

MONTHLY COMMENTARY

## February Credit Update

TAMMY KARP | MARCH 6, 2018

After getting lulled into complacency by low volatility and consecutive years of continuous spread tightening, the markets experienced a meaningful correction in February. Inflationary worries, rising rates, a “hawkish” Fed, and the short volatility ETN unwind were the culprits – or so we are told. But perhaps it is years of the QE-led reach for yield that has masked vulnerabilities, including peak levels of leverage and the massive growth in the credit markets. February was marked by wider spreads and higher yields. The credit index OAS widened 9 basis points in February, the weakest month in over two years. The credit index yield of 3.64% (the highest yield since December 2011), is 25 basis points higher on the month and 45 basis points higher YTD. As a result, both excess and total returns were negative, at -.56% and -1.51% respectively on the month. Liquidity deteriorated as technicals took a sharp U-turn to the negative, a fresh reminder how quickly sentiment can change. Another factor weighing on the market was the large pending M&A supply out of the healthcare sector (CVS/AET). Additionally, front-end selling accelerated from both foreign investors, as hedging costs have increased, and corporations looking to repatriate earnings.

**Credit Index Yields and Spreads:** Index yield of 3.64% highest since Dec 2011. Spreads still near the post crisis tights.



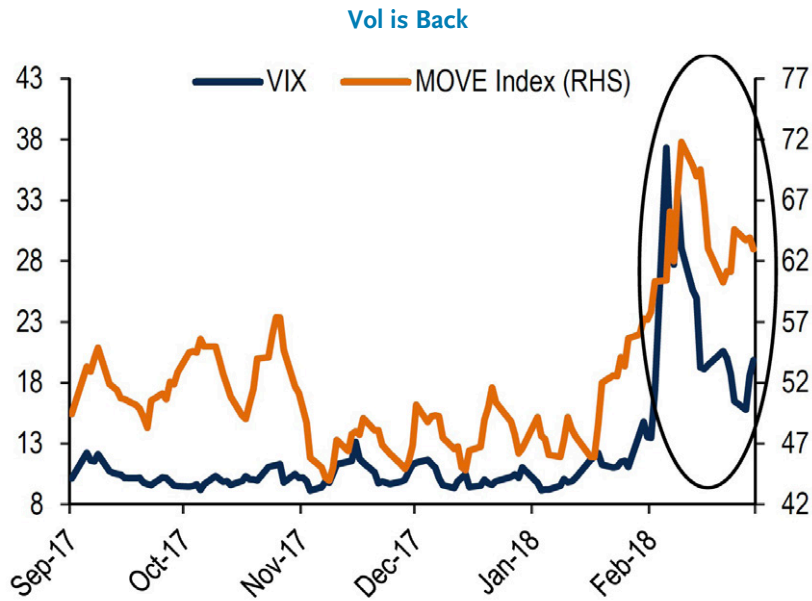
Label	Last	Minimum	Min Date	Maximum	Max Date	Average	Std Dev	Std Dev Chg
Left – U.S. Credit - OAS	90.705	81.068	02/02/2018	231.262	11/25/2011	134.061	30.737	1.369
Right – U.S. Credit - Yield to Worst	3.638	2.464	05/02/2013	3.964	04/06/2011	3.105	0.302	0.033

Source: Bloomberg Barclays

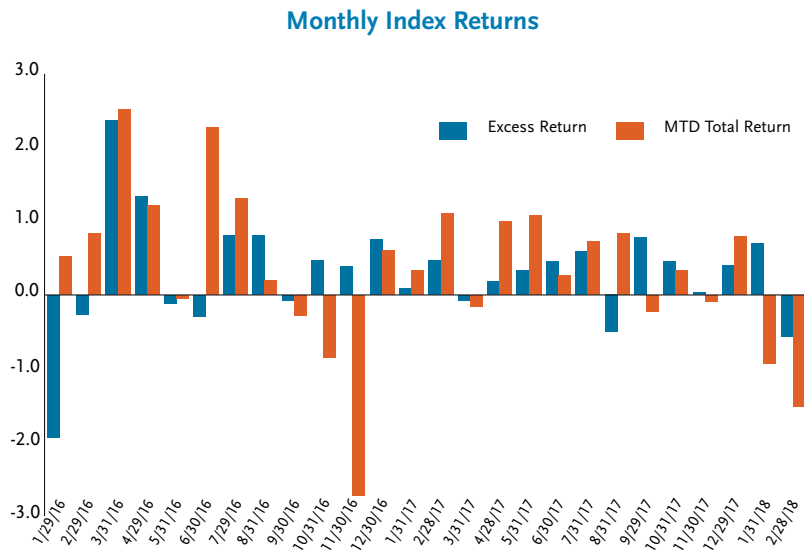


**Tammy Karp**  
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Ms. Karp is a Managing Director in the Fixed Income group where she trades investment grade and cross over securities. Ms. Karp joined TCW in 2009 during the acquisition of Metropolitan West Asset Management LLC (MetWest). Prior to joining MetWest in 1997, she was with the fixed income department at The Capital Group. Ms. Karp earned her BS in Business from University of Arizona.



Source: Bloomberg Barclays



Source: BofA Merrill Lynch Global Research

## February Credit Update

**Index Performance:** The credit index OAS of +91 basis points over Treasuries was 9 bps wider in February. Higher Treasury yields and wider spreads negatively impacted returns which were -1.51% (total return) and -.56% (excess return) on the month. Year to date, the total return of the index is -2.43% while the excess return remains marginally positive at .13% as positive carry offset the 2 basis points of YTD widening. February performance was generally weak across the board though higher quality (AA's and A's) and lower beta sectors such as munis and utilities outperformed. The decompression was most notable in the cyclical sectors like energy and metals, which widened 13 basis each. Within energy, refining underperformed (+21 bps) due to the recent rise in gasoline inventories, which has negative implications for refining margins. Other notable underperformers were healthcare related sectors like pharma (+12) and health insurers (+12), which were pressured by the imminent \$40 billion CVS/AET bond deal – which will be the third largest corporate bond deal ever.

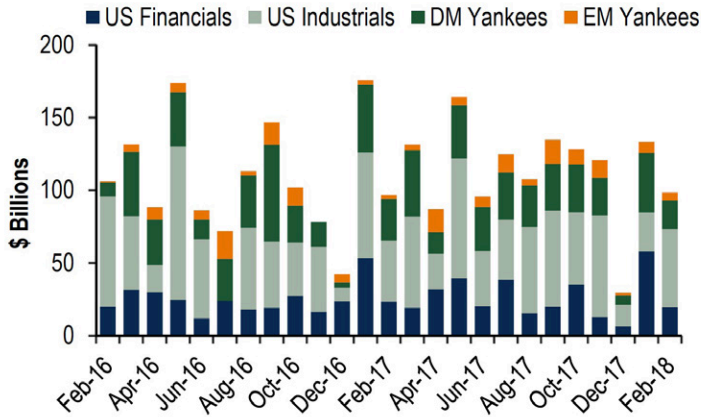
### February Credit Index Returns

	Month-to-Date Excess Return	Month-to-Date Total Return	Option-Adjusted Spread	Option-Adjusted Spread Month-to-Date Change
Credit Index	-0.56%	-1.51%	91	+9
Industrials	-0.67%	-1.78%	99	+10
Financials	-0.56%	-1.26%	91	+11
Utilities	-0.46%	-1.95%	91	+6
Municipals	0.91%	-1.55%	109	+4
Sovereigns	-1.08%	-2.31%	110	+15
AA	-0.24%	-1.10%	57	+6
A	-0.61%	-1.62%	78	+9
BBB	-0.68%	-1.71%	123	+11

Source: Bloomberg Barclays

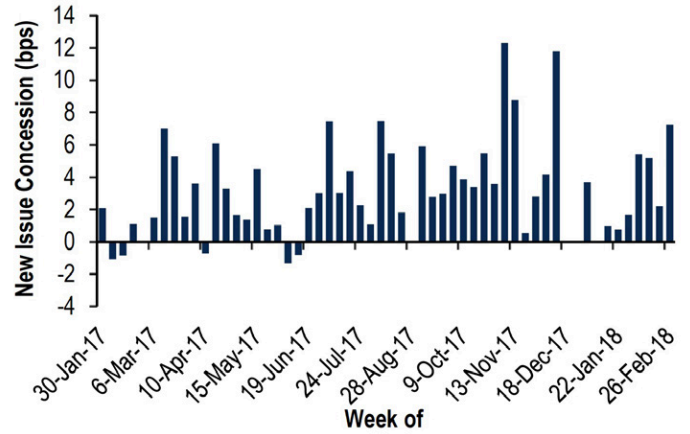
**February Investment Grade Supply:** New IG volumes of \$98.4 bln were dominated by industrials (\$66.8 bln), which accounted for 68% of total issuance. Financial supply was \$31.2 bln after a record January supply of bank issuance. Concessions widened as the month progressed due to poor new issue performance. Several deals, including two lower beta/higher quality issuers, priced with 10-15 basis point concessions in the latter part of the month, including WPZ (30yrs priced at +172/olb, 12 bp concession), EIX fmb (30yr priced at +100/olb, +15 bp concession) and TRV (30yr priced at +95/olb, 15 bp concession).

IG Monthly Issuance



Source: BofA Merrill Lynch Global Research

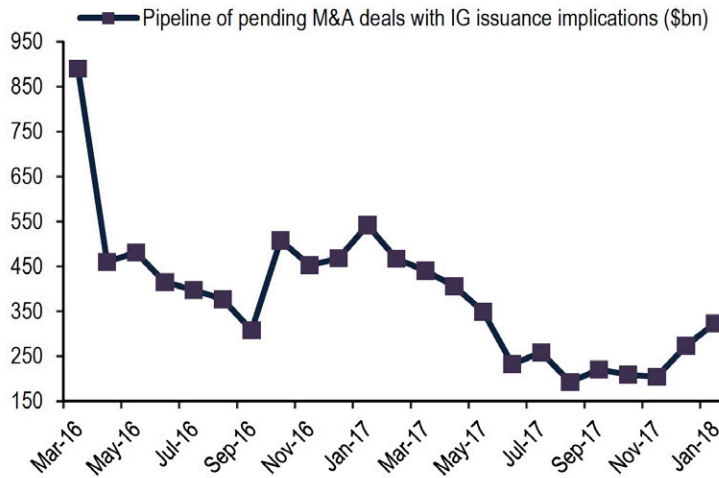
New Issue Concessions



Source: BofA Merrill Lynch Global Research

Mergers & Acquisitions

Transactions have increased which has implications for bond issuance



Source: BofA Merrill Lynch Global Research, Bloomberg

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