

MONTHLY COMMENTARY

July Credit Update

TAMMY KARP | AUGUST 8, 2018

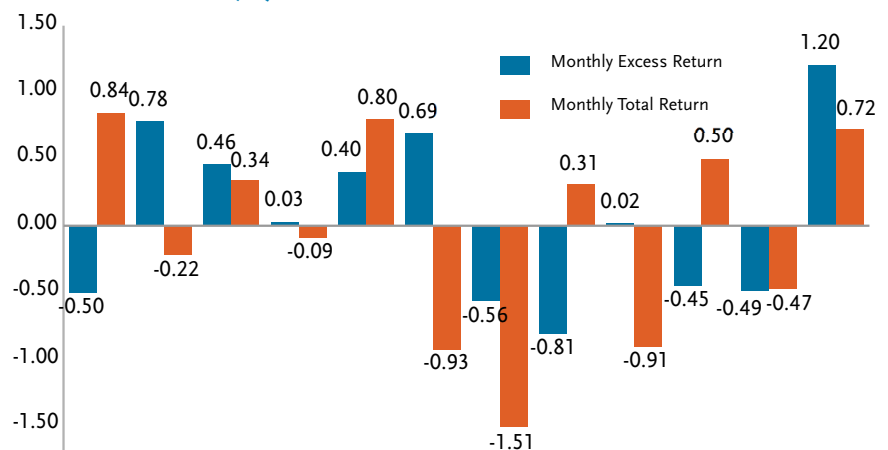
Credit staged a meaningful rebound in July as geopolitical risks and a volatile macro backdrop took a backseat to strong corporate earnings and an improved supply/demand picture for IG credit. While the macro issues – notably EM concerns, a rise in Chinese corporate defaults, trade wars and new U.S. sanctions on Russia and Turkey – continue to be a source of concern, a light new issue calendar coupled with historically low dealer inventories kept the supply/demand balance in check. On the supply side, new issue volumes were down significantly due to a big drop in M&A-related issuance. Investment grade supply was only \$67 bln in July, compared to \$120 bln in June and an average YTD monthly run rate of \$122 bln. The technicals were good in July, but eventually supply will pick back up and the transition from QE to QT should lead to more spread volatility. The fundamentals, which have been overshadowed by the QE-led technicals, should be a better determinant of spread moves going forward. While earnings have been good on a year-over-year basis, we have not seen that translate into better credit metrics as the majority of the benefit of tax cuts and repatriation has gone to shareholders.



Tammy Karp
Managing Director
Fixed Income

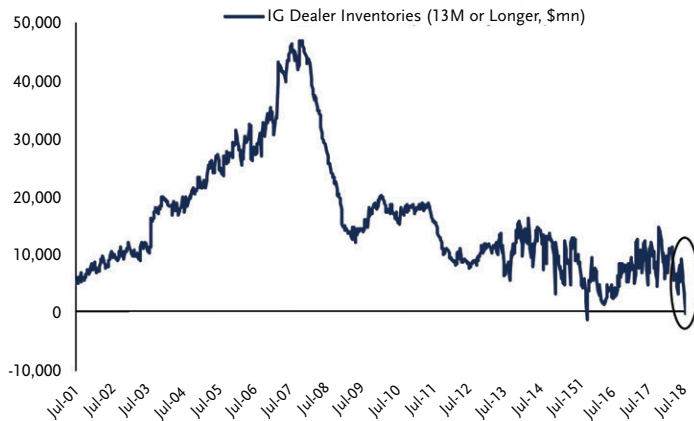
Ms. Karp is a Managing Director in the Fixed Income group where she trades investment grade and cross over securities. Ms. Karp joined TCW in 2009 during the acquisition of Metropolitan West Asset Management LLC (MetWest). Prior to joining MetWest in 1997, she was with the fixed income department at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

July Excess Returns of 1.2% a YTD Best



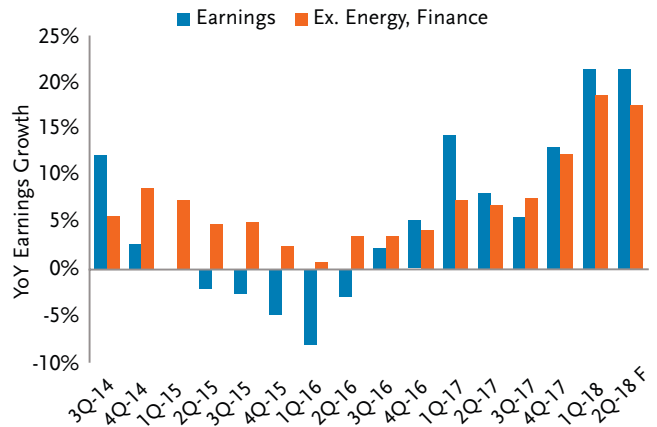
Source: Barclays Capital

Light Dealer Inventories Exacerbate the Moves in Both Directions



Note: Federal Reserve data until July 2018. Estimated using Trace in Bloomberg afterward.
Source: Federal Reserve, Trace, BofA Merrill Lynch Global Research

Earnings For IG Issuers Up 21.6% YoY



Source: BofA Merrill Lynch Global Research

Earnings Growth For IG Issuers by Sector

Sector	Earnings Growth (YoY)	Sales Growth (YoY)
Aerospace/Defense	20.2%	7.6%
Automobiles	-15.7%	1.2%
Banks/Brokers	26.3%	5.0%
Basic Materials	35.2%	13.1%
Consumer Products	4.0%	2.7%
Energy	93.1%	20.5%
Finance	18.6%	11.2%
Food, Bev , & Bottling	7.1%	4.2%
Health Care	10.9%	6.4%
Industrial Products	25.0%	11.5%
Insurance	12.2%	5.3%
Media & Entertainment	18.2%	6.3%
REITs	2.8%	2.7%
Retail	20.2%	7.8%
Technology	27.3%	11.6%
Telecom	21.7%	1.6%
Transportation	24.2%	9.9%
Utilities	5.0%	0.2%
Other	16.6%	6.1%
Total US HG public co's	21.6%	8.4%
Total ex. Financials	22.3%	8.9%
Total ex. Energy	18.1%	6.9%
Total ex. Fin. & Energy	17.7%	7.2%
Yankee and private co's	n.a.	n.a.

Source: BofA Merrill Lynch Global Research, FactSet

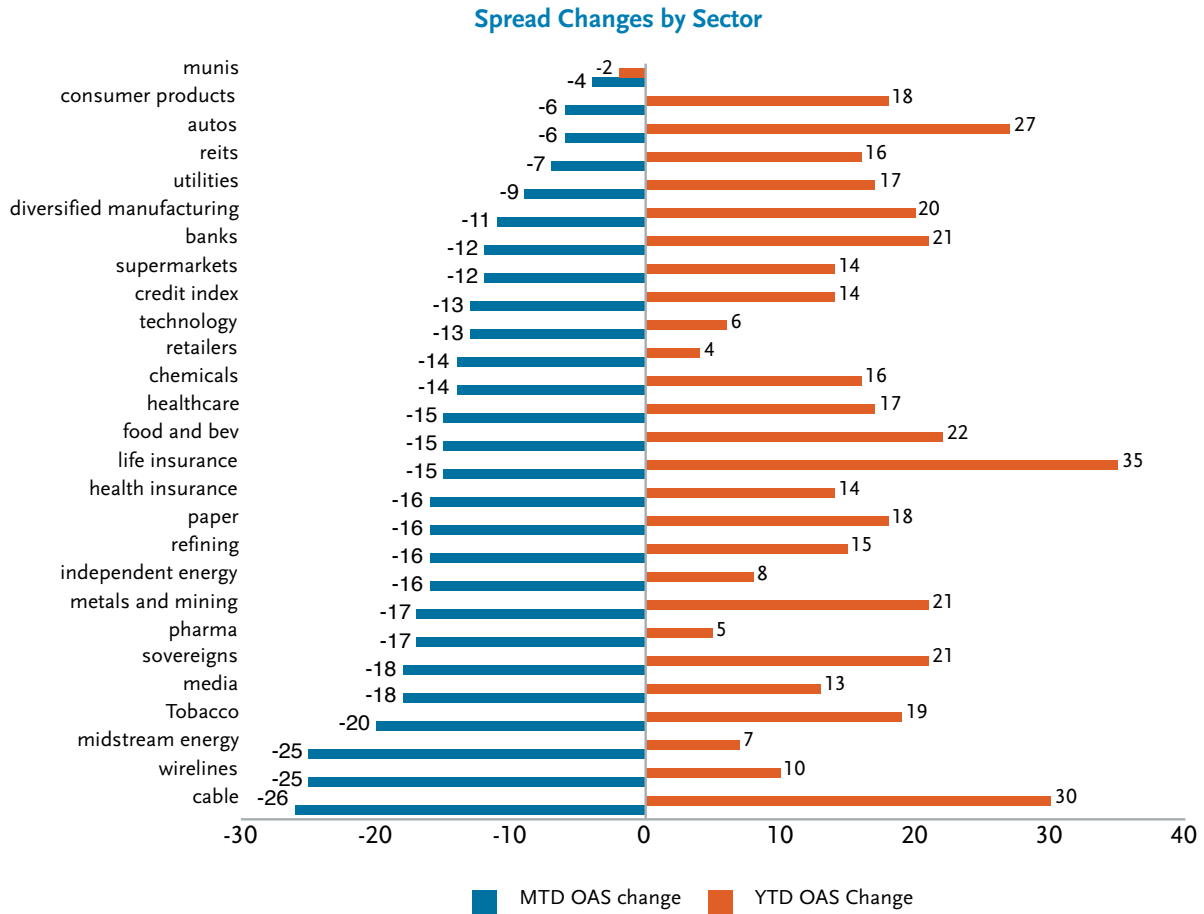
July Credit Update

Index Performance: The credit index tightened 13 basis points in July, reversing all of the widening that occurred in May and June. The index OAS of +103 is now in the middle of the YTD range (+81 to +117) but still much closer to the tightness (+81) vs. the mean (+166 10yr mean). Both excess (+1.20%) and total (+.72%) returns were positive on the month as significant spread tightening offset higher Treasury yields. As such, the credit index yield of 3.92% was only two basis points lower on the month. YTD excess returns improved to -0.38% while YTD total returns remain in deeply negative territory at -2.29%. Both duration and beta outperformed in July. The bid for duration improved, resulting in marginally flatter credit curves as longer dated corporates outperformed (-18 bps). By ratings quality, the BBB portion of the index outperformed (-16 bps) driven by higher beta sectors like wirelines (-25 bps), energy (-20 bps), and sovereigns (-18 bps). The best performing sector in July was cable (-26 bps) as better than expected subscriber trends (video subscription losses moderated, healthy broadband adds) and clarity around the Fox assets helped spreads remediate. The FOXA/DIS/CMCSA saga is nearing its conclusion as Comcast pulled out of the bidding war for Fox and is now focused on winning the SKY assets. This outcome is probably the best bondholders could have hoped for as it greatly reduces the amount of debt that would be issued if both the Fox and Sky assets were purchased by one acquirer (either cmcsa or dis). Moreover, the odds of CMCSA holding its (low) single A ratings (at least at two out of three agencies) is now greater than 50%. Within energy, midstream outperformed (-25 bps) as positive earnings results and progress on de-leveraging efforts for credits like KMI and ETP caused the midstream vs. independent E&P basis to compress. One of the major themes for the midstream sector this year has been the simplification of corporate structures with several consolidations announced this year including ETE/ETP, WMB/WPZ and SEP/EEP/ENB. These structural consolidations are credit-friendly transactions that improve cash flow by re-sizing distributions and eliminating IDR payments, thereby providing companies with more balance sheet flexibility and ability to de-lever.

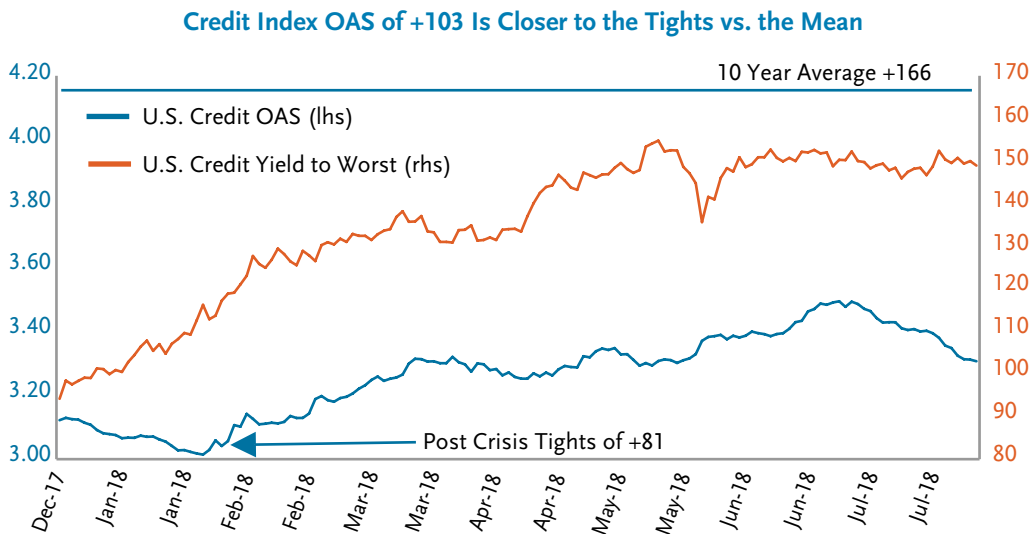
July Credit Index Returns

	Month-to-Date Excess Return	Month-to-Date Total Return	Option-Adjusted Spread	Option-Adjusted Spread Month-to-Date Change
Credit Index	1.20%	.72%	103	-13
Industrials	1.54%	.99%	111	-15
Financials	1.01%	.65%	105	-13
Utilities	1.04%	.31%	109	-9
Municipals	.05%	.12%	115	-4
Sovereigns	1.79%	1.17%	126	-18
AA	.62%	.18%	63	-7
A	1.16%	.66%	89	-12
BBB	1.54%	1.03%	141	-16

Source: Bloomberg Barclays



Source: Barclays Capital

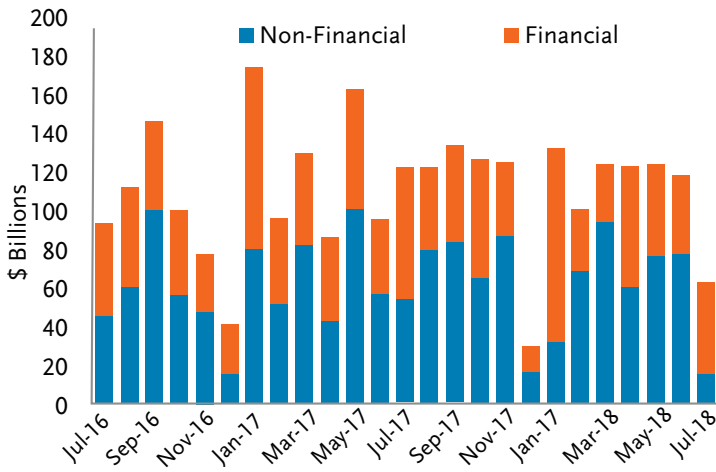


Source: Barclays Capital

July Credit Update

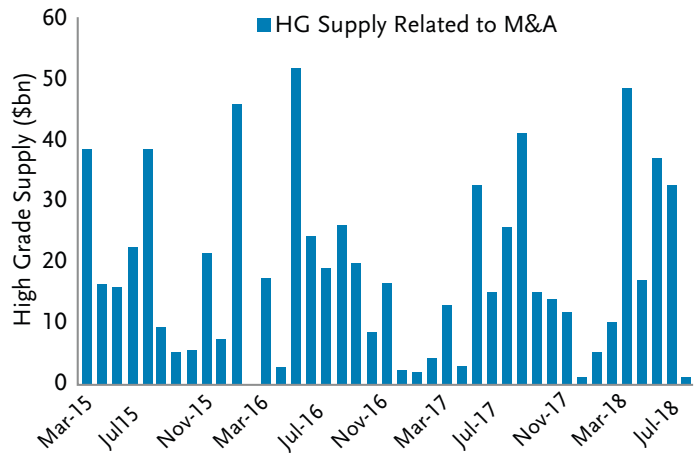
June Investment Grade Supply: July supply volumes were only \$67 bln, a big drop from the \$119 bln in June and the lightest month so far this year. M&A-related issuance was only \$1.3 bln in July, compared to an average YTD run rate of \$22 bln per month. We expect M&A-related issuance to pick up as the pipeline of pending deals remains elevated. July supply volumes were dominated by financials (\$50.9 bln) as several banks issued post earnings including JPM (\$6.5 bln across two maturities, 6nc5 priced @ +105/5yr, 11nc10 priced at +135/10yr), BAC (\$6 bln across two maturities, 6nc5 priced @ +110/5yr, 11nc10 priced @ +140/10yr), and Citi (\$5 bln total comprised of 3yr fixed sr bank @ +77 and 30yr holdco @ +170/olb). New issue concessions collapsed to 0-3 bps by the end of the month as demand improved. ■

IG Monthly Supply Volumes



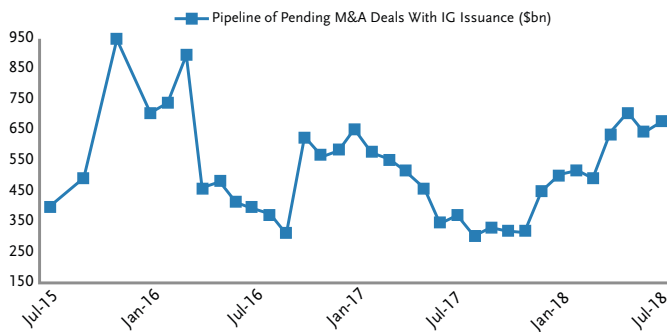
Source: BofA Merrill Lynch Global Research

HG Monthly Supply Volumes



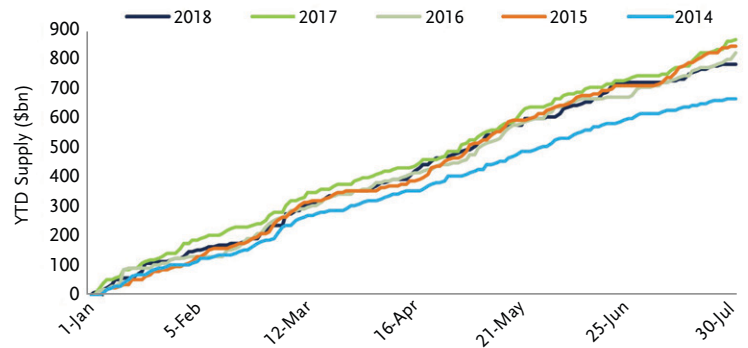
Source: BofA Merrill Lynch Global Research

Pipeline of M&A (Enterprise Value)



Source: BofA Merrill Lynch Global Research

Cumulative IG Supply (\$Bln)



Source: BofA Merrill Lynch Global Research

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