High Yield Strategy | Global
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How low can we go?

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The lower bound on spreads

With our view established that the Fed has pushed the credit cycle out several years to late 2016/early 2017, we have been asked over the last several weeks a natural follow-on question: how low can spreads go this cycle? Our answer? Theoretically as low as 200bp, though more likely not much further below 300bp.

What's the market thinking?

We have maintained over the last several weeks that as tapering expectations are pushed further into next year, the market is setting itself up for a surprise if the Fed were to reduce purchases beginning in January, as our economists believe, or in March, as is currently market consensus. This week our economists discuss just this issue, highlighting five exaggerated stories about the Fed exit.

Flows: Muted flows

Flows across most asset classes were pale compared to last week. US HY fund flows, while still positive, were +$730mn this week vs. the +2.3bn last week, while funds domiciled outside the US also slowed down, adding +880mn.

Issuance: Solid end to October

Global developed market issuance this week was better than last week as 16 deals for a total of $8.7bn came to market. $7.7bn came from the US, while $1.0bn came from Europe.

Performance

On a weekly basis, about half of our asset classes gained, including US HY (+0.25%), EU HY (+0.39%), and Munis (+0.26%). However, this week's performance was led by EM equities, which gained 0.70%, bringing monthly returns to 4.76%. US equities declined 0.18% and US IG lost 0.05%.

Fundamentals: BYD: Boo! 3Q Miss; Maintain Ratings

James Kayler (Gaming and Lodging) published an earnings report today on Boyd Gaming today maintaining his OW-30% rating on the Boyd 8.375% senior notes (issued at its Peninsula Gaming subsidiary) and his UW-30% rating on Boyd's restricted group notes. Additionally, Matt Fields (Metals and Mining) published his first weekly, noting earnings reports on ten names. In the report he discusses index and sector performance, bond relative value, and relevant commodity data.

CLOs: The impact of Energy Future

In a new recurring section beginning this week we include the key points to our CLO strategist's (Ryan Asato) weekly publication. This week's key topic: TXU's impact to the CLO market. TXU's loans are held in 229 outstanding deals. Despite the breadth of holdings in CLOs, however, we expect the impact of any restructuring to be minimal for most deals as the weighted average exposure across deals with exposure is 1.6% - with many having concentrations of less than 1%.

What we're reading

Relative Value Strategist: The turning tides of taper talk 01 November 2013

High Yield Strategy: HY Credit Chartbook 01 November 2013

Boyd Gaming: Boo! 3Q Miss; Maintain Ratings 01 November 2013

High Yield Metals & Mining Weekly: High Yield Metals & Mining Weekly Market Update 01 November 2013

CLO Weekly: The Impact of Energy Future on CLOs 01 November 2013

Refer to important disclosures on page 15 to 17. Analyst Certification on Page 14. Link to Definitions on page 14. COAS Certification on page 14. 11327817

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The view from above

What is the market thinking?

Over the last several weeks we have discussed our findings that investors have begun to dangerously push their tapering expectations too far into 2014. We have maintained that as expectations are pushed further, the market is setting itself up for a surprise if the Fed were to reduce purchases beginning in January, as our economists believe, or in March, as is currently market consensus. In our view, the weakness following this week's FOMC meeting is a testament to our belief that the markets are getting a bit ahead of themselves. Despite marginal changes to the Fed's language, we think the mere fact that there wasn't additional dovish rhetoric has caused a bit of weakness in the back half of this week. We maintain our cautious outlook headed into the new year, despite market technicals - positive flows, light issuance - that favor a long position over the last two months.

Our economists wrote about the aforementioned shift of market sentiment in last week's US Economics Weekly, in particular writing about the "endless array of exaggerated stories about the Fed exit." The five key arguments that they contest include: Janet Yellen is a super dove and will delay pulling the trigger as long as possible; The Fed missed a great "opportunity" to taper; The Fed now knows it can't exit without crushing the markets; The Fed cannot taper until the fiscal outlook is clear and that could take years; and The economy is on Fed life support and will never be able to stand on its own. Their bottom line continues to be that the Fed call has been and will be about the economy. We agree.

In other relevant news, late last week Priya Misra, our rates strategist, recommended clients scale into shorts in the 5y-10y part of the curve. She notes that negative economic news is already baked in and treasuries consequently seem priced to perfection. Additionally, she notes that political risk may be more muted than investors are giving credit for while the risk of higher vol will make carry in the belly of the curve unattractive. Given the high yield market's relentless grind tighter (not withstanding some recent malaise), we believe if Priya is right and volatility increases while rates widen, we could see some pressure in spreads.

Weekly Recap

As of Halloween 2013, 135 high yield companies have reported earnings (about 1/3 of all firms). On a year-over-year basis, EBITDA is up 8% while debt is up nearly 10%. On a quarter-over-quarter basis, revenue growth remains depressed at just 0.9% while EBITDA growth is coming in at 8.5% (Table 1). Since last Thursday, high yield spreads tightened 4bp from 440bp to 436bp while 5y rates increased 5bp from 1.28% to 1.33%. Index constituent changes associated with month-end rebalancing contributed to 7bp of spread tightening, however, so in reality, the tightening on the index was not due to a market move. It was a muted week in flows as US HY funds added $730mn. On a par weighted basis, 66% of our HY index is now trading inside a yield of 6%, down marginally from 67% last week but up from 54% back on September 30th. Issuance caught up to last year's record pace as $7.7bn came to market this week in the US. At the single name level, TXU made its November 1st $270mn interest payment after restructuring talks faltered while EM's OGX Petroleo filed for bankruptcy- the largest EM default on external bond debt. Anne Milne, Head of EM research and Chris Hays, our EM strategist note that in 2013, EM default rates will surpass developed markets for the first time since 2004 (report in sidebar).

Table 1: HY Q3 earnings: 135 companies

YOY Pct Change				QOQ Pct Change			
EBITDA	Debt	Rev	COGS	EBITDA	Debt	Rev	COGS
8.0	9.6	3.7	3.9	8.5	4.3	0.9	0.0

Source: BofA Merrill Lynch Global Research

Global Emerging Markets Credit Research: Default rate rising amongst Latin American corporates 30 October 2013

The HY Wire: Pushing out the default cycle 21 October 2013

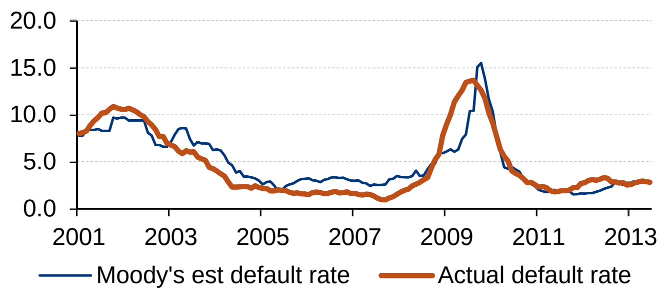
The lower bound on spread

With our view established that the Fed has pushed the credit cycle out several years to late 2016/early 2017 (see October 21 "The HY Wire" in the sidebar), we have been asked over the last several weeks a natural follow-on question: how low can spreads go this cycle? This week we discuss a framework to answer this question. Using both realized and past expected credit losses for the HY market we estimate the minimum premium that investors demand to compensate for defaults. In addition, we overlay historical precedent with our qualitative judgment based on recent experience. When relying solely on past default premiums our analysis suggests that spreads could tighten to as low as 200bp. However, when factoring in the severity of the last default wave, and an increased liquidity premium due to regulations, we think 250bp-300bp presents a more realistic lower bound.

Default expectations versus reality

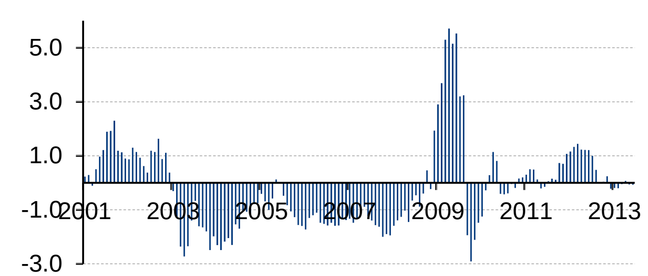
In order to quantify a lower bound to spreads, we look at the excess spread investors demand over the next twelve months' credit losses. Because we don't know what the future default rate will be, in an ideal world we would run our analysis using the market's expectations for default rates in one year. In this way, we could see exactly how much the market demands in excess of expected future credit losses. Unfortunately, we only have expected default rates (as provided by Moody's) dating back to 2001. Chart 1 shows the Moody's estimated twelve month default rate against the realized default rate while Chart 2 shows the difference between the actual and estimated. Note that in the midst of the last two default cycles, Moody's underestimated the default rate by 1 percentage point on average in the early part of the decade and by about 4 percentage points during the heart of the last crisis. In contrast to these periods, Moody's overestimated the default rate in the periods between default cycles. Since the crisis, Moody's default rate estimates were too low in 2012 while very much in-line with the realized rate in 2010, 2011 and 2013.

Chart 1: Moody's estimated 12m default rate versus actual 12m default rate



Source: BofA Merrill Lynch Global Research, Moody's

Chart 2: In between default cycles, Moody's default estimates are too high, while during default cycles, estimates are too low

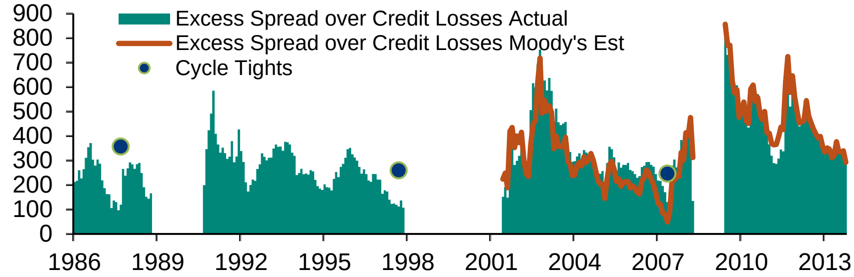


Source: BofA Merrill Lynch Global Research, Moody's

Excess spread to actual next twelve month credit losses

Assuming perfectly efficient markets, investors should be willing to take on one year credit risk if they are compensated with a return in excess of the next twelve months' worth of losses. In an ideal world, we would have a long-term history of market default expectations, however, given our limited dataset, we must combine both actual and expected data over time and draw a conclusion using both. Our analysis shows that over the last three credit cycles, the market has demanded on average 120bp of spread over the next twelve months of realized credit losses (Chart 3), when the market was at its tights. Additionally, we see that the cycle tights tend to be reached 1-2 years prior to when defaults pick up meaningfully. Assuming our late 2016 estimate of a turn in the credit cycle is accurate, we would expect spreads to collapse further through 2014 and into 2015 before reaching their tights some time before 2016. This is consistent with our base-case view that 5y rates should rise in 2014 and spreads should react with a negative spread beta. The risk to such a scenario, and what concerns us, is a turn in the economy that would suggest QE has not worked. If liquidity is pulled and earnings and economic growth begin to contract, we would expect the default cycle to be pulled forward significantly and the theoretical tights discussed in this analysis to never be breached. Although our base case is for growth and tighter spreads over time, this fear is certainly the worst case outcome that would change our tune.

Chart 3: Excess spread and cycle tights, 1986-present



Source: BofA Merrill Lynch Global Research

Excess spread to estimated next twelve month credit losses

If we quantify the excess spread investors demand over expected credit losses, we see a significant difference than what is presented using actual data. For example, on May 31st 2007 our High Yield Index (H0A0) traded at 246bp (OAS) and the excess spread over expected credit losses was just 49bp (in contrast to the 120bp using realized default rates). This reflects the market's higher expectation for credit losses than what was ultimately realized (3.4% estimated versus 2.0% realized). Today the market is pricing in 293bp over anticipated next twelve month credit losses, a premium very much in line with what the market was demanding in May 2005 (296bp), 2 years prior to that cycle's tights. As mentioned above, if our turn in the credit cycle analysis proves correct, we would expect cycle tights in about 2 years, so the similarities are worth noting.

Another way to think about the analysis is to consider that if the market were to instantaneously price in the same amount of excess spread (49bp) as during the tights of the last cycle, while keeping spread where it is today, default expectations would have to adjust from the current 2.8% to 7.2%. Or, with current default expectations, spreads would need to collapse from the current level of 445bp to 200bp, thereby establishing our view of a lower bound to spreads.

Table 2: Excess spread over next 12 months credit losses (actual and estimated)

Date	Sprd (bp)	NTM est default rate	Act 12M default rate	NTM Credit Losses Est (bp)	NTM Credit Losses Actual (bp)	Excess Spread over Credit Losses Est (bp)	Excess Spread over Credit Losses Actual (bp)
30-Sep-87	357	--	4.1	--	237	--	120
30-Sep-97	259	--	2.6	--	147	--	112
31-May-07	246	3.4	2.0	197	116	49	130
31-Oct-13	445	2.8		152		293	
Average*	287						120

Source: BofA Merrill Lynch Global Research
*Excludes 31-Oct-2013 data

Actual, estimated and new spread premiums

Though theoretically 200bp seems to be the lower bound on spreads for this cycle using our excess spread over expected next twelve month credit loss analysis, we believe in-reality spreads will likely end up closer to 250bp-300bp than 200bp. Using the average excess spread over actual credit losses, we see that 120bp would imply a lower bound on spreads of 272bp (assuming the Moody's expected default rate is realized), very close to the three-cycle average tight of 287bp. Additionally, we believe two factors need to be considered for this cycle that weren't as much of a consideration in prior cycles.

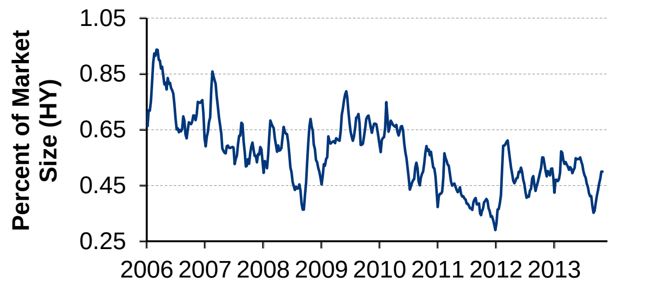
Chart 4: Bid/Ask in BBs vs. BBBs

Source: BofA Merrill Lynch Global Research

Liquidity Premium

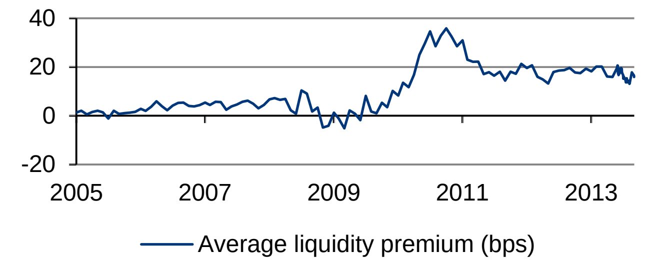
Today we see a higher liquidity premium built into the market that will limit how tight spreads can go relative to past cycles. Chart 5 shows that high yield trading volumes have fallen since 2006 while Chart 6 highlights the jump in off-the-run versus on-the-run spreads in investment grade credits since pre-crisis. Though we don't have good "liquidity premium" data prior to 2011 in high yield, anecdotally we would expect a similar pattern to emerge. In fact, ever since the crisis, BB bid-ask spreads have risen significantly more than BBB bid-ask spreads (Chart 4), supporting our view that Chart 6 would look similar for high yield companies, if not more dramatic.

Chart 5: Trace HY trading volume has gone down since pre-crisis



Source: BofA Merrill Lynch Global Research

Chart 6: Average high grade liquidity premium

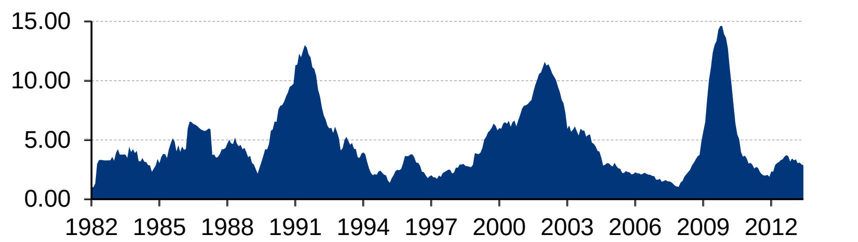


Source: BofA Merrill Lynch Global Research

Crisis Premium

Although not entirely quantifiable, we believe the severity and type of the last credit crisis will ultimately limit investor comfort with 200bp spread levels. Certainly every day we move past the last default cycle is yet another day the crisis falls further into the rearview mirror. However, given the sharp spike in defaults in 2009, the fact that the crisis was led by a near global collapse of the banking system that claimed the largest bankruptcy in US history (Lehman of course) we believe the memory of the last cycle will linger through this next wave.

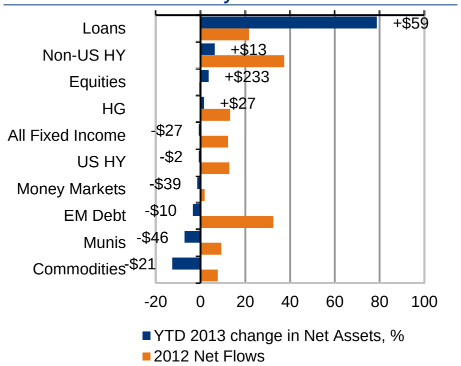
Chart 7: The 2009 default cycle was fast and furious, creating a "permanent" spread premium



Source: BofA Merrill Lynch Global Research

This is an excerpt from last night: [The High Yield Flow Report: Muted Flows 31 October 2013]

Chart 8: Annual flows by asset class



Source: BofA Merrill Lynch Global Research, EPFR

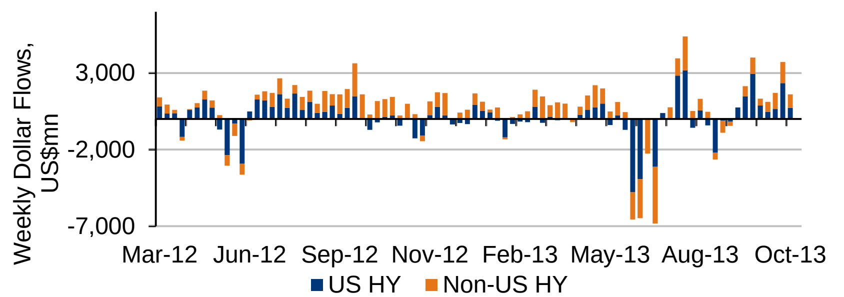
Flows

Flows across most asset classes were pale compared to last week. Of course the comparison is a tad unfair to begin with as last week's rebound was a result of the September payrolls number which returned investors back to a goldilocks scenario for credit.

US HY fund flows, while still positive, were +$730mn this week vs. the +2.3bn last week, while funds domiciled outside the US also slowed down, adding +880mn. Within US HY, flows were evenly split between ETF and non-ETF funds. EM funds continued down their negative trajectory, reporting a softer outflow of -$600mn compared to the -$1.6bn outflow last week. Loan funds, which have been recently witnessing decelerating inflows, came in at +$670mn.

Exceptions to the muted theme of this week were US Equity funds, which recorded a sizable +$10bn inflow, while US IG funds reported a meaningful -$2.6bn outflow. However, the outflow was driven by just one intermediate term fund and represents ~11% of its AUM, which leads us to suspect certain abnormalities with the report. Discounting the contribution from this one fund, the asset class remained net flat for the week.

Chart 9: Global HY flows distributed between US-domiciled and non US-domiciled funds



Source: BofA Merrill Lynch Global Research, EPFR

New Issue Round Up

Global developed market issuance this week was better than last week as 16 deals for a total of $8.7bn came to market. $7.7bn came from the US, as year-to-date issuance is now back in line with 2012's record pace, while $1.0bn came from Europe. A sizable portion of this week's volume can be attributed to a moderately large 2-tranche Kinder Morgan offering, which contributed $1.5bn to total supply. Of the $8.7bn issued this week, $2.3bn is rated BB, $3.2bn is B, and the remaining $3.2bn is CCC or not rated. Month-to-date, we have seen a total of $34.0bn come to market in October, while year-to-date we now stand at $331.5bn. For comparison, last year at this time we saw only $306.5bn of global issuance year-to-date.

Table 3: Global issuance over time

	Global	United States	Europe	BB	B	CCC/NR
WTD Nov 01	8.7	7.7	1.0	2.3	3.2	3.2
Wk Oct 25	7.7	6.0	1.7	2.9	3.7	1.2
Wk Oct 18	6.2	4.2	1.7	1.5	2.9	1.8
Wk Oct 11	10.1	7.7	2.1	7.8	1.3	1.0
MTD Oct	34.0	26.4	6.5	15.0	11.9	7.1
September	49.4	43.1	4.5	17.7	21.3	10.4
August	14.0	12.3	1.6	3.8	4.2	6.0
July	29.4	18.4	10.5	6.2	17.5	5.7

Table 3: Global issuance over time

	Global	United States	Europe	BB	B	CCC/NR
YTD 2013	331.5	235.8	81.3	116.4	148.7	66.3
YTD 2012	306.5	235.7	55.7	89.0	159.1	58.4
2012	365.7	280.5	65.5	103.6	195.5	66.6
2011	257.4	189.3	57.2	80.4	131.9	45.1
2010	303.7	227.5	58.9	80.1	177.7	46.0

Source: BofA Merrill Lynch Global Research

A further analysis shows that about 37% of new issues were rated B, while only 26% were BB. The remaining 36% attained either a CCC rating or was not rated. This trend is similar to last two weeks as B-rated bonds made up the largest portion of new issues. However, earlier in the year, we saw quite a bit more issuance from the BB segment. In terms of seniority, most issues were Secured this week (about 50%), while 40% were Senior Unsecured, and 10% were Subordinated. This is inconsistent with recent history as we've generally seen more Unsecured issuance relative to Secured. Finally, all of this week's deals were private offerings. This is a bit of a reversal as recent weeks have seen a lot more private placement issuance.

Table 4: New issue breakdown by week, last 6 months

		Ratings				Currency (US$mn equivalents)				Seniority			Deal Type		
	Total	BB	B	CCC	NR	USD	EUR	GBP	CAD	Secured	Senior	Sub	144a w RR	144a w/o RR	Public
07/12/2013	5,504	1,359	3,131	662	352	1,530	3,292	682		3,043	2,461		855	2,252	2,397
07/19/2013	7,412	500	6,752	160		6,135	1,049	228		3,537	3,875		225	5,062	2,125
07/26/2013	9,578	2,516	3,414	3,647		6,210	2,832	536		3,522	6,056		3,033	5,766	779
08/02/2013	8,661	1,800	5,261	1,600		7,865	796			1,930	6,732		4,130	3,082	1,450
08/09/2013	7,479	2,044	1,055	4,380		7,285			194	130	7,349		1,555	4,780	1,144
08/16/2013	4,690	1,750	2,080	860		4,690				415	4,275		2,200	1,240	1,250
09/06/2013	7,950	700	7,250			7,950					7,950		6,800		1,150
09/13/2013	14,102	5,750	4,010	4,342		13,692		323	87	2,673	10,429	1,000	8,237	3,923	1,942
09/20/2013	10,265	650	5,212	3,903	500	8,800	338	835	292	2,246	8,019		4,104	6,161	
09/27/2013	17,066	10,570	4,832	1,665		16,460	606			4,695	12,371		10,375	6,197	495
10/04/2013	1,285	500	785			1,285				360	925		500	785	
10/11/2013	10,096	7,812	1,273	985	25	8,823	1,272			350	9,746		2,879	575	6,641
10/18/2013	6,174	1,518	2,890	1,765		4,185	1,056	665	267	1,920	4,253		1,817	3,360	997
10/25/2013	7,749	2,850	3,706	1,193		6,365	573	811		1,631	6,118		5,636	1,637	476
11/01/2013	8,693	2,300	3,227	2,605	561	7,725	407	561		4,309	3,385	1,000	2,440	6,253	

Source: BofA Merrill Lynch Global Research

At the single name level the most notable deal this week was a secured 2-tranche offering from Kinder Morgan worth $1.5bn. Each were issued in equal amounts of $750mn, though the notes that mature in 2021 pay a 5% coupon and the notes that mature in 2023 pay a 5.625% coupon. Proceeds will be used to repay borrowings from a revolving line of credit. Other large deals this week include the $1bn offering from First Data Corp and the $800mn from Seagate HDD Cayman.

Table 5: New Issues October 25th – October 31st

Pricing Dt	Name	Size ($)	Snr	Cpn	Maturity	Price	Yld	Moody's	S&P	Type	Sector	Region
10/31/2013	NH Hoteles SA	339	Sr Sec Nts	6.88	15-Nov-19	100.00	6.88	0	B	144A for Life	Lodging	Europe
10/31/2013	AA PIK Co. Ltd	561	Sr Nts	9.50	7-Nov-19	100.00	9.50	NR	NR	144A for Life	Holding Cos-Divers	Europe
10/31/2013	Vantage Oncology	50	Sr Sec Nts	9.50	15-Jun-17	100.00	9.50	B2	B	144A for Life	Healthcare-Services	United States
10/31/2013	Seagate HDD Cayman	800	Sr Nts	3.75	15-Nov-18	100.00	3.75	Ba1	BBB-	144a w/RR	Computers	United States
10/31/2013	Kinder Morgan Inc	750	Sr Sec Nts	5.63	15-Nov-23	100.00	5.63	Ba2	BB	144A for Life	Pipelines	United States
10/31/2013	Kinder Morgan Inc	750	Sr Sec Nts	5.00	15-Feb-21	100.00	5.00	Ba2	BB	144A for Life	Pipelines	United States
10/31/2013	Capsugel SA	465	Sr Nts	7.00	15-May-19	100.00	7.00	Caa1	B-	144A for Life	Pharmaceuticals	United States
10/30/2013	Abengoa Finance Sau	69	Sr Nts	8.88	5-Feb-18	105.25	7.41	B2	B	144A for Life	Engineering&Construct	Europe
10/30/2013	Level 3 Financing Inc.	640	Sr Nts	6.13	15-Jan-21	100.00	6.13	B3	CCC+	144a w/RR	Telecommunications	United States
10/30/2013	First Data Corporation	1000	Sr Sec Nts	11.75	15-Aug-21	100.00	11.75	Caa2	CCC+	144a w/RR	Software	United States

Table 5: New Issues October 25th – October 31st

Pricing Dt	Name	Size ($)	Snr	Cpn	Maturity	Price	Yld	Moody's	S&P	Type	Sector	Region
10/29/2013	Pittsburgh Glass Works LLC	360	Sr Sec Nts	8.00	15-Nov-18	100.00	8.00	B3	B	144A for Life	Auto Parts&Equipment	United States
10/29/2013	Navios Maritime Acquisition Corp	610	Sr Sec Nts	8.13	15-Nov-21	100.00	8.13	B3	B	144A for Life	Transportation	United States
10/29/2013	Calpine Corporation	490	Sr Sec Nts	5.88	15-Jan-24	100.00	5.88	B1	BB-	144A for Life	Electric	United States
10/28/2013	USG Corporation	350	Sr Nts	5.88	1-Nov-21	100.00	5.88	B2	BB-	144A for Life	Building Materials	United States
10/28/2013	Freescale Semiconductor Inc	960	Sr Sec Nts	6.00	15-Jan-22	100.00	6.00	B1	B	144A for Life	Semiconductors	United States
10/28/2013	Chinos Intermediate Hold A, Inc.	500	Sr Nts	7.75	1-May-19	100.00	7.75	Caa1	CCC+	144A for Life	Retail	United States
10/25/2013	Rhino Bondco	276	Sr Sec Nts	550.00	15-Dec-19	100.00	5.50	B2	B	SEC	Auto Parts&Equipment	Europe
10/25/2013	Rhino Bondco	297	Sr Sec Nts	7.25	15-Nov-20	100.00	7.25	B2	B	144A for Life	Auto Parts&Equipment	Europe
10/25/2013	Topaz Marine SA	350	Sr Nts	8.63	1-Nov-18	100.00	8.63	B3	B-	144A for Life	Transportation	Europe
10/25/2013	Dole Food Company	300	Sr Sec Nts	7.25	1-May-19	100.00	7.25	Caa1	CCC+	144A for Life	Food	United States

Source: BofA Merrill Lynch Global Research

Performance Summary

October ended on a strong note as cross-asset returns were all positive through the end of the month. However, on a weekly basis, about half of our asset classes gained, including US HY (+0.25%), EU HY (+0.39%), and Munis (+0.26%). This week's performance was led by EM equities, which gained 0.70%, bringing monthly returns to 4.76%. US equities declined 0.18% and US IG lost 0.05%. This biggest underperformer this week was TIPs, which declined 0.32%.

Rating performance was concentrated in CCCs (+0.30%), Bs (+0.24%), and BBs (+0.24%) while investment grade rating segments continued to lag (Chart 10). In fact, AAAs were the biggest underperformer, declining -0.17% during the week.

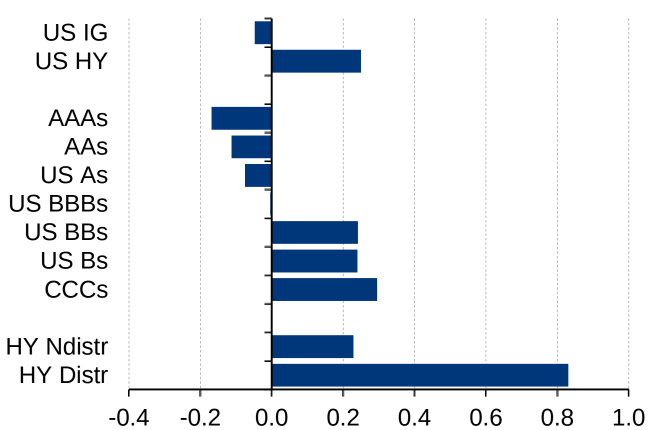
On sectors, performance looked very positive with all 18 of our high yield sectors gaining on the week (Chart 11). Utilities led, adding 0.87%, followed by Gaming (+0.49%) and Retail (+0.43%), while Technology (+0.04%), Health Care (+0.05%), and Food (+0.06%) underperformed. This was quite the reversal for Technology, which was the best performing sector last week with a +0.80% return. However, Food and Health Care were the two biggest underperformers last week as well.

Table 6: Total returns across asset classes

Ticker	Name	WTD (%)	MTD (%)	YTD (%)
G0QI	TIPs	-0.32	0.63	-6.77
CDXHY	CDX.HY	-0.26	2.40	13.07
SPX	S&P 500	-0.18	4.49	23.16
EMGB	EM Govts	-0.16	2.48	-3.03
M0A0	Mortgages	-0.11	0.71	-0.23
C0A0	US IG	-0.05	1.50	-0.99
GA05	5yr TRSY	-0.04	0.58	-1.01
CDXIG	CDX.IG	-0.04	0.53	2.78
EMIB	EM IG	0.02	1.90	-1.21
LCDI/ALL	Lev Loans	0.10	0.73	4.28
H0A0	US HY	0.25	2.46	6.34
EMHB	EM HY	0.26	2.59	1.48
U0A0	Municipals	0.26	0.94	-2.34
HE00	EU HY	0.39	2.17	8.21
MXEF	EM Eqty	0.70	4.76	-2.02

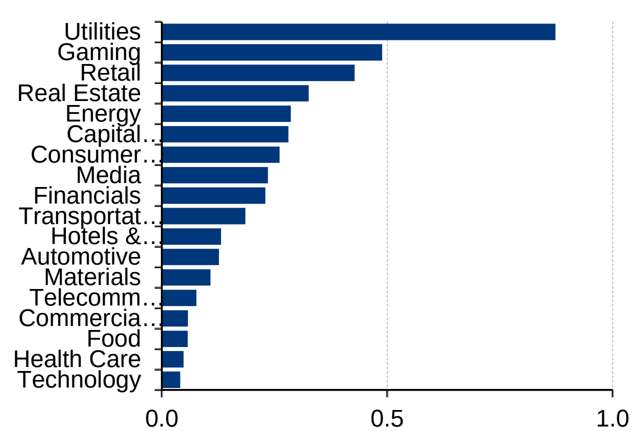
Source: BofA Merrill Lynch Global Research

Chart 10: Segment and rating returns, week-to-date



Source: BofA Merrill Lynch Global Research

Chart 11: Sector returns, week-to-date



Source: BofA Merrill Lynch Global Research

Top performers this week were dominated by Texas Competitive Electric Holdings Co LLC, which claimed the top three places on the list (Table 7), though coming off a very low base. The Texas power company, which is in the midst of efforts to restructure its roughly $44bn of debt, reported a quarterly profit of $5mn in the third quarter due to commodity hedging, the first profit the company has booked in more than two years. For comparison, TXU reported a $407mn loss one year earlier. The company made its $270mn interest payment due today, November 1st. The TXU '15s climbed 170.1% while the '21s gained 23.5%. Other top performers included JC Penney Co Inc, which saw its bonds add over 7%, and Caesars Entertainment Corp, which saw its bonds gain over 3%.

Table 7: Top 10 performers October 25th – October 31st

Issue	Rating	Price	Yield (%)	ZSpread	Px Change	Px Change (%)	Volume
TXU 10.25 '15	C	5.23	324.85	32424	3.3	170.1	31
TXU 10.25 '15	C	5.54	314.68	31409	3.3	143.9	52
TXU 15 '21	CC	30.01	53.13	5187	5.7	23.5	57
JCP 7.4 '37	CCC2	68.50	11.24	824	4.8	7.6	16
JCP 7.65 '16	CCC2	82.11	15.84	1520	5.6	7.3	18
CZR 10 '18	CC	50.20	29.40	2806	1.8	3.8	58
CZR 12.75 '18	CCC3	59.39	29.81	2870	1.8	3.0	9
FTR 9 '31	BB2	106.29	8.31	532	2.6	2.5	10
CCMO 11 '16	CC	96.89	0.00	1173	1.8	1.9	22
ETE 7.5 '20	BB2	115.45	4.85	290	2.1	1.8	7

Source: BofA Merrill Lynch Global Research

This week's biggest underperformers are led by NII Holdings Inc, which saw its '16s lose 11.9% and its '21s lost 11.2% (Table 8). The company, which sells Nextel wireless communication service in Latin America, plummeted after announcing that it will miss its 2013 profit forecast by more than 30%. The company cited both weaker-than-expected results and currency depreciation as the cause. Besides NII, weak performers included the Momentive Performance Materials '16s (-2.9%) , the RadioShack Corp '19s (-2.8%), and the Hexion US Finance Corp '20s (-2.8%).

Table 8: Bottom 10 performers October 25th – October 31st

Issue	Rating	Price	Yield (%)	ZSpread	Px Change	Px Change (%)	Volume
NIHD 10 '16	CCC2	77.41	21.13	2050	-10.4	-11.9	79
NIHD 7.63 '21	CCC2	59.06	17.77	1582	-7.4	-11.2	58
MOMENT 11.5 '16	CC	76.61	22.42	2172	-2.3	-2.9	10
RSH 6.75 '19	CCC3	66.12	16.27	1473	-1.9	-2.8	4
HXN 9 '20	CCC1	95.66	9.87	796	-2.7	-2.8	27
XCO 7.5 '18	CCC1	96.87	8.29	694	-2.2	-2.2	9
NES 9.88 '18	B3	102.09	9.15	811	-1.5	-1.4	8
MOMENT 9 '21	CCC3	88.91	11.29	934	-1.1	-1.2	12
HXN 8.88 '18	CCC1	103.24	7.72	684	-1.3	-1.2	15
MOMENT 8.88 '20	B3	106.23	7.35	579	-1.2	-1.1	37

Source: BofA Merrill Lynch Global Research

Rating Actions

General Cable Corp was downgraded by Moody's during the past week as the company recently announced that it received bank lender approval to both extend and amend the waiver related to any default arising from the failure of General Cable to comply with its reporting requirements. Additionally, Moody's noted that the company is taking longer than anticipated to file its financial statements, a situation that it already indicated could result in a ratings downgrade. Another notable downgrade this week was BJ's Wholesale Club Inc, which S&P lowered from a B to a B-. S&P indicated that the downgrade was a result of the retailer upsizing its existing bank facilities and using borrowings to pay a $450mn dividend to its shareholders.

In addition to downgrades, there were several ratings upgrades this week as well. CommScope Holding Co Inc, the direct parent of telecom infrastructure provider

CommScope Inc, was upgraded from B+ to BB- by S&P as a direct result of its IPO, in which the company received $437mn in net proceeds. Of this, $399mn is being used to repay a portion of the principal outstanding of its $1.5bn 8.25% senior notes, which are due to mature in 2019. Finally, its worth highlighting Levi Strauss Corp, which was also upgraded from B+ to BB- by S&P. The rating reflects the agency's expectation that Levi's operating performance and cash flow generation will remain steady due to stable performance and cotton prices.

Table 9: Rating actions on HY issuers

Date	Action	Company Name	Rating Type	Agency	Curr Rtg	Last Rtg
10/31/2013	Downgraded	General Cable Corp	Senior Unsecured	Moody's	B2 *-	B1
10/31/2013	Downgraded	General Cable Corp	Subordinated	Moody's	B3 *-	B2
10/31/2013	Downgraded	Getty Images Inc	Senior Unsecured	Moody's	Caa2	Caa1 *-
10/31/2013	Downgraded	AM Castle & Co	LT Local	S&P	B-	B
10/31/2013	Downgraded	BJ's Wholesale Club Inc	LT Local	S&P	B-	B
10/30/2013	Downgraded	Brock Holdings II Inc	LT Local	S&P	B	B+
10/30/2013	Downgraded	Brock Holdings III Inc	LT Local	S&P	B	B+
10/30/2013	Downgraded	Tube City IMS Corp	LT Local	S&P	B+	BB- *
10/28/2013	Downgraded	Pittsburgh Glass Works LLC	LT Local	S&P	B	B+
10/25/2013	Downgraded	Shale-Inland Holdings LLC	LT Local	S&P	B-	B
11/1/2013	Initiated	Golden Nugget Escrow Inc	Senior Unsecured	Moody's	Caa1	
11/1/2013	Initiated	United Continental Holdings Inc	Senior Unsecured	Moody's	B2	
11/1/2013	Initiated	Crosby Worldwide Ltd	LT Local	S&P	B	
11/1/2013	Initiated	MCS AMS Sub-Holdings LLC	LT Local	S&P	B	
10/31/2013	Initiated	Medical Specialties Distributors LLC	Senior Secured	Moody's	B3	
10/30/2013	Initiated	ARG IH Corp	LT Local	S&P	B	
10/30/2013	Initiated	CWGS Enterprises LLC	LT Local	S&P	B	
10/28/2013	Initiated	Chinos Intermediate Holdings A Inc	Senior Unsecured	Moody's	Caa1	
10/28/2013	Initiated	OCI Beaumont LLC	LT Local	S&P	B-	
10/25/2013	Initiated	Digital Insight Corp	LT Local	S&P	B	
10/25/2013	Initiated	TGGT Holdings LLC	LT Local	S&P	B	
11/1/2013	Upgraded	Levi Strauss & Co	LT Local	S&P	BB-	B+
10/31/2013	Upgraded	CommScope Holding Co Inc	LT Local	S&P	BB-	B+
10/31/2013	Upgraded	CommScope Inc	LT Local	S&P	BB-	B+
10/30/2013	Upgraded	Dell Inc	Senior Unsecured	Moody's	B1	Baa1 *-
10/30/2013	Upgraded	Deluxe Corp	LT Local	S&P	BB	BB-
10/30/2013	Upgraded	Transnet SOC Ltd	Senior Unsecured	Fitch	BBB	BB+
10/29/2013	Upgraded	Sanmina Corp	LT Local	S&P	BB-	B+
10/29/2013	Upgraded	USi Inc	LT Local	S&P	B	B-
10/28/2013	Upgraded	CommScope Holding Co Inc	Senior Unsecured	Moody's	B3	Caa1
10/28/2013	Upgraded	CommScope Inc	Senior Unsecured	Moody's	B2	B3
10/28/2013	Upgraded	Golden Nugget Inc	LT Local	S&P	B	B-
10/25/2013	Upgraded	CACI International Inc	LT Local	S&P	BB+	NR
10/25/2013	Upgraded	Spirit Realty Capital Inc	LT Local	S&P	BB-	B *+

Source: BofA Merrill Lynch Global Research

Fundamental Monitor

Boo! 3Q Miss; Maintain Ratings

Boyd Gaming: Boo! 3Q Miss; Maintain Ratings 01 November 2013

James Kayler (Gaming and Lodging) published an earnings report on Boyd Gaming today maintaining his OW-30% rating on the Boyd 8.375% senior notes (issued at its Peninsula Gaming subsidiary) and his UW-30% rating on Boyd's restricted group notes. Offered at a YTW of 4.5% Boyd's (Peninsula) 8.375% notes seem like reasonable yield to call paper to the 8/15/14 call, James notes.

He also discusses his preference for other diversified gaming bonds such as Pinnacle's 6.375% senior notes offered at a YTW of 5.1% or Station Casinos 7.5% senior notes offered at a YTW of 5.8% over Boyd's 9.0% and 9.125% senior notes offered at YTW's of 6.8% and 4.2%, respectively, given better trends and more credit momentum at those issuers. The full report can be found in the sidebar.

High Yield Metals and Mining Weekly

High Yield Metals & Mining Weekly: High Yield Metals & Mining Weekly Market Update 01 November 2013

Matt Fields (Metals and Mining), published his first weekly market update last week, noting earnings for a number of metals and mining companies. In the report he discusses index and sector performance, bond relative value, and relevant commodity data. Matt discusses ten names, specifically: SunCoke Energy, US Steel, Arch Coal, Consol Energy, Cloud Peak Energy, Noranda Aluminum, Walter Energy, Taseko Mines, First Quantum Minerals and Alpha Natural Resources. The full report can be accessed via the link in the sidebar.

Relative Value

Cash v. CDS

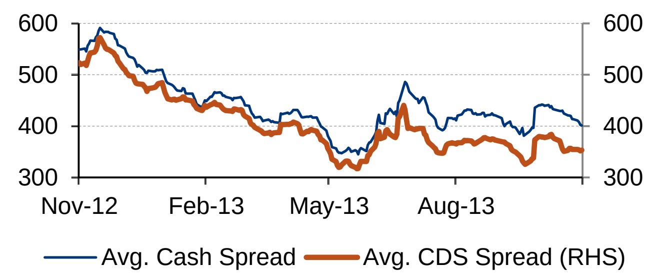
Cash indices outperformed CDX over the week. Our US HY cash index OAS was 4bp tighter, while CDX HY widened by the same amount (Table 10). The average cash-CDS basis for the CDX HY21 issuers we track has similarly become more positive (Chart 13). The average basis now stands at -48bp, about 11bp wider over the week

Table 10:CDX vs. ML Cash Indices

Index	Spread	1W-Chng	1M-Chng	3M-Chng
CDX IG	73	1	-7	-8
HG Cash	145	0	-11	-8
CDX HY	354	4	-37	-46
HY Cash	436	-4	-47	-35

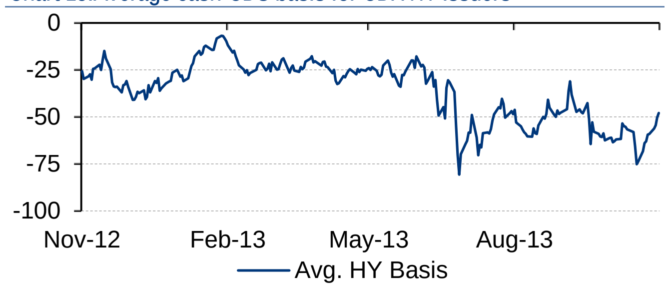
Source: BofAML Global Research, 5y spreads for CDX, OAS for cash

Chart 12:Average cash and CDS spreads for CDX HY issuers



Source: BofA Merrill Lynch Global Research, Average spreads for a selection of issuers in the On The Run CDX HY index. Currently includes 82 HY20 constituents.

Chart 13:Average cash-CDS basis for CDX HY issuers



Source: BofA Merrill Lynch Global Research, Average basis for a selection of issuers in the On The Run CDX HY index. Currently includes 82 HY20 constituents.

CDS Indices

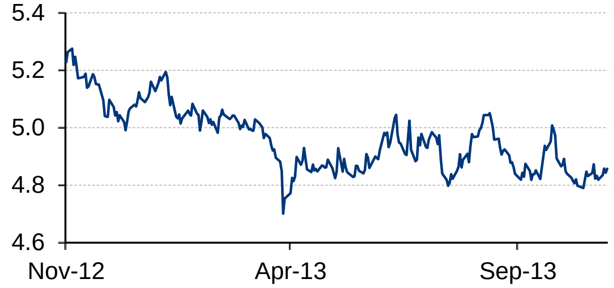
CDX underperformed iTraxx this week, while skews continued to become less negative across all indices (Table 11). The HY/IG ratio is now up at 4.86 compared to 4.82 last week (Chart 14). The XO-HY at -12bp is the lowest since January this year (Chart 15).

Table 11: CDS Indices – spread, intrinsic and skew

Index	5y Spread	1W-Chng	1M-Chng	3M-Chng	5y Intrinsic	1W-Chng	1M-Chng	3M-Chng	Skew	1W-Chng	1M-Chng	3M-Chng
CDX IG	73	1	-7	-8	76	-1	-9	-12	-3	1	2	4
CDX HY	354	4	-37	-46	361	0	-35	-52	-6	5	-2	6
iTraxx Main	83	-3	-15	-21	85	-3	-14	-18	-2	0	-2	-3
iTraxx XO	342	-7	-56	-103	337	-8	-54	-79	4	1	-2	-24

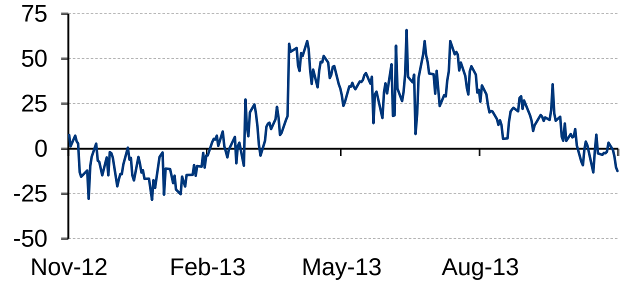
Source: BofA Merrill Lynch Global Research

Chart 14: HY/IG



Source: BofA Merrill Lynch Global Research

Chart 15: XO-HY

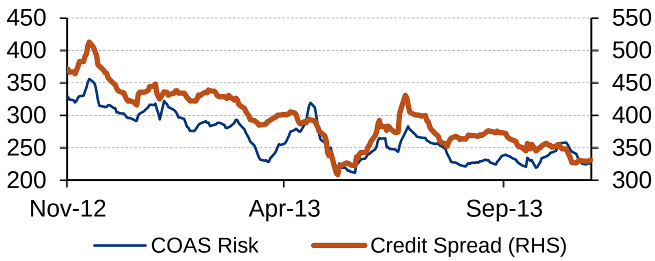


Source: BofA Merrill Lynch Global Research

Credit v. Equities

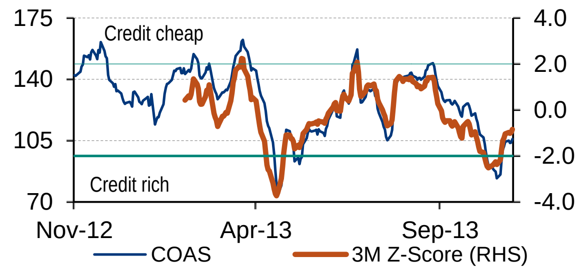
Average spread for our HY universe widened 1bp compared to a 3bp tightening in equity implied credit risk (Chart 16). The US HY COAS value at 105bp, is about 0.84 standard deviations below its 3m average as the credit-equity dislocation observed earlier this month continues to correct itself (Chart 17).

Chart 16:US HY COAS Risk vs. Spread



Source: BofA Merrill Lynch Global Research

Chart 17:US HY COAS & Z-Score



Source: BofA Merrill Lynch Global Research

CLOs

CLO Weekly: The Impact of Energy Future on CLOs 01 November 2013

In a new recurring section beginning this week we include the key points to our CLO strategist's (Ryan Asato) weekly publication. As noted above, TXU was in the news again this week, this time because of its payment of a $270mn interest payment, made today, November 1st. Ryan explores the impact of TXU on the CLO market, as the deal is largely held in CLOs.

Market View

Secondary activity picked up this week with BWIC volumes totaling over $600 million. Amidst the heavier activity, secondary 1.0 spreads ended the week at 110, 160, 215, 300 and 500bp which represented tightening of 10, 15 and 25bp for single-As to double-Bs from last week's levels. Two deals priced this week in the US market, pushing total 2013 issuance to over $67 billion. In Europe, CQS Investment Management's €361 million Grosvenor Place 2013-1 became the 15th 2.0 Euro deal to price. Given that CLO spreads have stayed mostly stagnant over the last few months and the tightening in October has largely lagged other sectors including non-agency MBS and CMBS, we believe that there is room for further tightening and look for the CLO credit curve to flatten as investors search for yield.

The Impact of Energy Future on CLOs

Although negotiations with creditors did not ultimately result in an agreement as Energy Future Holdings decided to make its November 1st payment today, the probability of an eventual filing stands high. Given the size of the leveraged buyout that took the company private in 2007 and the amount of debt issued as part of the transaction, their loans are broadly held by CLOs in 229 outstanding deals. Despite the breadth of holdings in CLOs, we expect the impact of any restructuring to be minimal for most deals as the weighted average exposure across deals with exposure is 1.6% - with many having concentrations of less than 1%. Furthermore, most deals holding Energy Future loans have sufficient junior OC cushions and have full NAV coverage for the rated tranches.

Looking more broadly at other distressed CLO holdings, we also believe the impact on most CLOs to be minimal should any or all of the ~40 distressed issuers that we track ultimately default.

Link to Definitions

Credit

Click here for definitions of commonly used terms.

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Equity Preferreds: Equity preferreds are recommended on an individual basis under the Credit Opinion Key. Issuer credit recommendations do not apply to equity preferreds.

Recommendation	Investor Action Points (Cash and/or CDS)	Primary Investment Return Driver
Overweight-100%	Up to 100% Overweight of investor's guidelines	Compelling spread tightening potential
Overweight-70%	Up to 70% Overweight of investor's guidelines	Carry, plus some spread tightening expected
Overweight-30%	Up to 30% Overweight of investor's guidelines	Good carry, but little spread tightening expected
Underweight-30%	Down to 30% Underweight of investor's guidelines	Unattractive carry, but spreads unlikely to widen
Underweight-70%	Down to 70% Underweight of investor's guidelines	Expected spread underperformance
Underweight-100%	Down to 100% Underweight of investor's guidelines	Material spread widening expected

Time horizon – our recommendations have a 3 month trade horizon

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