

Situation Room

Bank risks vs the Fed

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Unexpected losses reported by a smaller regional bank NYCB (see [New York Community Bancorp: 4Q loss, FY24 guide and dividend-cut to weigh on stock](#)) more than offset a somewhat hawkish FOMC, leading to a big bull-flattening of the Treasury yield curve. The combination of potentially higher CRE (commercial real estate) risks and a less accommodating Fed led to the largest drop in the S&P 500 YtD (-1.6%) and a 2-5bps widening in liquid IG bond spreads. Today's market action illustrates our biggest risk to IG spreads in 2024: higher US growth risks and less attractive yields. At the same time the NYCB headline does not impact our bullish view on banks, as the issue appears to be one-off and 2024 Fed cuts should benefit bank credit valuations relative to industrials.

Asymmetric risk to IG spreads

We can group US risks for IG spreads broadly into two categories: 1) sticky inflation, strong growth, hawkish Fed, higher long-term rates and 2) lower growth, lower inflation, dovish Fed, lower long-term rates. IG spreads should be resilient to risk #1, as lower stocks / potentially higher rates vol are offset by more attractive yields and potentially less supply on higher borrowing costs (see [Situation Room: Fed vs. credit](#)). However, in scenario #2 lower yields instead amplify the negative impact of higher US growth risks on IG spreads, as happened today.

Banks over industrials

Despite recent outperformance we continue to prefer big sig and large regional US banks over industrials (Exhibit 1). First, unlike for NYCB, the 4Q results for the big six US banks as well as large regionals were constructive on credit quality (see [Banks: Constructive tone on credit continues](#)). That suggests the NYCB surprise was likely a one-off and not an indicator of a wider problem. Second, larger banks have strong capital buffers against credit losses. Third, tail risk related to the Fed hiking cycle – which we think is the key reason for bank spread underperformance post SVB last year – should decline in 2024 as the Fed cuts rates.

A two-handed Fed

Economists famously do not take a firm position on issues, instead saying “but on the other hand.” The January FOMC was similarly two-handed. The key hawkish message was Chair Powell stating that he did not think it “likely” that the Committee would be ready to cut rates in March. As a result, the chance of a Fed cut in March based on market pricing dropped to 35% today on Jan 31st from 42% on January 30th. On the other hand, the Fed acknowledged the progress on inflation and is now more focused on the dual mandate rather than just price stability, hence tilting more dovish. Hence Chair Powell stated during the press conference that a weaker US labor market could be a reason to accelerate the pace of expected rate cuts in 2024.

31 January 2024

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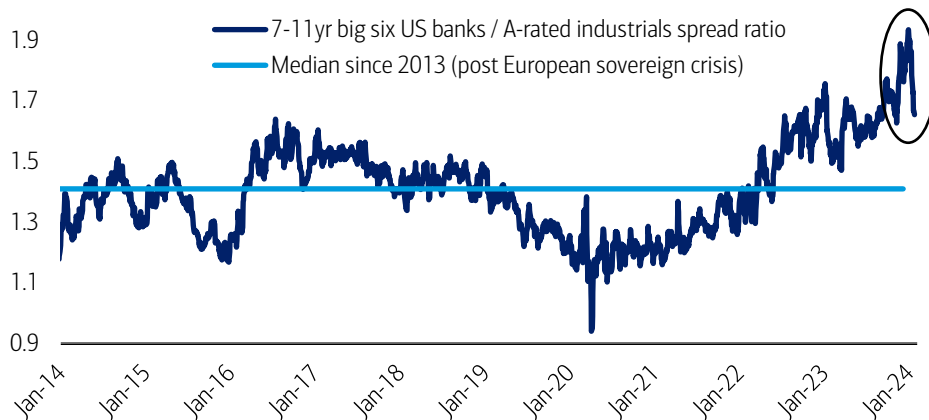
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Timestamp: 31 January 2024 07:25PM EST

Exhibit 1: Bank spreads have outperformed A-rated industries in January

The ratio of 10yr big six US bank spreads to A-rated industrials declined to 1.66 on Jan 30 from 1.94 on Jan 4. Industrial spreads are unchanged while bank spreads are 21 bps tighter over the same period.



Source: BofA Global Research, ICE Data Indices, LLC

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Daily credit snapshot

US IG issuance totaled \$0bn across no deals today, \$20.3bn WTD and \$192.7bn MTD.

S&P 500 closed -1.61%, 10-year Treasury yields -12bps, CDX IG +2.3bps, CDX HY - \$0.46pts, and cash bond spreads quoted +2/-5 bps today, LQD closed 4.73bps wider today.

Exhibit 2: Recent new issue pricing and new issue concessions

List of new issues in the IG corporate bond market today along with performance metrics.

Date	Ticker	Name	Tenor	Size (\$mm)	Moody's/S&P Rating	Coupon (%)	Px Spread (bps)	New Issue Conc. (bps)	* Break performance	Current spread (bps)
2024-01-29	BRKHEC	Northern Natural Gas Co	30	500	A2/A-	5.625	127	n.a.	-5	122
2024-01-29	COF	Capital One Financial Corp	6NC5	1,000	Baa1/BBB	5.7	170	0	-8	160
2024-01-29	COF	Capital One Financial Corp	11NC10	1,000	Baa1/BBB	6.051	195	-0	-7	186
2024-01-29	GBDC	Golub Capital BDC Inc	5	600	Baa3/BBB-	6	225	13	n.a.	n.a.
2024-01-29	HYUCAP	Hyundai Capital Services Inc	3	500	Baa1/BBB+	5.125	110	n.a.	n.a.	n.a.
2024-01-29	HYUCAP	Hyundai Capital Services Inc	5	500	Baa1/BBB+	5.125	120	n.a.	n.a.	n.a.
2024-01-29	IBM	IBM International Capital Pte Ltd	2	600	A3/A-	4.7	45	5	-1	45
2024-01-29	IBM	IBM International Capital Pte Ltd	3	500	A3/A-	4.6	55	8	0	56
2024-01-29	IBM	IBM International Capital Pte Ltd	5	500	A3/A-	4.6	65	n.a.	0	69
2024-01-29	IBM	IBM International Capital Pte Ltd	7	500	A3/A-	4.75	75	10	2	77
2024-01-29	IBM	IBM International Capital Pte Ltd	10	1,000	A3/A-	4.9	85	n.a.	2	87
2024-01-29	IBM	IBM International Capital Pte Ltd	20	1,000	A3/A-	5.25	85	n.a.	1	89
2024-01-29	IBM	IBM International Capital Pte Ltd	30	1,400	A3/A-	5.3	100	17	-2	99
2024-01-29	KMI	Kinder Morgan Inc	5	1,250	Baa2/BBB	5	105	n.a.	n.a.	n.a.
2024-01-29	KMI	Kinder Morgan Inc	10	1,000	Baa2/BBB	5.4	135	-1	2	138
2024-01-29	NEE	NextEra Energy Capital Holdings Inc	2	600	Baa1/BBB+	FRN	SOFR+76	n.a.	n.a.	n.a.
2024-01-29	NEE	NextEra Energy Capital Holdings Inc	2	1,000	Baa1/BBB+	4.95	65	-3	n.a.	66
2024-01-29	NEE	NextEra Energy Capital Holdings Inc	5	900	Baa1/BBB+	4.9	95	-12	n.a.	95
2024-01-29	NEE	NextEra Energy Capital Holdings Inc	10	1,100	Baa1/BBB+	5.25	120	4	n.a.	119
2024-01-29	NEE	NextEra Energy Capital Holdings Inc	30	800	Baa1/BBB+	5.55	125	-4	n.a.	128
2024-01-29	NOC	Northrop Grumman Corp	5	500	Baa1/BBB+	4.6	65	n.a.	n.a.	67
2024-01-29	NOC	Northrop Grumman Corp	10	850	Baa1/BBB+	4.9	85	12	n.a.	86
2024-01-29	NOC	Northrop Grumman Corp	30	1,150	Baa1/BBB+	5.2	90	9	n.a.	91
2024-01-29	OCINCC	Blue Owl Credit Income Corp	7	750	Baa3/BBB-	6.65	290	n.a.	n.a.	n.a.
2024-01-30	KLAC	KLA Corp	10	500	A2/A-	4.7	72	14	n.a.	n.a.

Exhibit 2: Recent new issue pricing and new issue concessions

List of new issues in the IG corporate bond market today along with performance metrics.

Date	Ticker	Name	Tenor	Size (\$mm)	Moody's/S&P Rating	Coupon (%)	Px Spread (bps)	New Issue Conc. (bps)	* Break performance	Current spread (bps)
2024-01-30	KLAC	KLA Corp	28	250	A2/A-	4.95	80	6	n.a.	81

Note: We calculate new issue concessions by estimating the difference between new issue bond spread and interpolated G spread from comparable liquid secondary bonds of the same issuer prior to the new issue deal announcement, adjusted for the spread impact of dollar prices deviating from par. Break performance is computed as the difference between new issue pricing and secondary closing spread on the first day of trading.

Source: BofA Global Research, Bloomberg

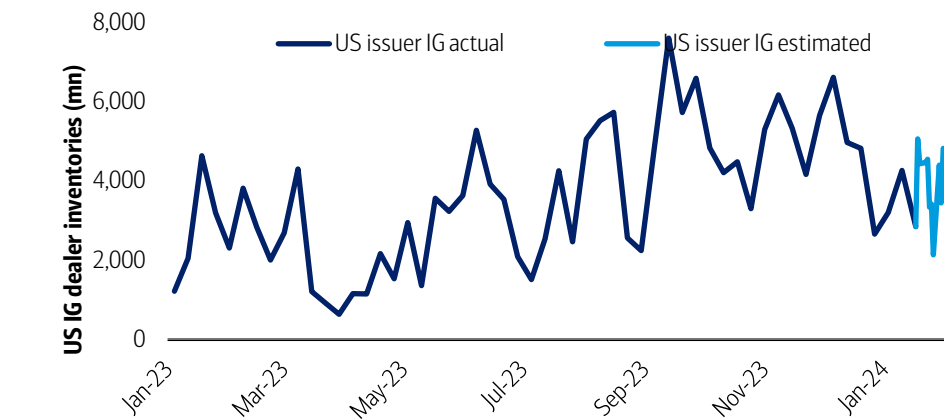
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Daily dealer inventories update

Below we estimate dealer inventories for the IG corporate bonds based on TRACE data. The actual inventories of US issuer bonds based on NY Fed survey, as well as the estimated change since the latest Fed report are plotted in Exhibit 3. We estimate the corresponding DV01 equivalent in Exhibit 4. More details by sector and maturity are available in Exhibit 5 and Exhibit 6. Finally, note that the data for the current date is through about 4:40 p.m. Eastern Standard Time.

Exhibit 3: Estimated dealer inventories of IG corporate bonds.

We estimate IG dealer inventories of US issuer bonds increased to \$4.8bn currently from \$2.9bn on Jan-17.



Note: data for US issuer bonds only, maturities 13M or longer. Actual dealer inventory data is from Primary Dealer Statistics survey by the NY Fed. The subsequent change in inventory is estimated based on TRACE.

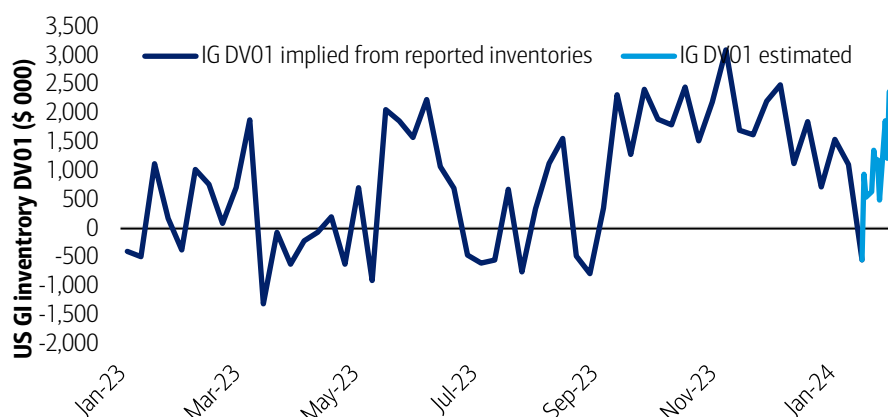
Source: BofA Global Research, FINRA, TRACE, Federal Reserve

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Exhibit 4: Estimated dealer inventory DV01 for IG corporate bonds.

We estimate IG dealer inventory DV01 of US issuer bonds increased to \$2.4mn currently from -\$0.5bn on Jan-17.



Note: data for US issuer bonds only, maturities 13M or longer. Actual dealer inventory data is from Primary Dealer Statistics survey by the NY Fed. The subsequent change in inventory is estimated based on TRACE.

Source: BofA Global Research, FINRA, TRACE, Federal Reserve

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Exhibit 5: Estimated changes in IG dealer inventories by maturity and broad sector.

We estimate IG dealer inventories increased \$1,635mn today and increased \$2,162mn over the prior week.

Sector	Net dealer buy (\$mn)					Net dealer DV01 change (\$thousand)					Trading volumes on 31-Jan-24 (\$mn)			
	31-Jan	30-Jan	1 W	2 W	4 W	31-Jan	30-Jan	1 W	2 W	4 W	Buy	Sell	Dealer	Total
High grade (13M+)	1,635	-1,255	2,162	2,054	10,931	1,257	-806	1,627	3,321	7,716	20,822	19,188	10,142	50,152
<3yr	532	-118	1,415	807	-223	87	-22	199	116	-72	3,320	2,787	1,478	7,584
3-5yr	342	-195	232	-998	1,951	146	-29	171	-290	792	3,992	3,649	2,419	10,060
5-11yr	71	-910	-1,390	-1,776	6,595	101	-680	-957	-1,234	4,005	7,690	7,619	3,720	19,029
11+yr	689	-31	1,905	4,021	2,609	923	-75	2,215	4,729	2,991	5,821	5,133	2,525	13,479
Fin	505	-1,113	127	-1,737	1,155	309	-508	484	335	1,509	9,108	8,603	3,970	21,681
Non-Fin	1,130	-142	2,034	3,791	9,776	948	-298	1,143	2,986	6,207	11,714	10,584	6,172	28,471
Fixed	1,618	-1,233	2,249	2,314	11,446	1,246	-801	1,625	3,296	7,705	20,634	19,016	10,028	49,679
Floating	17	-21	-87	-260	-515	11	-5	2	25	11	188	171	114	473
US issuers	1,375	-952	1,467	1,967	8,701	1,154	-648	1,260	2,902	5,894	16,712	15,337	8,419	40,468
DM Yankees	234	-260	610	-160	1,790	96	-130	282	241	1,505	3,605	3,371	1,474	8,450
EM Yankees	26	-42	85	248	440	8	-28	85	177	317	506	480	249	1,234

Note: data for maturities 13M or longer. Changes in inventories are estimated based on TRACE.

Source: BofA Global Research, FINRA, TRACE.

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Exhibit 6: Estimated changes in IG dealer inventories by sector.

We estimate today IG dealer inventories increased \$412mn for Banks/Brokers and increased \$89mn for Energy.

Sector	Net dealer buy (\$mn)					Net dealer DV01 change (\$thousand)					Trading volumes on 31-Jan-24 (\$mn)			
	31-Jan	30-Jan	1 W	2 W	4 W	31-Jan	30-Jan	1 W	2 W	4 W	Buy	Sell	Dealer	Total
Aerospace/Defense	-5	49	387	440	183	-77	45	324	350	40	498	503	346	1,347
Automobiles	-73	-37	-17	1	39	-52	-37	-110	-43	17	531	603	357	1,491
Banks/Brokers	412	-1,277	-219	-2,686	-1,418	268	-674	40	-371	148	6,830	6,418	2,716	15,965
Basic Materials	17	49	314	712	1,317	5	42	237	564	954	536	519	379	1,434
Commercial Services	-36	33	-24	10	-72	4	42	30	58	-27	130	166	95	391
Energy	89	128	-107	-117	-4	41	173	-110	26	-26	1,369	1,279	663	3,311
Finance	201	-28	240	449	1,019	111	-47	193	306	581	1,445	1,244	776	3,465
Food, Bev, & Bottling	-24	-147	-78	-199	207	-5	-141	-158	-143	211	532	556	349	1,437
Health Care	59	-105	305	1,019	1,731	113	-182	154	647	848	1,733	1,674	1,056	4,464
Industrial Products	-73	-27	203	56	377	-44	17	165	154	382	377	450	211	1,038
Insurance	-71	158	210	197	166	-52	161	279	290	152	416	487	233	1,136
Media & Entertainment	154	-195	-98	291	584	121	-200	-114	270	432	816	662	404	1,881
REITs	-38	34	-104	303	1,388	-17	52	-28	111	628	416	455	245	1,116
Retail	20	69	164	334	812	63	36	159	327	681	505	485	333	1,324

Exhibit 6: Estimated changes in IG dealer inventories by sector.

We estimate today IG dealer inventories increased \$412mn for Banks/Brokers and increased \$89mn for Energy.

	Net dealer buy (\$mn)					Net dealer DV01 change (\$thousand)					Trading volumes on 31-Jan-24 (\$mn)			
Technology	363	8	478	952	1,775	268	58	458	733	1,113	1,300	938	566	2,804
Telecom	176	-119	-160	-317	535	107	-139	-254	-268	152	899	722	288	1,909
Tobacco	-14	8	-31	-119	209	0	18	14	-18	212	132	147	103	382
Transportation	28	3	70	39	107	38	-20	35	-29	32	267	238	175	680
Utilities	475	93	543	518	1,469	382	-25	281	268	904	1,927	1,451	723	4,101
Other	-27	48	85	169	507	-15	14	32	87	284	162	189	124	475

Note: data for maturities 13M or longer. Changes in inventories are estimated based on TRACE.

Source: BofA Global Research, FINRA, TRACE.

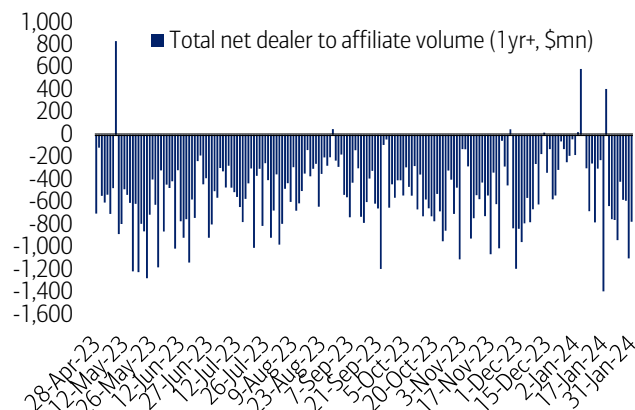
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Daily foreign demand tracker

We believe net dealer-to-affiliate volumes from Trace are correlated with foreign buying of US HG corporate bonds - i.e., negative numbers mean foreign investor buying (US dealers taking down inventory in favor of foreign affiliates). For supporting material see our “primer” on tracking foreign inflows. Exhibit 7 shows the overall daily dealer-to-affiliate volumes while Exhibit 8, Exhibit 9 and Exhibit 10 show subsets of this data. In particular Exhibit 8 shows net dealer-to-affiliate volumes for longer maturity (12+ years) bonds, Exhibit 9 displays volumes reported to Trace before 8am NY time (biased toward Asian buying) and Exhibit 10 shows the subset of net trades reported between 8am and noon (biased toward European buying).

Exhibit 7: Net dealer buying from affiliate (1yr+)

Exhibit shows inconsistent overall foreign buying of US IG corporate bonds for some time.



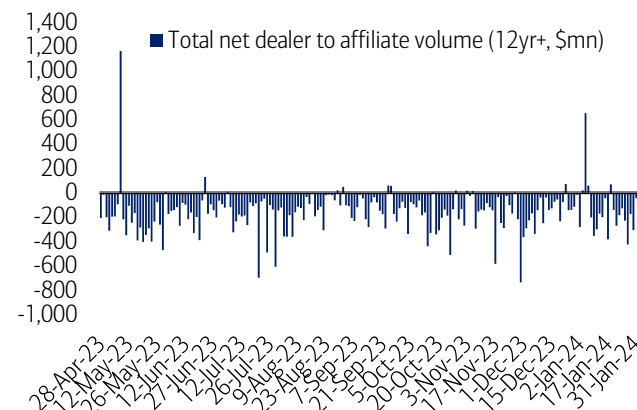
Note: Net dealer-to-affiliate volumes are correlated with foreign buying/selling. Negative numbers indicate foreign buying.

Source: Bloomberg, TRACE

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Exhibit 8: Net dealer buying from affiliate (12yr+)

Foreign buying of longer maturity US IG corporate bonds has been consistent this year



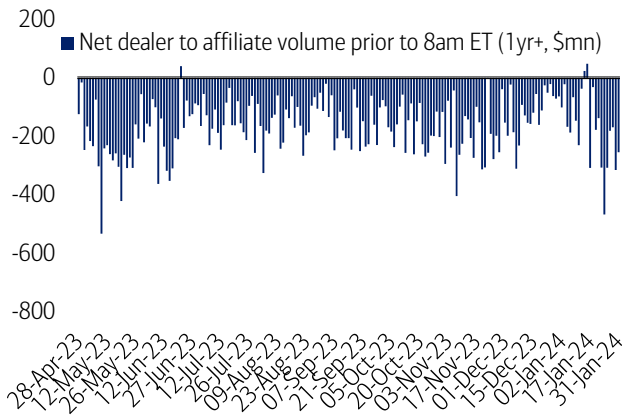
Note: Net dealer-to-affiliate volumes are correlated with foreign buying/selling. Negative numbers indicate foreign buying.

Source: Bloomberg, TRACE

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Exhibit 9: Net dealer-to-affiliate trading volumes before 8am ET

Foreign buying before 8am NY time is dominated by Asia and has been consistent this year



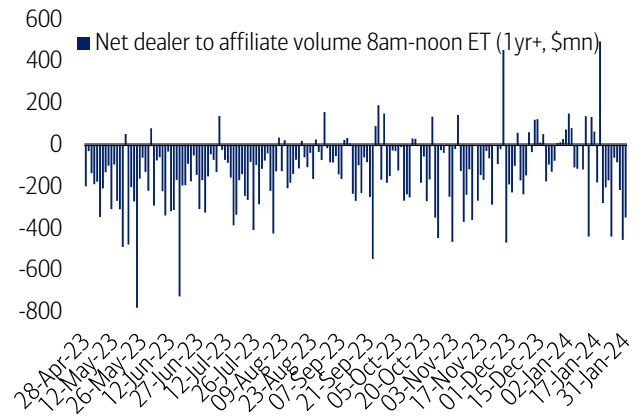
Note: Morning share of daily trading volume is correlated with secondary market activity of foreign investors due to different time zones.

Source: BofA Global Research, TRACE

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Exhibit 10: Net dealer-to-affiliate trading volumes 8am - noon ET

Foreign buying 8am-noon NY time is dominated by Europe and has been inconsistent this year



Note: Morning share of daily trading volume is correlated with secondary market activity of foreign investors due to different time zones.

Source: BofA Global Research, TRACE

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Common abbreviations:

IG: Investment Grade
 HG: High Grade
 LQD: iShares iBoxx \$ Investment Grade Corporate Bond ETF
 DV01: Dollar value of a basis point
 CDX IG: The Markit CDX North America Investment Grade Index
 CDX HY: Markit CDX North America High Yield Index
 ECB: European Central Bank
 QE: Quantitative Easing
 CSPP: corporate sector purchase programme
 Unchd: Unchanged
 CPI: Consumer Price Index
 FOMC: The Federal Open Market Committee

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