The HY Wire

Death by a thousand cuts

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High Yield Strategy
Global

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With our Year Ahead views playing out, what happens now

In our Year Ahead report from last November we discussed how the basis for our relatively bearish outlook for 2015 stemmed from the realization that the best of times are now behind the market. And with rising defaults and a higher premium demanded for liquidity, high yield would struggle to maintain any significant traction following a seasonally strong first quarter. With many of our themes having played out, in this week's piece we review our positioning for the rest of the year, and find that all the factors that turned us bearish nearly a year ago remain for the foreseeable future.

On China, lack of leadership in HY and equity resilience

We also highlight three additional thoughts that we think will be important to consider when forecasting high yield (and perhaps equity) performance for the rest of the year. First, the impact of last week's devaluation of the Yuan and its influence on commodities and potentially the dollar. Second the lack of leadership in the market. Third, the correlation between equities and high yield.

Flows: Outflows galore

Credit funds reported outflows last week: US HY at -$1.1bn driven by ETFs (-$960mn), Loan funds at -$350mn, while IG funds also came in negative at -$1.1bn. Other fixed income asset classes also experienced outflows with EM bond funds, non-US domiciled HY funds and Municipal funds, all posting outflows. Equities experienced a small rebound reporting +$890mn and commodities also breathed a sigh of relief coming in at +$450mn after a month of consecutive outflows.

Issuance: Still lagging

DM high yield issuance was in-line with recent weeks as 6 deals for a total of $4.6bn came to market. All of new issues came from the US. Of the $4.6bn issued this week, $1.1bn was rated BB and $3.5bn was B. There was no CCC issuance. Global loan issuance still remains muted as no new deals came to market last week. Year-to-date we have seen a total of only $178bn in the primary market, well below 2014's pace. Last year at this time, we had already seen $291bn of new supply globally.

Performance: Energy led selloff

Markets sold off last week, triggered by China currency devaluation and what that means for the global economy. Concerns around demand from China, along with strengthening USD, weighed on the market. There was a rush to safe haven securities such as treasuries and mortgages while riskier assets were in the red. US HY was one of the worst performers generating -0.91% while Loans were close behind at -0.35%. Energy was the worst performing sector and lost -2.67% and Materials, with its -1.26% returns was the next worst.

Recent publications

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The View From Above

With our Year Ahead views playing out, what happens now

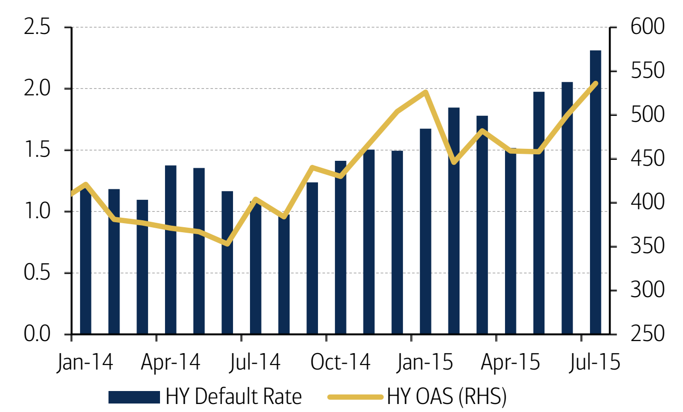
As we approach the end of the summer and take stock of where the US high yield market stands today relative to our bearish view back in November 2014 we find that many of our forecasts are playing out. The question is with four months still left in the year does high yield stage a comeback or does this beginning of the end of the credit cycle continue to drag on in painful mediocrity? In the View from Above we revisit some of our key projections as well as pose three new questions to consider for the remainder of 2015.

The best of times are behind the market

The basis for our relatively bearish outlook for 2015 stemmed from the realization that the best of times are now behind the market and, with rising defaults and a higher premium demanded for liquidity, that high yield would struggle to maintain any significant traction following a seasonally strong first quarter.

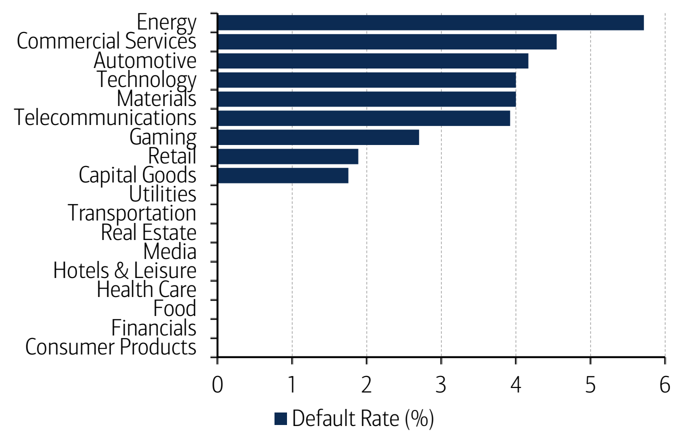
Headed into the fall, we maintain our view that the best of times are in the market's rearview mirror and continue to believe that the end of this credit cycle is now upon us. Although it sounds disastrous, we think the end is likely to play out over a long time, characterized by an increase in defaults, likely dominated by commodity names at first, and a slow unwind of crowded trades. In many ways, this could be more painful than the alternative: a steep cathartic move that cleanses the market. We think the remainder of the year likely experiences further weakness as poor energy performance leaks into the rest of the market, and lackluster global growth and a strong dollar weighs on fundamentals.

Chart 1: Defaults are increasing, but are still at low levels...



Source: BofA Merrill Lynch Global Research

Chart 2: ... as the energy sector currently leads default rates



Source: BofA Merrill Lynch Global Research

The era of indiscriminate beta compression is over

We have had a long-standing view that accounts have shifted their collective mindset from one where they were scared to sell bonds for fear of not being able to buy them back to one where they want to sell positions they don't view as core long-term holdings for fear of not being able to sell them later. As such, we wrote, the bond market would struggle in 2015 to surpass 2-3% total returns and that there would be more disparity between winners and losers.

Again, we continue to like this theme going into the end of the year as we expect continued bifurcation between credits and sectors. With underwhelming fundamentals serving as a backdrop for higher leverage and increasing scrutiny on earnings (see Telecom recently), we believe those companies that manage to avoid big earning misses or being swept up in the weak global growth and strong dollar environment will fare

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better than those which are exposed to non-domestic forces or have questionable balance sheets and future growth prospects.

In this way, we envision clear winners and losers in the last third of the year as credit selection becomes the number one focus for capital preservation. Take for example returns in Technology, Automotive, Materials and Energy, four sectors that are either directly or indirectly exposed to dollar strength or non-US factors. Out of our 18 sectors, these four are placed 13th, 15th, 18th and 17th in terms of decreasing year-to-date total returns. Meanwhile, Food, Hotels and Leisure, Healthcare and Real Estate, 4 sectors that are very domestically exposed have the 1st, 4th, 5th and 6th best returns year-to-date.

Table 1: Percentage of revenue from within the US, by sector

Sector	Total	US	Pct
Technology	161,491	72,862	45.1%
Automotive	236,275	122,325	51.8%
Materials	181,192	109,401	60.4%
Capital Goods	107,054	66,492	62.1%
Consumer Products	61,637	41,911	68.0%
Gaming	36,785	25,450	69.2%
Media	120,941	89,986	74.4%
Commercial Services	67,830	53,670	79.1%
Retail	227,414	195,512	86.0%
Health Care	141,289	122,150	86.5%
Hotels & Leisure	36,142	31,396	86.9%
Food	165,959	144,239	86.9%
Financials	132,872	117,329	88.3%
Telecommunications	108,871	96,344	88.5%
Utilities	46,687	41,550	89.0%
Real Estate	100,491	91,224	90.8%
Transportation	63,853	59,300	92.9%
Energy	253,779	236,722	93.3%
Total	2,250,561	1,717,863	76.3%

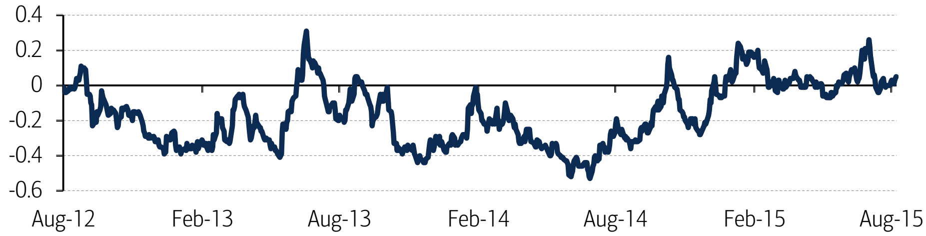
Source: BofA Merrill Lynch Global Research, Bloomberg

Global economic uncertainty, including risks from China would create volatility

Our position last year was that global growth would remain challenging and that despite a likely rate hike (or two), treasury yields would remain low by historic standards. In particular, we felt that geopolitical risk would create volatility in the markets, and that high yield, as an expression of risk off, would suffer the consequences of an increase in uncertainty.

So far in 2015 the GFSI (Global Financial Stress Index) has spent the most time above 0 in years, suggesting that financial risk has increased despite low levels of equity volatility and implied credit volatility. Of course, realized high yield vol has picked up substantially the last several months as geopolitical uncertainty has caused the commodity based sectors in particular to drop significantly. We think the trend continues and likely begins to leak into non-commodity sectors as the Energy story gets worse in the fall and investors reallocate positions post Labor Day ahead of the Fed and with a greater realization of a global economic soft patch. ETF flows, subject to macro and cross asset players, will continue to be used as an expression of risk off, in our opinion, creating an environment that remains difficult for the asset class to rally absent significant inflows or a steep rally in crude prices.

Chart 3: The GFSI has been elevated relative to the past several years



Source: BofA Merrill Lynch Global Research

Market to not receive cash, and outflows could cause problems

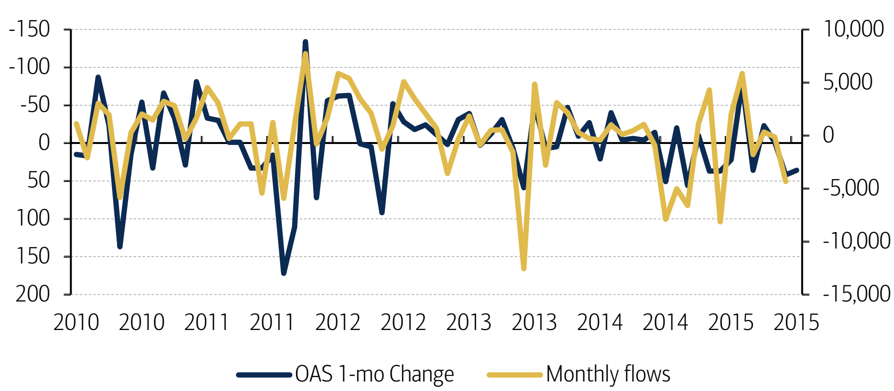
We also highlighted that we did not think the market would receive a significant influx of cash in 2015, and that the potential for outflows could be detrimental for returns.

We continue to believe that the argument of "where is the money going to go" doesn't hold water for high yield, as in a world where uncertainty reigns and fundamentals are weak, high yield is unlikely to experience significant inflows. However, we would be remiss if we didn't write that it has been surprising to us that the market has so far experienced less open ended mutual fund outflows than we would have expected given the weakness the last two months.

Although over the last 10 weeks open-ended funds (non-ETFs) have realized about $5bn in mutual fund outflows, these pale in comparison to late last year or 2013 when similar moves in high yield led to over $12bn in outflows. We think there are a few reasons for the relatively benign exodus. First, the market has experienced very few inflows for the last two years. In fact, when taking into account the taper tantrum and last year's exodus, US high yield has actually seen aggregate outflows to the tune of $24bn (8% of AUM). Perhaps the several big moves we have experienced since 2013 have flushed out the "weak hands".

The second reason could be that there hasn't been a strong catalyst or several specific days of significant weakening. Outflows tend to accompany large moves in price that happen quickly. This contrasts to the death by a thousand cuts scenario we have experienced since June. For example, in each of the last 3 years the periods where outflows were most severe coincided with about 100bp-120bp moves in OAS in a month's time. Although we have had about 120bp of widening with this most recent bout of weakness, it has occurred over nearly double the amount of time from other high outflow periods. In our view, outflows will likely continue at a modest but consistently negative pace for a long period of time, only reaching very high levels upon idiosyncratic shocks.

Chart 4: Each bout of outflow has been more muted than the previous since 2013



Source: BofA Merrill Lynch Global Research

Key to outlook: Energy

Finally, we wrote that perhaps most key to our outlook was how Energy paper would perform in 2015 as the sector would set the tone for the overall universe and that the rest of the market would have a hard time coping with downward moves in the sector.

We clearly continue to be big supporters of this idea, particularly as fall redetermination looms and crude prices continue to feel pressure. In fact, we think that because the non-commodity portion of the market has held up so well that it also has further room to decline come the last several months of the year. If earnings don't improve across high yield and liquidity remains challenging, we envision Energy weakness to affect overall sentiment and increase risk aversion, similar to what we saw last fall.

Our thoughts on…

…effect of the Chinese devaluation of the Yuan and apparent economic slowdown

This week's move in the Yuan came as a surprise to many market participants, but the potential for devaluation has been something that Bank of America Merrill Lynch economists and rate strategists have written about at length. In our research we have frequently highlighted our disbelief of the Chinese GDP numbers, mentioning the risks in our year-ahead report in November and HY Wire publications in February and March. Clearly this week we saw further evidence that the Chinese government is taking extreme steps to manage a slowdown in the domestic economy.

Our view is that China's slowdown, the shift away from fixed asset investment to domestic consumption, and the consequential move by the PBOC will affect high yield mostly in the commodity sectors, but potentially more broadly depending on how persistent the weakness is and the consequential actions of other foreign governments.

As our commodity strategists note, the last several months have seen investments in the power grid fall, the production of cement, a proxy for construction, contract, and steel output flat line. The slowdown has already sharply affected China's offtake of industrial metals and materials like copper and steel. Additionally, they note that a sharp devaluation of the CNY would be a net negative for USD commodity prices, with a 10% correction yielding a 5% downside in Brent.

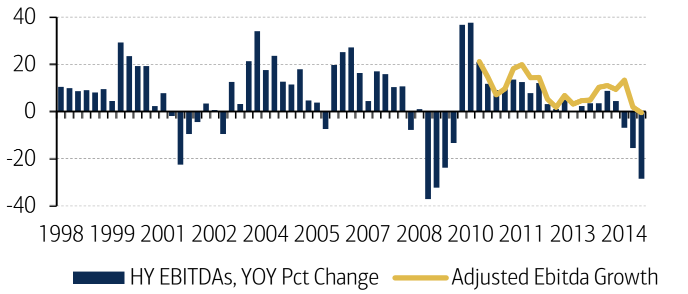
Although lower near-term crude prices will not be good for high yield, we are more concerned about the prospects for a lower for longer environment. We mentioned in the winter that oil volatility is bad for firms, as they try and forecast production levels, capex, etc., but what is worse is a sustained downturn that leads to capital drying up and an increase in defaults. This week's actions and the apparent reason for the currency moves suggest to us that the commodity recovery will likely not be driven by China- a potential big problem for high yield given the high weight and broad impact of the Energy and Materials sectors.

Furthermore, we also consider the prospect that the weakness in China persists while the US economy continues to heal. Under such a scenario it is possible that the Fed decides that the economy is strong enough to sustain policy normalization, hiking in September as our economists expect, but Chinese growth continues to fall, prompting a further devaluation later in the year. One could see a situation where other governments feel China's affect and also devalue, creating further dollar strength and continued risks to corporate earnings. Although the Fed would likely recognize such a scenario as being a poor outcome for US inflation and growth, and halt any tightening, the impact would likely cause market disruption and further weakness in high yield.

…lack of leadership in the market

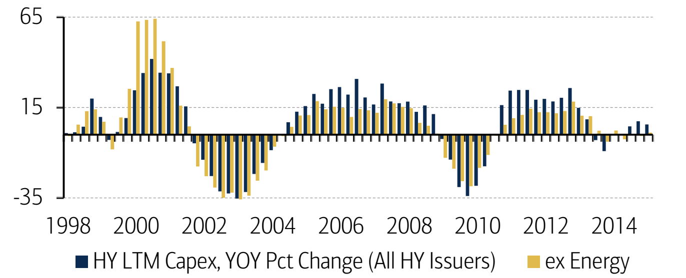
One of the biggest reasons the high yield selloff has been so painful is the lack of leadership from any one sector. What the market needs is a purge and for a leader to emerge- something we think will be very unlikely. Outside of Healthcare, fundamentals are uninspiring while innovation, for now, seems to have been replaced by capital preservation. Capex is virtually non-existent, issuance has plummeted, and no sector has proven to be the one to make investors feel good about the space.

Chart 5: EBITDA growth has been plummeting...



Source: BofA Merrill Lynch Global Research, Bloomberg

Chart 6: ... and y-o-y capex growth is virtually 0%

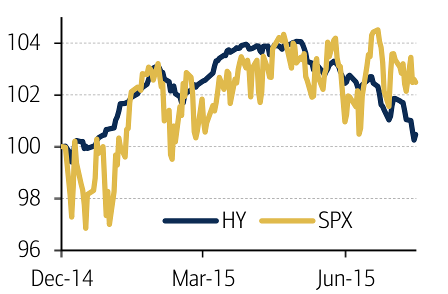


Source: BofA Merrill Lynch Global Research, Bloomberg

...correlation between high yield and equities

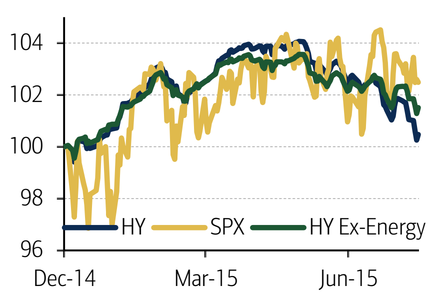
Recently there's been much hand-wringing over what HY performance could portend for the equity market. On the face of it, yes the resilience in equities looks quite remarkable (Chart 7). But as we discussed in our recent piece on credit spreads versus equity volatility, it's a matter of perspective really. For one, the Energy sector has had an outsized impact on HY performance over the last three months. Ex-Energy performance doesn't look as out of line compared to S&P 500 (Chart 8). As a matter of fact, while the total return for the HY index as a whole is just 0.5% year-to-date, the ex-Energy segment has returned 1.5%. This compares well to the 2.5% total return for the S&P 500 on a beta-adjusted basis. Of course, SPX does have a relatively large Energy component itself (about 7%), but these tend to be higher quality companies than HY Energy issuers. Even within HY Energy, lower quality paper has substantially underperformed higher quality over the last three months. On the whole, it isn't much of a stretch to pin a fair amount of the recent outperformance of S&P on HY's unique Energy travails. More interestingly, when compared to small and mid-cap equities (using Russell 2000), HY volatility looks almost subdued (Chart 9).

Chart 7: S&P too high vs HY?



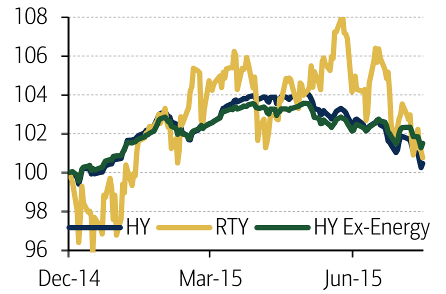
Source: BofA Merrill Lynch Global Research, Total returns based at 100 as of 31-Dec-2014.

Chart 8: Not so much, if adjusted for Energy



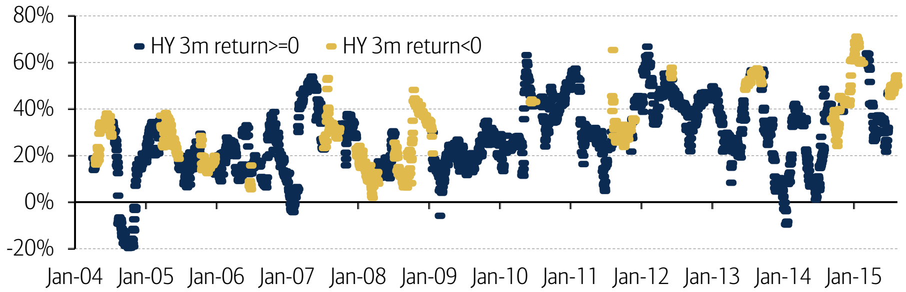
Source: BofA Merrill Lynch Global Research, Total returns based at 100 as of 31-Dec-2014.

Chart 9: And RTY has had just as bad a year



Source: BofA Merrill Lynch Global Research, Total returns based at 100 as of 31-Dec-2014.

Chart 10: 3m rolling correlation between HY and S&P 500 (using daily returns)



Source: BofA Merrill Lynch Global Research

Cross-asset correlations are also not that weak (Chart 10). In fact, compared to other periods when HY had negative returns, the correlation between SPX and our HY index has been relatively high in recent weeks. The seeming divergence between the two is perhaps more of scale than direction. And this can largely be attributed to the idiosyncrasies within each asset. The problems in HY are mainly low commodity prices, terrible market liquidity and general investor risk-aversion as the credit cycle begins to turn. Within the S&P, our Equity colleagues recently highlighted how inter-sector correlations have plummeted, leaving the index itself unmoved. In essence, there has been enough divergence between sector performances, so that the bad apples have been offset by the good eggs.

On the whole, while valuations admittedly point to equities being the better short in the event of a sell-off here, we'd caution against reading credit tea-leaves to predict the next leg in stocks. Since last summer credit has been engaged in a steady re-pricing, with spreads drifting wider and unable to return to former tights. This is part of the regime change we'd expect as we enter the beginning of the end of the credit cycle. The problems in credit though, for now, appear to be unique to the asset class. For those concerned about stocks, we think keeping an eye on global growth and Chinese data is more important than high-yield at this point.

Weekly Recap

Nearly 300 high yield companies have reported their Q2 earnings so far. On a year-over-year basis, EBITDA decreased 43% while debt grew at 8% and revenue contracted 5%. EBITDA adjusted for one-time items was a lot more benign coming in at -1%. On a quarter-over-quarter basis, EBITDA growth declined 15% while revenue growth was positive at 2.6%. Excluding energy names, YoY EBITDA still decreased at 12.5%, while debt grew at a lesser pace at 5%. In the last one week, high yield spreads widened 26bps from 540bps to 566bps while 5y rates tightened 5bps to 1.56%. US high yield funds saw outflows (-$1.1bn) driven by ETFs while US investment grade funds also saw large outflows. US high yield issuance is now roughly in line with last year's pace as issuance slowed down significantly through July and August. Loan issuance is down 40% YTD.

Table 2: HY issuer fundamentals

YoY Pct Change				YoY Pct Change, Ex Energy			
EBITDA	Debt	Rev	COGS	EBITDA	Debt	Rev	COGS
-43.0	7.8	-4.7	-6.6	-12.5	5.4	-0.8	-1.9

Source: BofA Merrill Lynch Global Research

Fixed income assets report outflows

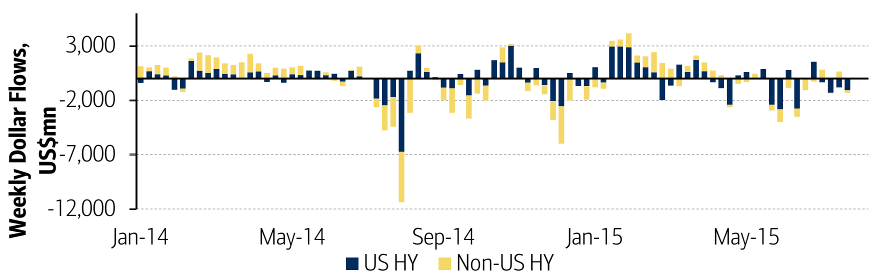
This is an excerpt from our recently published report: The High Yield Flow Report: Outflows galore 13 August 2015

US investment grade funds reported an outflow of -$1.1bn this week after spending 16 weeks in positive territory. Numerically this is the highest weekly outflow for the asset class since 2013. However we advise caution against reading too much into the number as the magnitude is amplified by the technicalities around monthly vs weekly reporting IG funds. In effect, IG funds have witnessed similar outflows before, but most of those have failed to materialize in weekly numbers because the universe of weekly reporters is not the same as those of the monthly reporting funds.

Case in point, the month of Dec'14 which actually saw -$300mn flow out of the IG asset class when weekly flow aggregates pointed to a $15bn inflow. This weekly-monthly discrepancy has slowly been weathering out, because of which a weekly outflow of this week's magnitude may seem out of the ordinary but is not the case on ground. Other credit funds also reported outflows: with US HY at -$1.1bn driven once again by ETFs (-$960mn), and Loan funds reporting -$350mn.

Other fixed income asset classes also experienced outflows with EM bond funds at -$780mn, non-US domiciled HY funds reporting -$240mn, and Municipal funds posting -$250mn in outflows. Equities experienced a small rebound reporting +$890mn after nearly -$8bn of outflows over the last 3 weeks. Meanwhile commodities also breathed a sigh of relief coming in at +$450mn after a month of consecutive outflows.

Chart 11: Global HY flows distributed between US-domiciled and non US-domiciled funds



Source: BofA Merrill Lynch Global Research, EPFR Global

New Issue Roundup

Bonds

DM high yield issuance was in-line with recent weeks as 6 deals for a total of $4.6bn came to market. All of new issues came from the US. Of the $4.6bn issued this week, $1.1bn was rated BB and $3.5bn was B. There was no CCC issuance. Month-to-date, we stand at $8.9bn, while year-to-date primary deals total $244.8bn, more than $20bn behind of last year's pace. For comparison, last year at this time we had seen $267.2bn of issuance in the developed markets. The US is more than $10bn ahead of last year's pace, while Europe is well behind.

A further analysis shows that most of the issuance (about 76%) was rated B, while 24% was BB. The distribution looks typical, as recently we have seen the most issuance in the B-bucket. In terms of seniority, 89% of new issues were senior unsecured this week, while 11% were secured. Finally, about 94% of deals last week were private placements, all without reg rights. Public deals accounted for 6% of the new issuance. Private placements have consistently outpaced public deals.

Table 3: DM issuance summary ($bn)

	DM	United States	Europe	BB	B	CCC/NR
WTD Aug 14	4.6	4.6	0.0	1.1	3.5	0.0
Wk Aug 07	4.3	4.3	0.1	0.7	1.8	1.8
Wk Jul 31	3.2	1.7	1.5	0.0	2.3	0.9
Wk Jul 24	10.7	1.3	4.9	5.4	4.2	1.1
MTD Aug	8.9	8.9	0.1	1.8	5.3	1.8
July	18.3	7.4	6.4	7.2	8.6	2.4
June	27.7	20.9	6.6	8.1	13.8	5.8
May	34.4	28.8	2.7	12.7	17.7	4.0
YTD 2015	244.8	166.4	62.8	81.7	127.4	35.6
YTD 2014	267.2	153.6	103.3	79.4	140.9	46.8
2014	376.0	238.8	119.5	129.9	186.8	59.2
2013	378.3	270.3	91.5	128.8	172.4	77.2
2012	365.7	280.5	65.5	103.6	198.3	63.8

Source: BofA Merrill Lynch Global Research

Table 4: New issue breakdown by week, last 3 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
05/08/2015	9,861	2,050	6,161	1,650		9,175	478		208	524	8,887	450	4,503	2,508	2,850
05/15/2015	8,582	3,765	4,202	615		8,515	67			1,817	6,765		2,807	3,465	2,310
05/22/2015	4,826	2,000	2,356	470		4,720	106			806	4,020		906	2,220	1,700
05/29/2015	10,058	4,864	4,473	720		8,975	1,083			4,055	6,003		1,283	6,275	2,500
06/05/2015	11,105	3,450	4,655	3,000		9,840	1,181	84		1,074	9,431	600	5,100	5,671	334
06/12/2015	5,705	1,080	3,734	891		1,835	2,469	1,401		3,141	2,139	425	2,321	3,159	225
06/19/2015	3,472	1,000	1,922	550		3,000	255			472	3,000		1,650	1,472	350
06/26/2015	6,364	2,600	2,920	724	120	5,655	709			335	6,029		1,050	3,314	2,000
07/03/2015	1,085		600	485		1,085					1,085		600	485	
07/10/2015	200	200				200					200			200	
07/17/2015	4,175	1,600	2,200	375		4,175					4,175		1,275	1,150	1,750
07/24/2015	10,708	5,437	4,159	1,112		3,305	6,528	875		3,507	7,201		2,366	8,342	
07/31/2015	3,191		2,271	920		2,480		711		1,096	2,095		273	2,917	
08/07/2015	4,342	700	1,832	1,810		4,270	72			1,282	3,060		1,407	2,935	
08/14/2015	4,600	1,100	3,500			4,600				500	4,100			4,300	300

Source: BofA Merrill Lynch Global Research

At the single name level, the largest deal last week was the $1.2bn two-part offering from Post Holdings. Both tranches are are senior unsecured, while one pays an 8% coupon and one pays a 7.75% coupon. Proceeds from the deal will be used to reginance a portion of its term loan and for GCP, including future acquisitions. Other large deals last week include the $1bn two-part offering from Owens-Brockway and the $800mn offering from MSCI Inc.

Table 5: New issues August 8th – August 14th

Pricing Dt	Name	Size ($)	Snr	Cpn	Maturity	Price	Yield	Moody's	S&P	Type	Sector	Region
8/12/2015	Post Holdings Inc.	400	Sr Nts	8.00	15-Jul-25	100.00	8.00	B3	B-	144A for Life	Food	United States
8/12/2015	Post Holdings Inc.	800	Sr Nts	7.75	15-Mar-24	100.00	7.75	B3	B-	144A for Life	Food	United States
8/12/2015	Amag Pharmaceuticals Inc	500	Sr Nts	7.88	1-Sep-23	100.00	7.88	B3	B+	144A for Life	Biotechnology	United States
8/11/2015	Owens-Brockway Glass Container Inc.	300	Sr Nts	6.38	15-Aug-25	100.00	6.38	B1	BB-	144A for Life	Packaging&Containers	United States
8/11/2015	Owens-Brockway Glass Container Inc.	700	Sr Nts	5.88	15-Aug-23	99.22	6.00	B1	BB-	144A for Life	Packaging&Containers	United States
8/11/2015	Midcontinent Communications	300	Sr Nts	6.88	15-Aug-23	100.00	6.88	B3	B	144A for Life	Media	United States
8/11/2015	Infor (US), Inc.	500	Sr Sec Nts	5.75	15-Aug-20	99.00	5.99	B1	B+	144A for Life	Software	United States
8/10/2015	Service Corporation International	300	Sr Nts	5.38	15-May-24	103.75	4.72	Ba3	BB	SEC	Commercial Services	United States
8/10/2015	MSCI Inc.	800	Sr Nts	5.75	15-Aug-25	100.00	5.75	Ba2	BB+	144A for Life	Software	United States

Source: BofA Merrill Lynch Global Research

Loans

Global loan issuance still remains muted as no new deals came to market last week. Year-to-date we have seen a total of only $178bn in the primary market, well below 2014's pace. Last year at this time, we had already seen $291bn of new supply globally.

Table 6: Global loan issuance over time ($bn)

	Global	BB	B	CCC/NR	Cov lite	2nd lien
WTD Aug 14	0.0	0.0	0.0	0.0	0.0	0.0
Wk Aug 07	2.1	0.6	1.5	0.0	2.0	0.0
Wk Jul 31	5.8	1.4	4.3	0.0	3.7	0.2
Wk Jul 24	15.4	5.4	9.3	0.7	9.2	0.7
MTD Aug	2.1	0.6	1.5	0.0	2.0	0.0
July	35.1	10.6	22.7	1.8	25.3	2.1
June	29.7	11.7	16.3	1.7	18.7	1.5
May	26.7	10.7	15.1	0.8	19.9	0.9
YTD 2015	178.0	74.6	95.5	7.9	121.3	7.8
YTD 2014	291.0	83.7	165.0	42.3	205.2	29.1
2014	379.4	109.5	218.3	51.6	267.1	36.6
2013	454.9	152.8	261.7	40.4	279.1	28.9
2012	295.3	105.0	161.9	28.4	97.5	17.2

Source: BofA Merrill Lynch Global Research, S&P LCD

Table 7: New issue breakdown by month, last 3 months

		Ratings						
	Total	BB	B	CCC	NR	TLb	2nd Lien	Cov Lite
05/01/2015	7,760	5,050	2,710			7,435	325	4,585
05/08/2015	3,731	614	2,740	378		3,309	423	2,985
05/15/2015	7,988	3,425	4,563			7,988		5,283
05/22/2015	11,898	6,550	5,348			11,898		9,570
05/29/2015	2,954	126	2,396	432		2,522	432	2,077
06/05/2015	7,007	2,648	4,100	259		6,748	259	5,483
06/12/2015	11,065	4,015	6,015	1,035		9,930	1,035	5,405
06/19/2015	7,778	2,520	4,913	345		7,603	175	5,285
06/26/2015	3,810	2,486	1,299	25		3,785	25	2,550
07/03/2015	650		650			650		650
07/10/2015	2,883	1,068	1,571	245		2,538	345	1,816
07/17/2015	10,390	2,700	6,855	835		9,555	835	9,970
07/24/2015	15,362	5,425	9,267	670		14,692	670	9,222
07/31/2015	5,780	1,445	4,335			5,580	200	3,690
08/07/2015	2,094	630	1,464			2,094		1,955

Source: BofA Merrill Lynch Global Research, S&P LCD

At the single-name level, the largest deal so far in August was the $850mn HD Supply term loan offered on August 3rd. The loan is a cov-lite due in 2021 that pays 275bps above Libor with a 1% Libor floor. The company plans to use the proceeds from the offering to refi its existing term loan and redeem its 11% notes due in 2020. Other deals in August include those from AMAG Pharmaceuticals and ServiceMaster Global Holdings.

Table 8: New issues August

Launch Dt	Issuer	Deal Name	Deal Size ($)	New Institutional Money ($)	Moody's	S&P	Asset Backed	Cov Lite	Proceeds	Sector	Region
8/6/2015	National Veterinary Associates Inc	National Veterinary (Add-on 9/15)	75	75	B1	B	No	Yes	Acquisition	Services & Leasing	North America
8/5/2015	ServiceMaster Global Holdings	ServiceMaster (Add-on 9/15)	400	400	B1	B+	No	Yes	Refinancing	Services & Leasing	North America
8/4/2015	Acrisure LLC	Acrisure (Add-on 9/15)	139	139	B2	B	No	No	Acquisition	Insurance	North America
8/4/2015	AMAG Pharmaceuticals Inc	AMAG (9/15)	350	350	Ba2	BB	No	Yes	Acquisition	Healthcare	North America
8/3/2015	HD Supply Inc	HD Supply (9/15)	850	850	B1	BB-	No	Yes	Refinancing	Retail	North America
8/3/2015	TerraForm Power Inc	TerraForm Private (9/15)	280	280	Ba2	B+	No	Yes	Acquisition	Utilities	North America

Source: BofA Merrill Lynch Global Research, S&P LCD

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Performance Summary

Markets sold off last week, this time triggered by China currency devaluation and what that means for the global economy. Primary concerns around the decrease of demand from Chinese consumers, along with secondary effect on US companies because of strengthening USD, weighed on the market. There was a rush to safe haven such as treasuries and mortgages which outperformed all else. Riskier asset classes were glaringly in the red. US HY was one of the worst performers generating -0.91% while Loans were close behind at -0.35%. Taking the bottom spot was the EM Equity index which lost -2.27% last week.

Amongst sectors, Energy got hit hard due to the double dip in Oil which is currently at 6 year lows. The sector lost -2.67% in the week, while the rout claimed another issuer as Hercules Offshore filed for bankruptcy on Friday. Materials, with its -1.26% returns was the next worst.

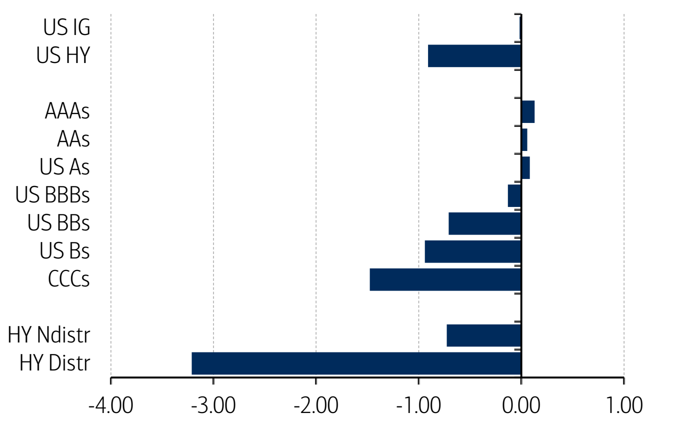
Table 9: Total returns across asset classes

Ticker	Name	WoW (%)	MTD (%)	YTD (%)
MXEF	EM Eqty	-2.27	-4.09	-9.57
H0A0	US HY	-0.91	-1.37	0.47
CDXHY	CDX.HY	-0.49	-0.98	-0.35
LCDI/ALL	Lev Loans	-0.35	-0.39	2.42
EMHB	EM HY	-0.28	-1.15	5.72
HE00	EU HY	-0.09	-0.32	2.66
CDXIG	CDX.IG	-0.08	-0.25	0.05
C0A0	US IG	-0.02	-0.22	-0.14
SPX	S&P 500	-0.01	-0.97	1.19
EMGB	EM Govts	-0.01	-0.38	1.15
EMIB	EM IG	0.00	-0.22	1.62
G0QI	TIPs	0.12	-0.60	-0.23
M0A0	Mortgages	0.16	-0.04	0.81
U0A0	Municipals	0.17	0.12	1.02
GA05	5yr TRSY	0.23	-0.06	1.61

Source: BofA Merrill Lynch Global Research

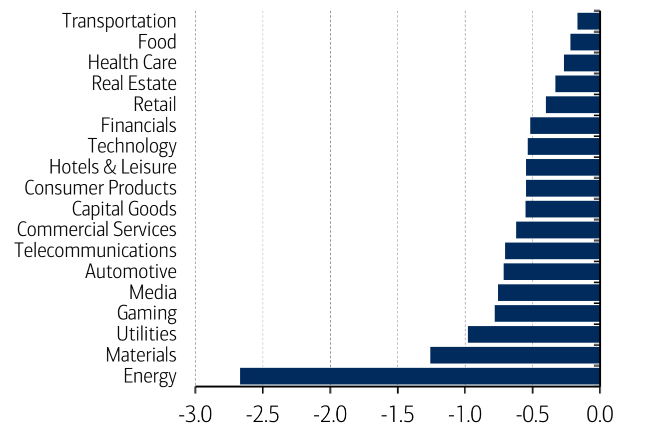
Ratings wise, performance was in line with betas, with riskier credits underperforming better credits. CCCs returned -1.5%, followed by Bs at -0.9% and -0.7%.

Chart 12: Segment and rating returns, week-on-week (WoW)



Source: BofA Merrill Lynch Global Research

Chart 13: Sector returns, week-on-week (WoW)



Source: BofA Merrill Lynch Global Research

Top performers

The top performers for last week were filled with a host of various sectors. Dex Media was a top performer with its 14% bond gaining 4 points. Heckmann Corp was another issuer which saw its bonds gain last week, followed by Genworth Holdings, Universal Hospital, and APX Group.

Table 10: Top 10 performers July 10th – July 17th

Issue	Rating	Price	Yield (%)	ZSpread	Px Change	Px Change (%)	Volume
DXM 14 '17	CCC3	9.73	0.00	31836	4.3	79.6	5
NES 9.88 '18	CCC1	62.43	31.82	3062	2.3	3.8	11
GNW 6.51 '18	BB2	102.06	5.70	452	2.6	2.6	14
UHOS 7.63 '20	B3	95.05	8.87	722	2.0	2.1	23
APXSEC 8.75 '20	CCC1	88.96	11.59	990	1.6	1.8	26
LINE 6.5 '19	B2	50.84	28.79	2738	0.8	1.6	20
PF 4.88 '21	B2	101.70	4.37	275	0.8	0.8	6
ACCO 6.75 '20	BB3	106.25	4.80	362	0.8	0.8	4
MTH 7 '22	BB3	107.75	5.58	370	0.8	0.8	3
S 6 '22	B1	88.60	8.11	615	0.6	0.7	23

Source: BofA Merrill Lynch Global Research

Bottom performers

On underperformers, the list was full of Exploration and Production companies, with a select few non-Energy related issuers such as Iheart Communications, Intelsat, Windstream, and PHH Corp. AK Steel also made it to the worst list with a 3 point drop in its 7.625% bonds. Worst in the list was Memorial Production Partners' 7.625% 2021 bonds which fell 11 points after a bleak earnings report and proposed dividend cuts which caused its stock to drop 20%.

Table 11: Bottom 10 performers July 10th – July 17th

Issue	Rating	Price	Yield (%)	ZSpread	Px Change	Px Change (%)	Volume
MEMP 7.63 '21	CCC1	68.45	16.33	1456	-11.1	-13.9	10
SD 7.5 '21	CCC3	24.81	45.70	4404	-3.5	-12.4	24
PVA 8.5 '20	CCC1	35.77	39.57	3800	-4.2	-10.5	18
EXXI 8.25 '18	CCC2	40.79	54.32	5305	-4.5	-10.0	29
SD 7.5 '23	CCC3	24.33	39.63	3779	-2.5	-9.4	11
VNR 7.88 '20	B3	78.67	14.35	1276	-7.6	-8.8	6
BBEP 7.88 '22	B3	54.10	20.96	1910	-5.1	-8.6	20
IHRT 14 '21	CCC3	60.61	0.00	2705	-4.6	-7.1	27
INTEL 8.13 '23	CCC2	73.94	13.66	1169	-5.0	-6.3	21
SSE 6.63 '19	B3	68.16	17.57	1605	-4.5	-6.2	20

Source: BofA Merrill Lynch Global Research

Rating Actions

Last week we saw a sizable number of ratings actions on high yield issuers, mostly in the form of downgrades. Notably, Moody's lowered ONEOK Inc's senior unsecured debt from Baa3 to Ba1. The ratings agency lowered the name due to the company's decision to undertake a proposed notes offering, which re-leverages OKE as a pure-play GP. Moody's similarly lowered Pennsylvania National Mutual Casualty Insurance Co from Baa3 to Ba1 due to uncertainty with regards to legacy lead paint claims, including the potential for issues in collecting reinsurance recoverables on the lead paint claims.

On upgrades, S&P lifted Equity Commonwealth to IG from BB+ to BBB-. S&P said the upgrade reflects the company's asset sales and planned debt reduction, which occurred at a faster pace than they anticipated. This has resulted in a buildup of significant amounts of unrestricted cash. Also on upgrades, S&P raised Best Buy from BB to BB+. The ratings agency cited Best Buy's stabilization in top line performance and improving comparable same-store sales in the past three quarters.

Finally, S&P listed two entities in selective default last week: American Seafoods Group LLC and ASG Consolidated LLC. The ratings actions reflect a distressed exchange: ASG Consolidated announced that American Seafoods has transferred $38.6mn of its 15% senior notes at a 55% discount to carrying value to an affiliate of Bregal Partners.

Table 12: Ratings actions on HY issuers

Date	Action	Company Name	Rating Type	Agency	Curr Rtg	Last Rtg
8/7/2015	Upgrade	YRC Worldwide Inc	LT Local Issuer Credit	S&P	B-	CCC+
8/10/2015	Upgrade	Best Buy Co Inc	LT Local Issuer Credit	S&P	BB+	BB
8/10/2015	**Upgrade**	**Equity Commonwealth**	**LT Local Issuer Credit**	**S&P**	**BBB-**	**BB+**
8/10/2015	Upgrade	Midcontinent Communications	LT Local Issuer Credit	S&P	BB-	B+
8/12/2015	Upgrade	Vulcan Materials Co	Senior Unsecured Debt	Moody's	Ba2	Ba3 *+
8/12/2015	Upgrade	Euramax International Inc	LT Local Issuer Credit	S&P	B-	CCC *
8/13/2015	Upgrade	Legacy Vulcan Corp	Senior Unsecured Debt	Moody's	Ba2	Ba3 *+
8/13/2015	Upgrade	Level 3 Communications Inc	Senior Unsecured Debt	Moody's	B2	Caa1 *+
8/13/2015	Upgrade	Level 3 Escrow II Inc	Senior Unsecured Debt	Moody's	B1	B3
8/13/2015	Upgrade	Level 3 Financing Inc	Senior Unsecured Debt	Moody's	B1	B3 *+
8/14/2015	Upgrade	Crown Castle International Corp	Senior Unsecured Debt	Moody's	Ba3	B1
8/7/2015	Initiated	CTP Transportation Products Holdings LLC	LT Local Issuer Credit	S&P	B+ *-	
8/7/2015	Downgrade	Communications Sales & Leasing Inc	Senior Secured Debt	Moody's	B1	Ba3
8/7/2015	Downgrade	Communications Sales & Leasing Inc	Senior Unsecured Debt	Moody's	Caa1	B3
8/7/2015	Downgrade	Windstream Services LLC	Senior Unsecured Debt	Moody's	B2	B1
8/10/2015	**Downgrade**	**Pennsylvania Nat'l Mutual Casualty Insurance Co**	**Senior Unsecured Debt**	**Moody's**	**Ba1**	**Baa3**
8/11/2015	Downgrade	Infor Software Parent LLC	Senior Unsecured Debt	Moody's	Caa2	Caa1
8/11/2015	Downgrade	Infor US Inc	Senior Unsecured Debt	Moody's	Caa1	B3
8/11/2015	Downgrade	BioScrip Inc	LT Local Issuer Credit	S&P	CCC+	B-
8/11/2015	Downgrade	Smile Brands Group Inc	LT Local Issuer Credit	S&P	CCC+	B- *-
8/12/2015	Downgrade	American Apparel Inc	Senior Secured Debt	Moody's	Caa3 *-	Caa2
8/12/2015	Downgrade	Penn Virginia Corp	Senior Unsecured Debt	Moody's	Caa2	Caa1
8/12/2015	Downgrade	Fibertech Networks LLC	LT Local Issuer Credit	S&P	B	B+ *-
8/12/2015	Downgrade	Titan International Inc	LT Local Issuer Credit	S&P	B-	B
8/13/2015	Downgrade	EXCO Resources Inc	Senior Unsecured Debt	Moody's	Caa3	B3
8/13/2015	Downgrade	LSB Industries Inc	Senior Secured Debt	Moody's	B1	Ba3
8/13/2015	**Downgrade**	**ONEOK Inc**	**Senior Unsecured Debt**	**Moody's**	**Ba1**	**Baa3**
8/13/2015	Downgrade	Pioneer Energy Services Corp	Senior Unsecured Debt	Moody's	B3	B2
8/13/2015	**Downgrade**	**Edgewell Personal Care Co**	**LT Local Issuer Credit**	**S&P**	**BB+**	**BBB- *-**
8/13/2015	Downgrade	First Credit Union	LT Local Issuer Credit	S&P	BB-	BB
8/13/2015	Downgrade	GrafTech International Ltd	LT Local Issuer Credit	S&P	B+ *-	BB- *-
8/14/2015	Downgrade	Transworld Systems Inc	Senior Secured Debt	Moody's	Caa2	B3
8/7/2015	Dropped	Sagittarius Restaurants LLC	LT Local Issuer Credit	S&P	NR	B+
8/11/2015	Dropped	Ducommun Inc	Senior Unsecured Debt	Moody's	WR	B3
8/11/2015	Dropped	FCC Holdings LLC	Senior Unsecured Debt	Moody's	WR	Caa1
8/12/2015	Dropped	Keurig Green Mountain Inc	LT Local Issuer Credit	S&P	NR	BB
8/13/2015	Dropped	Fibertech Networks LLC	LT Local Issuer Credit	S&P	NR	B
8/11/2015	Default	American Seafoods Group LLC	LT Local Issuer Credit	S&P	SD	CC
8/11/2015	Default	ASG Consolidated LLC	LT Local Issuer Credit	S&P	SD	CC

Source: BofA Merrill Lynch Global Research

Relative Value

Cash v. CDS

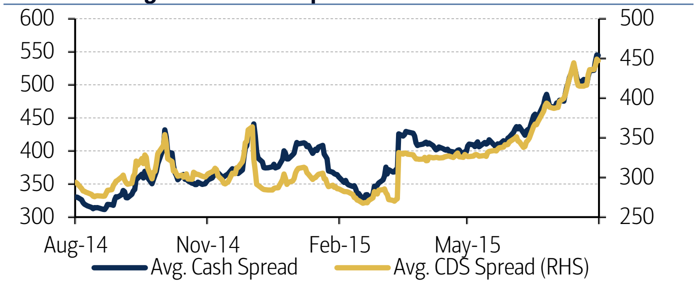
Cash indices underperformed CDX indices over the week (Table 13). CDX HY widened by 13bp while the HY cash index was 26bp wider. The average basis for CDX HY issuers we track similarly became more negative (Chart 15). The basis now stands at -97bp, 14bp lower over the week.

Table 13: CDX vs. ML Cash Indices

Index	Spread	1W-Chng	1M-Chng	3M-Chng
CDX IG	77	2	9	14
HG Cash	164	5	16	31
CDX HY	382	13	38	44
HY Cash	566	26	73	115

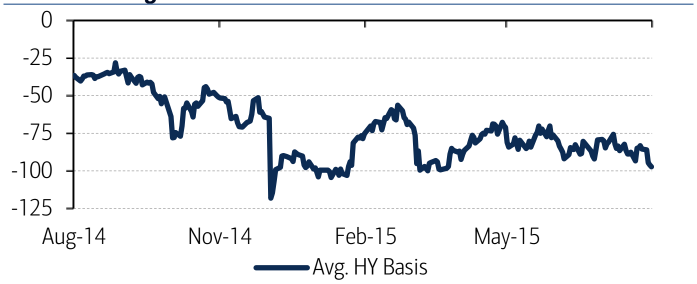
Source: BofAML Global Research, 5y spreads for CDX, OAS for cash

Chart 14: 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 15: 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

European indices performed in line with CDX (Table 14). The skew in HY became less positive as single-names underperformed the index. The IG skew continues to remain very wide, but became a little less negative over the week. The HY/IG spread ratio is now at 4.98, lower over the week (Chart 16), while the XO-HY spread was unchanged at -67bp (Chart 17).

Table 14: 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	77	2	9	14	82	1	10	16	-5	1	0	-2
CDX HY	382	13	38	44	378	17	41	43	4	-4	-3	1
iTraxx Main	68	3	2	7	70	3	4	9	-2	-1	-2	-2
iTraxx XO	315	13	31	39	325	12	20	42	-10	1	11	-3

Source: BofA Merrill Lynch Global Research

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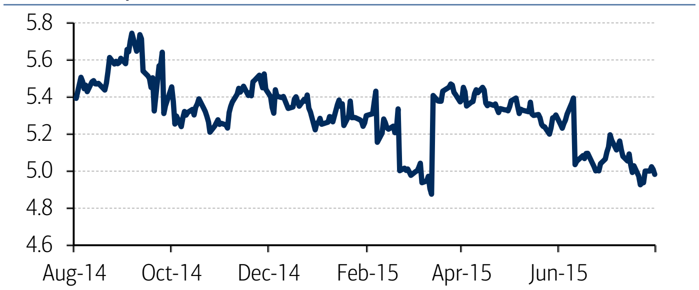
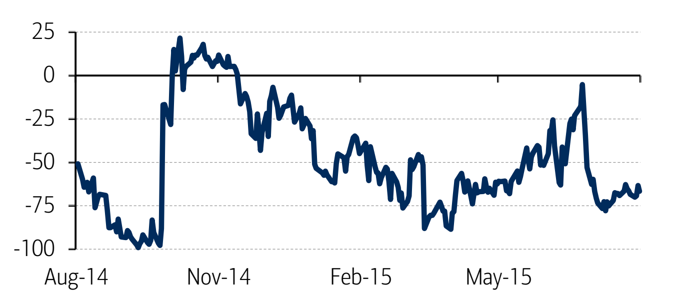
Chart 16: HY/IG



Source: BofA Merrill Lynch Global Research

Chart 17: XO-HY

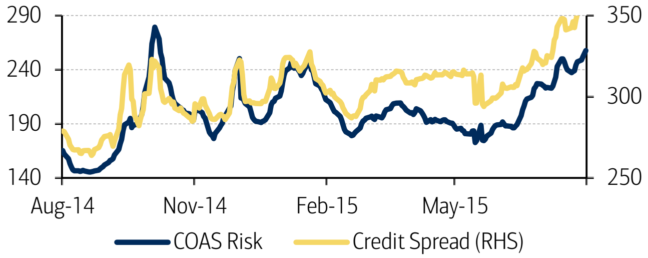


Source: BofA Merrill Lynch Global Research

Credit v. Equities

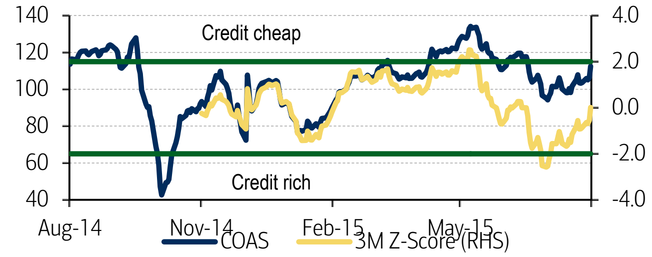
Average spread for our HY universe widened by 23bp compared to a 13bp increase in the equity implied credit risk (Chart 18). The US HY COAS value accordingly widened by 9bp. The COAS 3m z-score at 0.02 doesn't indicate any significant dislocation between HY credit and equity implied risk).

Chart 18: US HY COAS Risk vs. Spread



Source: BofA Merrill Lynch Global Research

Chart 19: US HY COAS & Z-Score



Source: BofA Merrill Lynch Global Research

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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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