127	-2	-5	-25	JC Penney	748	+12	+20	-22
iTraxx (Main)					iTraxx (Main)				
Carlsberg Breweries	80	-2	-8	-36	Anglo American	155	+6	+6	-38
Deutsche Bahn	18	-2	-2	-6	Glencore International	147	+5	+7	-43
Metro	88	-1	-7	-26	UniCredit	94	+3	+0	-36
Tate & Lyle	83	-1	-2	-12	Lloyds TSB Bank	46	+3	+2	-6
Enel	62	-1	-3	-19	RBS	56	+3	+4	-1
iTraxx (XO)					iTraxx (XO)				
Lock Lower Holdings	404	-12	-41	-108	Norske Skogindustrier	2,147	+52	+81	+284
Twinkle Pizza Hldg	381	-11	-16	-78	Hema Bondco I B.V.	941	+43	+23	-44
Portugal Telecom Intl Fin	362	-6	-6	-51	Hellenic Telecom	398	+34	+41	-130
Selecta Group B.V.	504	-2	-5	-33	Grupo Isolux Corsan Fin	727	+28	+17	-45
Financiere Quick	940	-2	-37	-59	Public Power Corp Fin	1,145	+25	+103	-245

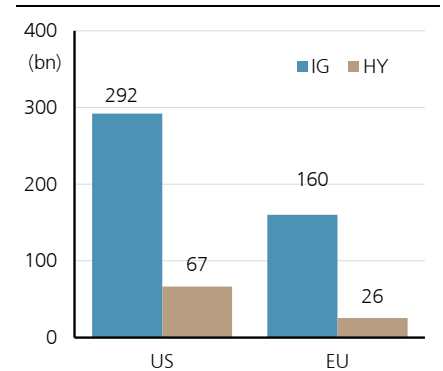
Source: UBS, Markit; Data as of 09-Mar-2015

Figure 12: Yesterday's Global Corporate Bond Issuance

Principal (mm)	Issuer	Cpn (%)	Maturity	Moody's	S&P	Spd (bp)
14,600	USD Investment Grade					
2,000	Zimmer Holdings Inc	3.550	4/1/2025	Baa3	NR	145
1,500	Zimmer Holdings Inc	2.700	4/1/2020	Baa3	NR	110
1,250	Zimmer Holdings Inc	4.450	8/15/2045	Baa3	NR	180
1,150	Zimmer Holdings Inc	2.000	4/1/2018	Baa3	NR	95
1,000	ING Bank NV	2.450	3/16/2020	NR	NR	88
1,000	ING Bank NV	1.800	3/16/2018	NR	NR	78
850	American Honda Finance	1.500	3/13/2018	A1	A+	47
750	Zimmer Holdings Inc	3.150	4/1/2022	Baa3	NR	125
650	Valero Energy Corp	4.900	3/15/2045	Baa2	NR	220
600	Valero Energy Corp	3.650	3/15/2025	NR	NR	155
500	Sempra Energy	2.400	3/15/2020	Baa1	NR	80
500	Priceline Group Inc/The	3.650	3/15/2025	Baa1	NR	155
500	Essex Portfolio Lp	3.500	4/1/2025	Baa2	BBB	140
500	Zimmer Holdings Inc	1.450	4/1/2017	Baa3	NR	80
500	Zimmer Holdings Inc	4.250	8/15/2035	Baa3	NR	160
400	American Honda Finance	2.150	3/13/2020	A1	A+	58
350	Tc Pipelines Lp	4.375	3/13/2025	Baa2	NR	230
350	ING Bank NV	FRN	3/16/2018	NR	NR	NA
250	Boardwalk Pipelines LP	4.950	12/15/2024	Baa3	BB+	285
1,600	USD High Yield					
600	Evolution Escrow Issuer	7.500	3/15/2022	B3	BB-	556
500	Kcg Holdings Inc	6.875	3/15/2020	B1	BB-	NA
500	Millicom Intl Cellular	6.000	3/10/2025	Ba2	NR	NA
7,650	EUR Investment Grade					
1,000	Nordea Bank Finland Plc	0.125	6/17/2020	Aaa	NR	30
1,000	Nordea Bank Finland Plc	0.625	3/17/2027	Aaa	NR	51
800	Bat Intl Finance Plc	0.375	3/13/2019	A3	NR	65
800	Bat Intl Finance Plc	0.875	10/13/2023	A3	NR	91
800	Bat Intl Finance Plc	1.250	3/13/2027	NR	NR	114
600	Bat Intl Finance Plc	2.000	3/13/2045	A3	NR	138
600	Metro AG	1.500	3/19/2025	NR	NR	127
500	Flowserve Corporation	1.250	3/17/2022	NR	NR	138
500	Neste Oil Oyj	2.125	3/17/2022	NR	NR	224
400	Enagas Financiaciones SA	1.000	3/25/2023	NR	NR	98
200	Intesa Sanpaolo SpA	FRN	3/12/2018	NR	NR	NA
150	Raiffeisen Bank Intl	FRN	3/20/2017	Baa2	NR	NA
100	Bayerische Landesbank	0.300	4/8/2022	NR	NR	NA
100	Bayerische Landesbank	0.700	3/28/2024	NR	NR	NA
100	Bayerische Landesbank	0.500	4/8/2024	NR	NR	NA
500	EUR High Yield					
500	Faurecia	3.125	6/15/2022	B1	NR	316
0	GBP Investment Grade					
NA						
0	GBP High Yield					
NA						

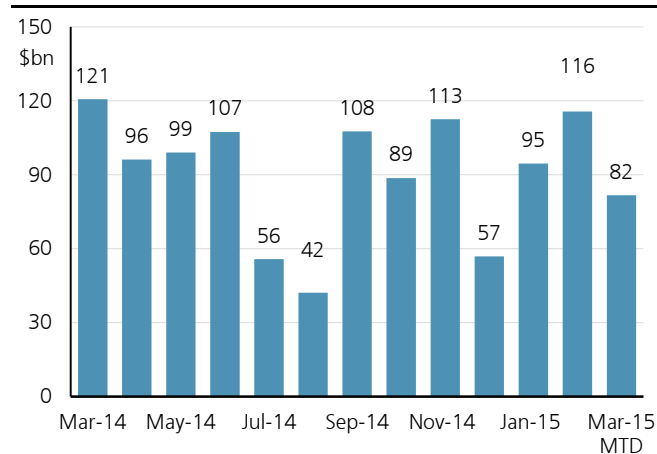
Source: UBS, Bloomberg; Amounts in local currency

Figure 11: YTD Issuance Summary



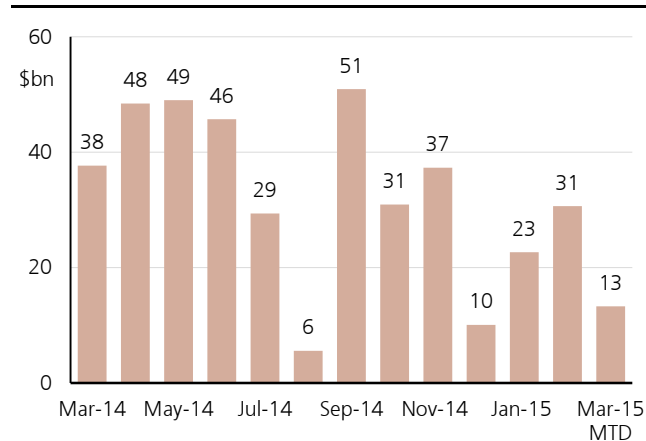
Source: UBS, Bloomberg; Amounts in local currency

Figure 13: USD – IG Monthly Issuance



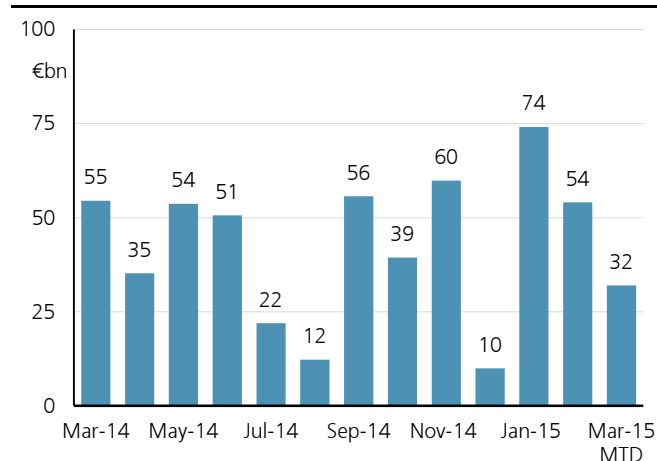
Source: UBS, Bloomberg

Figure 14: USD – HY Monthly Issuance



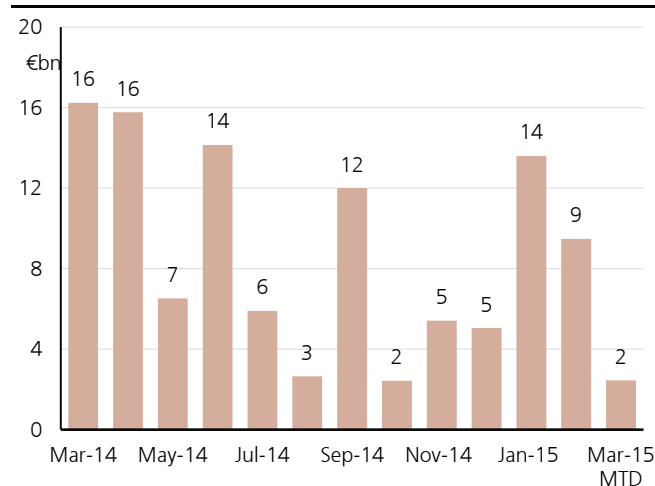
Source: UBS, Bloomberg

Figure 15: EUR – IG Monthly Issuance



Source: UBS, Bloomberg

Figure 16: EUR – HY Monthly Issuance



Source: UBS, Bloomberg

Figure 17: Today's Earning Releases

Time*	US	Estimate	Guidance	Time*	Europe	Estimate	Guidance
NA				6:00 AM	Adecco SA	3.78	--
				6:00 AM	Deutsche Post AG	1.71	--
				6:30 AM	E.ON SE	0.87	--
				7:00 AM	Verbund AG	0.58	--
				4:35 PM	Lagardere SCA	1.56	--
				Aft-mkt	Eurobank Ergasias SA	-0.07	--

Source: UBS, Bloomberg *US Time Zone – EST and Europe Time Zone – London Time; Amounts in local currency

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