Methodical, not indiscriminate compression

Bank of America Merrill Lynch

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High Yield Strategy
Global

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Drilling for signs of bank duress

As we enter into the final quarter of 2016 we fear just 3 events that have the potential to derail our base case of a slow grind tighter into year-end: a shock to the financial system precipitated by ailing banks, another collapse in oil prices, and a weak US jobs print. Two of our three uncertainties were addressed and dismissed last week as the market weathered both the woes of Deutsche Bank and another OPEC meeting, where it appears the cartel is willing to work together to freeze or reduce crude output beginning in November.

Down in quality or out the curve?

In our view, not only is the pull from foreign investors to safe yield strong, but the case can be increasingly made for why high yield in particular could be the beneficiary of a further draw of capital. However, we would prefer to enhance portfolio beta through careful addition of credit risk rather than reaching out the curve. Although we don't think low rates are going away any time soon, in our opinion valuations and rate sensitivity are overlooked as meaningful concerns in the market at the moment. And even though we remain uncomfortable with high yield fundamentals, our view is predicated on technicals and the belief that earnings will unlikely influence spread direction over the last quarter.

Flows:

US HY recorded a sizable $2.08bn (+0.9%) net inflow last week after the Fed elected not to raise rates and the BOJ announced their intention to keep the 10yr near its current level of 0%. Loans also recorded inflows to the tune of $557mn (+0.7%),

Issuance:

High yield issuance slowed down to $1.68bn this past week after the previous 2 weeks' $6.89bn and $7.96bn respectively. Although global loan issuance also modestly declined from its recent pace, the loan market remained heavily active with $9.4bn out of the United States. September concluded with $54.23bn in US Loan issuance, surpassing April 2007's $53.25bn for the largest ever dollar amount in a single month.

Performance:

Performance was strong in the first half of the week as the BOJ and Fed announcements created a bid for risk, though this faded in the back half of the week due to increased stress within the banking sector. US HY performed well with a +0.29% gain, led by triple-Cs (+0.57%).

Recent BofA Merrill Lynch Global Research Reports

Title: Subtitle	Primary Author	Date Published
The HY Note: BOJ and FOMC should spark HY buying	Michael Contopoulos	23 September 2016
The High Yield Flow Report: High yield steals the flow	Michael Contopoulos	29 September 2016
The High Yield Flow Report: Flows moderate after FOMC	Michael Contopoulos	22 September 2016
RV Brief: Get the fall rolling: CDX HY27 update	Michael Contopoulos	21 September 2016

Refer to important disclosures on page 14 to 15. Analyst Certification on page 13. COAS Certification on page 13.
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The View From Above

Drilling for signs of bank duress

As we enter into the final quarter of 2016 we fear just 3 events that have the potential to derail a slow grind tighter into year-end: a shock to the financial system precipitated by ailing banks, pension funds and insurance companies and exacerbated by low interest rates globally; another collapse in oil prices that corresponds with low growth and fears of recession; or a weak US jobs print that shakes investor confidence in the Fed's ability to generate growth and inflation. Two of our three uncertainties were addressed and dismissed last week as the market weathered both the woes of Deutsche Bank and another OPEC meeting, where it appears the cartel is willing to working together to freeze or reduce crude output beginning in November.

We have said in the past that we have never had strong financial markets without a strong banking system, and have been wary that the low interest rate environment and the challenges a flat yield curve present to banks can be a persistent state of the world. In fact, our biggest fear after speaking with innumerable international clients has been that BOJ Governor Kuroda and ECB President Draghi would begin to signal less accommodative action given the impact of low rates on the financial system. Coupled with unclear evidence that inflation and growth has picked up given negative deposit rates, and any shift in central bank policy that indicates a removal of accommodative action would likely have extreme consequences to the capital flow argument in the "reach for yield" camp.

And although Deutsche Bank's problems are not entirely created by low rates, but rather the profitability challenges they create for an institution hobbled by post crisis regulation where all banks need to maintain large liquidity reserves, the ripple effects from a bank that could have potentially lost the confidence of the market likely would have sparked fears for the entire global financial system. And although our equity analysts feel that DBK has insufficient earning's power to achieve the future minimum reserve requirement, and as a consequence will be forced into a capital raise, the rumoured smaller DOJ settlement ($5.4bn) related to the packaging, issuing and marketing of mortgage securities likely helps restore some degree of confidence in the firm's ability to weather the storm.

In the case of OPEC's decision to limit crude production, we see the likelihood of a steep decline in prices as now remote. As our Commodity Strategists note, the balance of risks have shifted to the upside, after news from Libya, Nigeria and Kashagan tilted them to the downside two weeks ago. Even after adjusting for higher Kashagan crude production and somewhat lower OPEC output, they leave their forward oil balances roughly unchanged. As a consequence, our strategists believe WTI will average $59/bbl next year with a high point of $69/bbl in Q2. Although we entered last week a bit nervous about the Energy space – after all, for the same level of WTI matched issuer spreads are 90bp tight today than 1 year ago -we remain constructive on Energy and E&P in particular. Though the bulk of the tightening has likely occurred since the lows on February 11th, we think as crude prices trend higher and earnings improve, the space has room to further compress.

Weekly Recap

High yield spreads continued to tighten last week as the market was able to successfully weather signs of stress from within the banking sector. Energy spreads significantly outperformed with 55bps of tightening after OPEC agreed to a cap on oil production for the first time in 8 years, sending WTI prices up over 10%. High yield issuance slowed down to $1.68bn this past week after the previous 2 weeks' $6.89bn and $7.96bn respectively. Although global loan issuance also modestly declined from its recent pace, the loan market remained heavily active with $9.4bn priced out of the United States.

Table 1: Spreads, yields, and returns

Index	OAS	1W-Chg	1M-Chg	YTW	WoW Return	YTD Return
US HY	503	-14	-11	6.31	0.41%	15.16%
ex-Energy	485	-8	2	6.12	0.25%	12.29%
ex-Materials	504	-13	-9	6.32	0.35%	13.78%
ex-E&M	484	-5	6	6.11	0.23%	10.94%

Source: BofA Merrill Lynch Global Research

Down in quality or out the curve?

Given the strength of technicals and a modestly improved fundamental picture, our base case for the last quarter of the year is a slow grind tighter. In our view, not only is the pull from foreign investors to safe yield strong, but the case can be increasingly made for why high yield in particular could be the beneficiary of a further draw of capital. First, although BBs in particular are more rate sensitive than they have ever been, relative to IG and treasuries, high yield is likely to be the least impacted of credit products if central banks decide to pull back on stimulus or shift their rhetoric on negative interest rate policy. Additionally, FX hedging costs are limiting the upside in Japanese dollar investors and we think these foreign investors in particular will likely search out higher yielding product to offset their costs. Second, with 92% of benchmark mutual fund high yield portfolios greater than $1bn in size underperforming their index, we believe some PMs may be incentivized to chase performance headed into year end. This is exactly the opposite of what we saw last year, when investors pulled back on risk and sold into weakness to "start fresh" in 2016. As we head into 2017, however, sentiment has changed, and long-only shops may be looking to increase risk headed into what is often a new year "pop".

In our view, however, searching for yield should not be indiscriminate; and based on recent trends our clients feel the same way. The lack of frenzy for paper is what so far has differentiated this rally from those that existed in 2013 and the beginning of 2014. However, there are signs that some froth may be returning to the market and in our view the question is, would you rather own credit risk or duration risk in the search for yield? Right now, we prefer the latter, though as we have highlighted for several months, believe there are ways to enhance portfolio beta without an over the top increase in risk.

An evolving world deserves an evolving strategy

About a year ago we coined the term "a rolling blackout" to characterize the default environment we're currently living through. The idea, we noted, is that individual sectors and types of companies experience their own unique moment of distress while the rest of the market remains resilient. Energy, Metals and Mining clearly represent the two most recent sectors realizing discreet bankruptcy risk, with perhaps Retail or Durable Goods coming down the line later next year into 2018. We have also noted that in a low-liquidity environment where poor fundamentals define the market, the risk for a total blackout increases exponentially, as fear and poor earnings create a negative feedback loop between investors, CEOs and CFOs and ultimately the consumer.

Generally, there are two fixes for the downward spiral: 1) earnings improve, confidence is restored, and the highest risks remain discreet and/or 2) valuations become too attractive to ignore, capital floods to the markets, credit lines become available, and businesses extend their lifelines. On the back of 2) earlier in the year we recommended that client's barbell their portfolio by adding long duration high quality paper in BBs and BBBs and names that have sold off the hardest (not necessarily triple Cs, but generally higher risk names). The idea, we reasoned, was that investors should want to own the names that have already sold off the most, while protecting themselves for broader contagion with safe credits. Rate risk was of little concern, as in our view, central banks would remain incredibly accommodative and rates were likely headed lower, not higher.

As the year has waned, however, we have shifted our strategy despite attractive returns in the barbell approach. One reason for our move has been our lack of comfort with a reliance on central banks to maintain low rates forever. Our thought process now is as follows: BBs have rallied significantly and fundamentals have improved, if even marginally. When coupled with central banks that are likely to maintain low rates, though likely not forever negative, we think investors will be forced to continue to reach for yield. However, when faced with adding duration or credit risk, we think valuations coupled with rate risk will nudge investors down in quality.

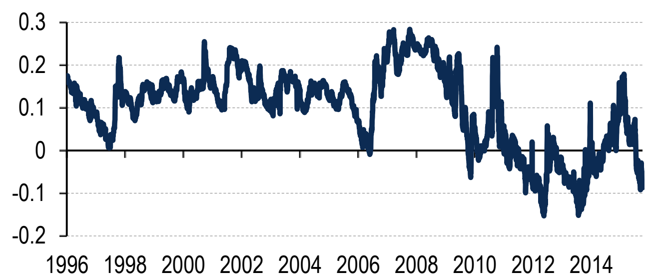
Out the curve may eventually lead to out of luck

Here we think it's important to note Kuroda's policy move 2 weeks ago where he acknowledged the impact of a flat yield curve on the performance of the financial sector, and his solution to peg the 10y JGB at 0%. Although not taken as a hawkish policy stance, we do think central banks could begin to add financial stability to their list of priorities (growth and inflation). In our view, this would imply higher rates and steeper curves. Couple a potential global central bank policy shift with a Fed that seems sure to hike in December, and although high yield has historically tightened 1 for 1 with moves higher in treasuries, we think the negative convexity of the market may result in a different reaction this go around.

Chart 1: HY spread beta to 5yr treasury

Source: BofA Merrill Lynch Global Research, Bloomberg

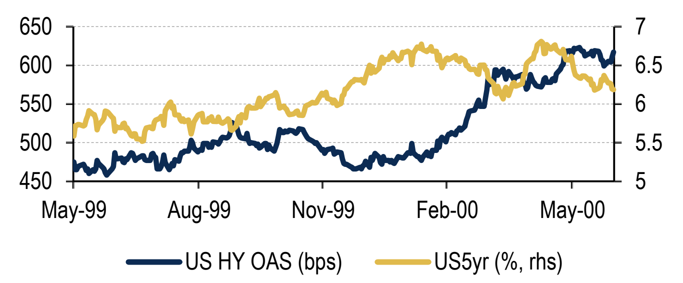
Chart 2: HY effective convexity



Source: BofA Merrill Lynch Global Research

This is not to say that we think low rates are going away anytime soon. In fact, we believe central banks will remain highly accommodative for some time to come. However, we also believe valuations and rate sensitivity are overlooked as meaningful concerns in the market, and should inflation actually begin to pick up, and the Fed need to get more aggressive, we have seen periods in history where rising rates has resulted in poor high yield performance. See the time between 1999 and 2000 below where spreads widened into higher rates (a stretch we think is strikingly similar to today). Of course we know in 2013 during the taper tantrum high yield spreads backed up over 100bp and just recently we saw high yield duration underperform significantly during the month of September as longer dated paper was unable to recover after the backup in the 10Y in the middle of the month.

Chart 3: Spreads can widen into higher rates (1999-2000 HY OAS vs 5yr treasury



Source: BofA Merrill Lynch Global Research, Bloomberg

Table 2: Longer dated HY couldn't recover from mid-Sep rate increase

	Years to Maturity									
	<2	2..	3..	4..	5..	6..	7..	8..	9..	10+
BB1	0.1	0.0	0.0	0.1	0.0	-0.1	-0.2	-0.4	-1.1	0.0
BB2	0.2	0.3	0.5	0.4	0.4	0.6	0.0	0.1	-0.2	0.4
BB3	-0.5	0.3	0.3	0.0	0.3	0.0	-0.2	-0.2	-0.5	-1.1
B1	0.2	0.4	0.5	0.5	0.1	0.2	-0.4	-0.5	-0.5	-0.6
B2	0.0	0.6	0.4	0.1	0.2	0.1	1.1	-0.2		
B3	0.3	0.2	0.9	0.8	1.3	1.0	0.5	0.3		5.7
CCC1	1.1	1.4	1.2	1.0	0.8	-0.2	0.4			
CCC2	1.3	2.3	2.6	1.7	2.9	0.2				
CCC3		1.2	1.1	1.2						
CC/C	5.0	-1.9	0.0	3.3						

Source: BofA Merrill Lynch Global Research

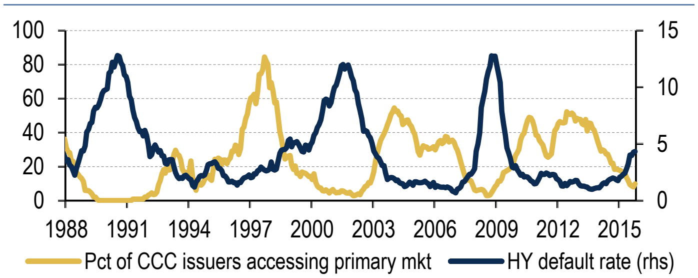
Down in quality should lead up in returns - for now

With rate risk coupled with tight valuations limiting the opportunities to add yield safely, we think the next area of high yield to realize strong returns will come from lower quality paper. Although we are uncomfortable with fundamentals, our view is predicated on technicals and the belief that earnings will unlikely influence spread direction over the last quarter. But with a cautious approach in mind, we prefer to first reach down in quality via loans and secured paper before dropping down to unsecured B or CCC paper. Our clients seem to be thinking along the same lines: CCC bond issuance still hasn't come back from near recessionary type levels, for example, while risk tolerance seems to be growing in the loan market.

In fact, the below chart on CCC issuance is one that is suggestive of a peak default rate (i.e. end of business cycle) next year; any time fewer than 20% of all CCC issuers tap the primary market over a 12 month horizon the default rate has reached double digits within 16-22 months. Although one of our favorite charts – as we think this highlights the reasons for default; not that companies perform poorly but rather because investors decide to no longer fund them – we do wonder if market structure has changed in such a way where the chart has less meaning today. Namely, have maturities been elongated such that fewer CCC companies need financing today or are there other financing opportunities for companies through shadow banking or the loan market that didn't exist in the past?

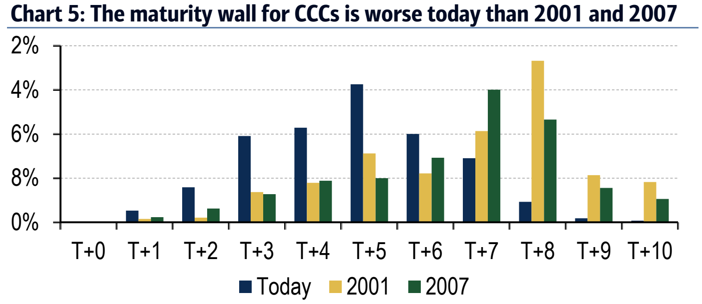
On the maturity schedule of the loan market, the CCC maturity wall looks significantly worse today than in 2007 and 2001, 2 years preceding a large pickup in default rates. This suggests to us that CCC issuers may want to extend, but have not for some other reason.

Chart 4: CCC issuer access



Source: BofA Merrill Lynch Global Research

Chart 5: The maturity wall for CCCs is worse today than 2001 and 2007

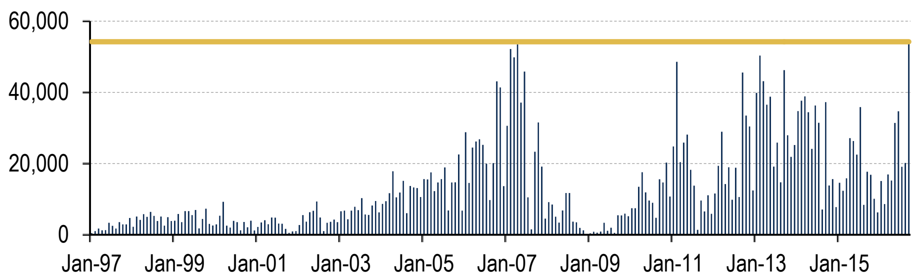


Source: BofA Merrill Lynch Global Research

Perhaps part of the answer is that more CCC issuers are coming to the loan primary market today than in past years. Though our data doesn't allow us to go that far back in history, what we do see is that out of the top 25 CCC bond issuers by par, just 2 have tapped the loan market in the last 1.5 years (Laureate Education and Avaya). Furthermore, only 5 have issued unsecured debt (Kinetic Concepts, Hub International, Solera Corp, Calumet, and Permian Resources). This leads us to believe that CCC companies with significant unsecured debt have also had trouble issuing in the secured market. We see this potentially causing a problem next year as 9 of the top 17 largest CCC bond issuers have paper that comes current in 2017; a time period where CFOs begin to explore refinancing existing debt. For this reason, we think the trend to lower quality remains confined, for now, in single B bonds and riskier loan paper in issuers without a significant amount of unsecured debt.

And right on cue, a record $54.23bn in new institutional money founds its way into the US loan market this September, overtaking April 2007's $53.25bn for the largest ever dollar amount in a single month (Chart 6). And as we recently wrote, the primary Loan market has become significantly more issuer-friendly in recent months; the clearing yields have been decidedly lower since February, and the number of deals that have reverse flexed continues to outweigh those flexed up. In terms of proceeds, the majority of September's issuance was geared towards refis ($20.66bn, 7th most ever) and acquisitions ($12.24bn, 6th most), while there was also a notable reduction in the quality of issuers coming to market; just 31% of September's total issuance was double-B rated, below the 2 year average of 41%. Filling the void was an increase in NR loans, which were responsible for $4.58bn or 8% of last month's supply. Year to date, loan issuance is currently $215.58bn, already above 2015's $214.08bn for the entire year. We think this trend has staying power for the rest of this year, as healthy CLO issuance (over $5bn priced in September) and the continued reluctance to fund riskier unsecured paper keeps the bid for loans elevated.

Chart 6: September's $54.23bn in US loan issuance was the largest ever amount



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

Despite the record setting issuance for loans, they managed to return 0.81% in September and outperformed the 0.50% gain that high yield experienced. In our opinion, this is indicative of an increased risk aversion to duration and desire to move up the capital structure while adding risk on the margins. Case in point, loans gained roughly $1.5bn (+1.9%) in net inflows during September, whereas open-ended high yield funds experienced just a $166mn (+0.0%) net inflow.

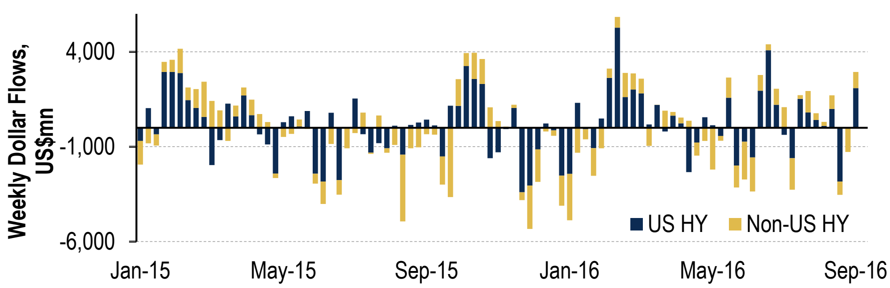
We think this outperformance of Loans has the potential to continue this year if our economists' call for a December rate hike from the Fed proves to be correct and investors continue to migrate into a more rate insensitive product. Additionally, as we noted above, with the majority of asset managers trailing their return bogey for 2016 we think they may feel forced into lower rated paper to chase returns into year-end. We therefore would prefer to barbell our portfolio with Loans and selectively chosen single-B/CCC unsecured names. In our opinion, these two pockets of the market will experience the strongest technicals for the remainder of this year and should leave the portfolio well positioned for downside scenarios including a backup in rates or a collapse in fundamentals.

Flows

This is an excerpt from our recently published report: [The High Yield Flow Report: High yield steals the flow 29 September 2016]

US HY recorded a sizable $2.08bn (+0.9%) net inflow last week after the Fed elected not to raise rates and the BOJ announced their intention to keep the 10yr near its current level of 0%. Most of the inflows ($1.84bn, +4.7%) came from HY ETFs which tend to be more institutionally driven and react more quickly to macro news, although open-end funds increased their AUM as well with a $243mn (+0.1%) net inflow. As we previously mentioned, we expected last week's minor $28mn inflow to continue into the current week as investors continued to buy riskier assets as a source of additional yield. However, given fresh concerns over several bank stocks and the recent selloff as a result, we would not be surprised to see these flows slow or even reverse next week. Although US HY gained the most in %AUM last week, most other risk assets recognized inflows as well. Non-US HY gained $851mn (+0.3%); EM debt added $2.41bn (+0.7%); and equities grew by $3.37bn (+0.07%), their largest inflow in 7 weeks. Loans also increased their AUM by $557mn (+0.7%), the 9th consecutive inflow for the asset class as money market reforms have caused LIBOR to increase to its highest level since 2009. Money market funds, which have experienced some of their largest outflows since 2010 recently, also recognized an inflow last week to the tune of $2.04bn (+0.1%). As a whole, fixed income funds gained $4.94bn (+0.2%).

Chart 7: 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 HY issuance slowed down this past week to $3.6bn from $8.5bn and $13.1bn from the 2 weeks prior, the smallest amount for any week this month. However, September still managed to conclude with $39.2bn in aggregate issuance ($23.8bn from the United States) for the largest dollar amount in 17 months (most in 4 months from the US). Year-to-date issuance stands at $208.4bn out of DM HY and $153.1bn from the US, 22% and 16% behind last year's paces respectively. At the current pace, we will conclude 2016 with $203.89bn in US HY issuance which represents a 6% decline from 2015's $215.23bn in aggregate.

Of this month's issuance, $20.64bn was double-B rated, $11.86bn was single-B, and the remaining $6.66bn was triple-C. This was the largest dollar amount of triple-C issuance in 2 years and more than the previous 4 months combined. However, in our opinion it is still too early to signal a broad-based increase in risk appetite at the primary level as the percent of CCC issuers accessing the primary market over the last 12 months remains at its lowest level since 2009.

Table 3: DM issuance summary ($bn)

	DM	United States	Europe	BB	B	CCC/NR
WTD Sep 30	3.6	1.7	1.9	0.8	1.6	1.2
Wk Sep 23	8.5	6.9	1.4	5.4	2.1	1.0
Wk Sep 16	13.1	8.0	5.1	6.7	3.8	2.6
Wk Sep 09	13.7	7.3	6.1	7.4	4.3	2.0
MTD Sep	39.2	23.8	14.6	20.6	11.9	6.7
August	21.3	17.9	3.4	9.7	10.6	1.0
July	18.4	13.2	4.7	4.1	13.5	0.5
June	24.8	19.3	2.0	14.3	9.3	1.2
YTD 2016	208.4	153.1	47.8	93.2	93.3	21.5
YTD 2015	267.0	181.2	69.6	94.3	136.2	36.5
2015	308.6	215.8	75.2	117.8	152.2	38.5
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

Source: BofA Merrill Lynch Global Research

Table 4: Most recent DM HY bond new issues

Pricing Dt	Name	Size ($)	Snr	Cpn	Maturity	Price	Yield	Moody's	S&P	Type	Sector	Region
9/29/2016	Schoeller Allibert Holding BV	235	Sr Sec Nts	8.00	10/1/2021	100.00	8.00	B2	B-	144A for Life	Transportation	Europe
9/29/2016	Virgin Media Inc	454	Sr Nts	5.50	9/15/2024	100.00	5.50		B	144A for Life	Media	Europe
9/29/2016	Jerrold Finco plc	486	Sr Sec Nts	6.25	9/15/2021	100.00	6.25	NR	BB-	144A for Life	Diversified Finan Serv	Europe
9/29/2016	Cabot Financial (Luxembourg) SA	454	Sr Sec Nts	7.50	10/1/2023	100.00	7.50	B2	B+	144A for Life	Diversified Finan Serv	Europe
9/29/2016	Mohegan Tribal Gaming Authority	500	Sr Nts	7.88	10/15/2024	99.27	8.00	B3	CCC+	144A for Life	Entertainment	United States
9/29/2016	Inventiv Group Holdings Inc	675	Sr Nts	7.50	10/1/2024	100.00	7.50	Caa2	CCC+	144A for Life	Diversified Finan Serv	United States
9/29/2016	Crescent Communities LLC	400	Sr Sec Nts	8.88	10/15/2021	100.00	8.88	Caa1	B+	144A for Life	Real Estate	United States
9/27/2016	Beazer Homes USA Inc	100	Sr Nts	8.75	3/15/2022	104.25	Float	B3	B-	144A w/RR	Home Builders	United States
9/26/2016	NH Hoteles SA	321	Sr Sec Nts	3.75	10/1/2023	100.00	3.75	Ba3	BB-	144A w/RR	Lodging	Europe

Source: BofA Merrill Lynch Global Research, Bloomberg, company filings

At the single-name level, 9 different issuers accessed the primary market last week for a combined $3.62bn in DM HY issuance. The largest pricing came from Inventiv Group Holdings Inc with a $675mn tranche of CCC rated senior notes. The offer was downsized from $720mn with the remaining $45mn in proceeds shifted to its concurrent term loan. The 7.5% yield printed at the tight end of talk in the 7.5% to 7.75% context, with proceeds used to refinance existing debt and fund Advent International's partial acquisition of inventive.

Also coming to market was Mohegan Tribal Gaming Authority with a $500mn offering of 7 7/8% senior notes. The B3/CCC+ issue priced at 99.271 to yield 8%, at the tight end of talk in the 8% to 8.25% context. The operator of gaming and entertainment enterprises plans to use the proceeds to refinance its entire capital structure.

Table 5: New issue breakdown by week, last 15 weeks

		Ratings				Currency (US$mn)				Seniority			Deal Type		
	Total	BB	B	CCC	NR	USD	EUR	GBP	CAD	Secured	Senior	Sub	144a w RR	144a w/o RR	Public
6/24/2016	1,350	1,350				1,350					1,350				1,350
7/1/2016															
7/8/2016	1,250		1,250			1,250					1,250			1,250	
7/15/2016	4,589	900	3,189	500		3,810	779			1,914	2,675		375	3,714	500
7/22/2016	5,821	880	4,941			4,075	1,189	557		3,296	2,525		4,721	1,100	
7/29/2016	6,709	2,275	4,084			5,775	934			700	6,009		1,970	2,614	2,125
8/5/2016	8,734	4,634	3,801	300		7,250	1,484			1,075	7,659		2,650	5,059	1,025
8/12/2016	6,933	4,050	2,808	75		6,665	268			1,523	5,410		1,600	3,033	2,300
8/19/2016	5,620	1,000	4,020	600		5,620				1,170	4,450		850	4,270	500
8/26/2016															
9/2/2016	292	292						292		292			292		
9/9/2016	13,684	7,423	4,275	1,986		9,520	4,164			6,108	7,577		4,966	8,218	500
9/16/2016	13,096	6,709	3,837	2,550		9,350	3,554		192	5,087	8,009		1,331	10,561	1,203
9/23/2016	8,462	5,404	2,108	950		6,550	1,761		152	2,799	5,663		2,800	5,662	
9/30/2016	3,625	807	1,643	1,175		1,675	556	1,394		1,896	1,729		421	3,204	

Source: BofA Merrill Lynch Global Research

Loans

Although global loan issuance slowed down modestly from its recent pace, it remained heavily active with $10.8bn priced globally and $9.4bn out of the United States. Most of last week's US loan activity was concentrated in the double-B bucket ($4.21bn), while $2.39bn came from single-B issuers and the remaining $2.85bn was not rated. As we mentioned above, September concluded with $54.23bn in new loan issuance which was the most ever for a single month.

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

	Global	US	BB	B	CCC/NR	Cov lite
WTD Sep 30	10.8	9.4	4.2	3.7	2.9	6.9
Wk Sep 23	14.3	14.3	4.5	8.5	1.3	9.4
Wk Sep 16	15.8	14.4	6.9	7.4	1.4	11.5
Wk Sep 09	17.3	16.1	3.3	13.4	0.6	12.2
MTD Sep	58.1	54.2	18.9	33.0	6.2	40.0
August	21.6	20.2	10.6	7.4	3.6	13.6
July	25.2	19.1	8.9	15.4	1.0	18.9
June	37.0	34.7	10.4	22.0	4.7	26.4
YTD 2016	233.0	215.6	90.4	122.6	20.1	167.2
YTD 2015	206.9	180.8	81.9	108.7	16.3	144.5
2015	257.3	214.1	112.9	126.6	17.7	186.4
2014	377.0	319.2	109.5	216.5	51.1	265.6
2013	454.9	389.8	152.6	261.9	40.4	279.0

Source: S&P LCD

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

		Ratings						
	Total	BB	B	CCC	NR	TLb	2nd Lien	Cov Lite
6/17/2016	8,295	4,060	3,355	205	675	8,090	205	5,500
6/24/2016	3,990	670	1,600		1719.8	3,990		2,565
7/1/2016	338		193		145	338		143
7/8/2016	1,500	1,100	400			1,500		1,450
7/15/2016	8,603	3,500	5,103		0	8,603		8,328
7/22/2016	5,126	1,200	3,218	490	218	4,636	490	3,943
7/29/2016	10018.63	3050	6645.62	323	0	9695.62	323	5170
8/5/2016	11,197	4,400	5,540	755	502	10,990	205	4,820
8/12/2016	8,941	6,187	1,864		890	8,941		7,321
8/19/2016	1,500			1,500		1,500		1,500
9/2/2016	0		0			0		0
9/9/2016	17,297	3325	13,407	375	190	16,922	375	12,225
9/16/2016	15,763	6,912	7,410	558	883.5	15,065	698	11,517
9/23/2016	14,260	4,490	8,475	640	655	13,410	850	9,390
9/30/2016	10,796	4205	3,741		2850	10,071	725	6,872

Source: S&P LCD

In terms of proceeds, the majority of September's issuance was geared towards refis ($20.66bn, 7th most ever) and acquisitions ($12.24bn, 6th most), while there was also a notable reduction in the quality of issuers coming to market; just 31% of September's total issuance was double-B rated, below the 2 year average of 41%. Filling the void was an increase in NR loans, which were responsible for $4.58bn or 8% of last month's supply. Year to date, loan issuance is currently $215.58bn, already above 2015's $214.08bn for the entire year. At the single name level, one of last week's largest pricings was a $1.647bn seven-year term loan from Platform Specialty Products Corp. Proceeds from the deal, together with cash, will be used to refinance existing term loans, including the dollar TLB-1 and TLB-2 tranches and the euro TLC-1 tranche.

Table 8: Recent leveraged loan new issues

Launch Dt	Issuer	Deal Name	Size ($)	New Inst. Money ($)	Moody's	S&P	Asset Backed	Cov Lite	Proceeds	Sector	Country
9/29/2016	Platform Specialty Products Corp	Platform Specialty (US 10/16)	1647	1647	B2	BB-	No	Yes	Refinancing	Chemicals	United States
9/29/2016	Tweddle Group	Tweddle (10/16)	225	225	NR	NR	No	No	GCP	Printing & Publishing	United States
9/29/2016	Talen Energy Corp	Talen Energy (10/16)	600	600	Baa3	BB	No	Yes	Acquisition	Utilities	United States
9/28/2016	Universal Fiber Systems LLC	Universal Fiber (Add-on 10/16)	44	44	NR	B+	No	No	Dividend	Textile & Apparel	United States
9/28/2016	Pacific Architects and Engineers Inc	PAE (2nd Lien 10/16)	175	175	NR	NR	No	Yes	Dividend	Services & Leasing	United States
9/28/2016	Pacific Architects and Engineers Inc	PAE (TL 10/16)	550	550	NR	NR	No	Yes	Dividend	Services & Leasing	United States
9/28/2016	Emerald Expositions Holdings	Emerald Expo (Add-on 10/16)	200	200	B2	BB-	No	Yes	Refinancing	Services & Leasing	United States
9/28/2016	Hargray Holdings LLC	Hargray (Add-on 10/16)	397	50	B2	B+	No	No	Dividend	Telecom	United States
9/27/2016	Ancestry.com	Ancestry.com (10/16)	1350	1350	NR	NR	No	No	Dividend	Computers & Electronics	United States
9/27/2016	Ancestry.com	Ancestry.com (2nd Lien 10/16)	550	550	NR	NR	No	No	Dividend	Computers & Electronics	United States
9/27/2016	Casella Waste Systems Inc	Casella Waste (TL 10/16)	350	350	B1	B+	No	Yes	Refinancing	Environmental	United States
9/27/2016	CBS Radio	CBS Radio (10/16)	1250	1000	Ba3	BB-	No	No	Acquisition	Radio	United States
9/27/2016	Lions Gate Entertainment Corp	Lions Gate (TL 10/16)	1900	1900	Ba2	BB-	No	Yes	Acquisition	Film	United States
9/27/2016	SRS Distribution	SRS Distribution (Add-on 10/16)	100	100	B2	B	No	Yes	Refinancing	Building Materials	United States
9/26/2016	Royalty Pharma Finance Trust	Royalty Pharma (10/16)	705	705	Baa2	BBB-	No	No	Refinancing	Services & Leasing	United States
9/26/2016	Reynolds Group Holdings Ltd	Reynolds Group (Add-on 10/16)	1350	1350	B2	B+	No	Yes	Refinancing	Forest Product	New Zealand

Source: S&P LCD

Performance Summary

Performance was strong in the first half of the week as the BOJ and Fed announcements created a bid for risk, though this partially faded in the back half of the week due to increased stress within the banking sector. High yield was the top performing asset class with a +0.59% return from CDX HY and +0.41% from our high yield cash index, while leveraged loans were the 3rd top performer (+0.22%). EM equities finished at the bottom of the list with a 1.53% decline, though they remain among 2016's top performers with a +13.77% return YTD.

Performance was mostly driven by risk across corporate rating

Table 9: Total returns across asset classes

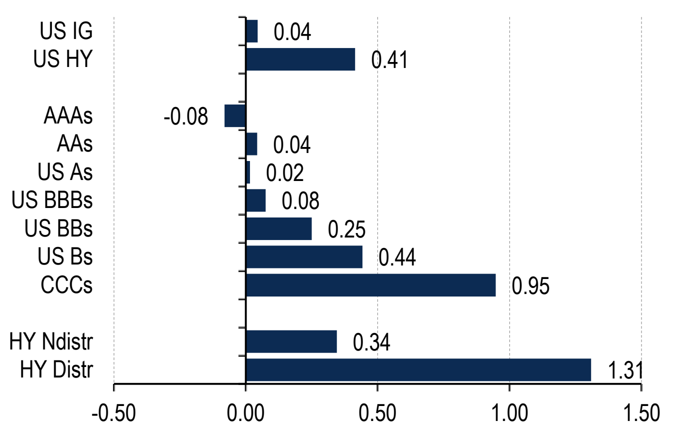
Ticker	Name	WOW (%)	MTD (%)	YTD (%)
MXEF	EM Eqty	-1.53	1.09	13.77
HE00	EU HY	-0.17	-0.49	7.12
EMGB	EM Govts	-0.09	0.31	12.98
EMIB	EM IG	-0.08	-0.30	8.61
G0QI	TIPs	0.01	0.55	7.70
C0A0	US IG	0.04	-0.29	9.11
U0A0	Municipals	0.06	-0.48	4.09
M0A0	Mortgages	0.06	0.28	3.72
GA05	5yr TRSY	0.07	0.27	4.00
CDXIG	CDX.IG	0.12	0.30	1.50

buckets. Triple-Cs were the top performer with a +0.95% return, followed by single-Bs (+0.44%) and double-Bs (+0.25%). As a whole, the nondistressed portion of high yield finished with a 0.34% gain, compared to a 1.31% return from distressed credits. All but 1 of our 18 high yield sectors finished with a positive WoW return in the final week of September. Energy (+1.02%) far and away outperformed after OPEC reached an agreement to cap oil production for the first time in 8 years, while Materials (+0.61%) and Utilities (+0.58%) also delivered st4rong gains. Food (-0.20%) was the lone sector with a negative return last week.

SPX	S&P 500	0.17	-0.12	6.08
EMHB	EM HY	0.18	1.13	16.69
LCDI/ALL	Lev Loans	0.22	0.86	7.72
H0A0	US HY	0.41	0.65	15.32
CDXHY	CDX.HY	0.59	1.13	8.40

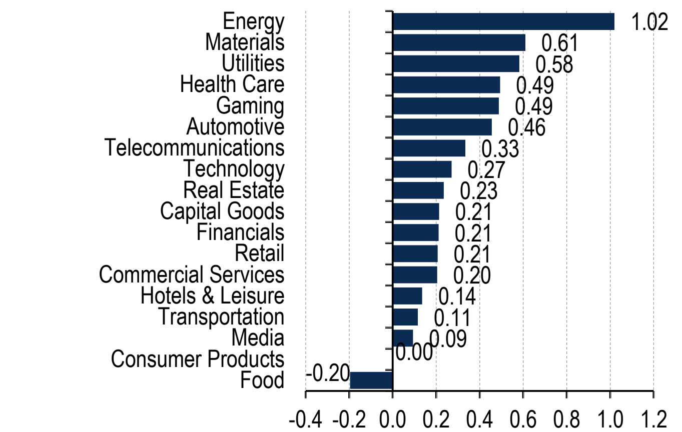
Source: BofA Merrill Lynch Global Research

Chart 8: Segment and rating returns, week-on-week (WoW)



Source: BofA Merrill Lynch Global Research

Chart 9: Sector returns, week-on-week (WoW)



Source: BofA Merrill Lynch Global Research

Top performers

Last week's top performing bond was the IHRT 10, which jumped 9.7% after the company proposed an amendment to its outstanding senior notes due 2021 to increase the aggregate principal by $500mn. However, the company's 9% issue due 2019 was one of last week's bottom performers in response to the news with a 2.4% decline. Taking spots 2-4 on the list of last week's top performers were 3 series of TCKBCN notes, which each gained between 6 and 7% after the company announced it intends to reduce debt by $1.5 to $2bn and improve its leverage to 2.5x at a leveraged finance conference. Other top performers include the VNR 7 7/8's (+5.8%), the SVR 9 1/8's (+5.4%), and the TCKBCN 6's (+5.3%).

Table 10: Top 10 performers, September 22nd – September 29th

Issue	Rating	Price	Yield	ZSpread	Px Chg	Pct Chg	Volume
IHRT 10 '18	CC	65.94	48.60	4745	5.8	9.7	38
TCKBCN 6.25 '41	B3	95.40	6.63	502	6.1	6.9	49
TCKBCN 5.4 '43	B3	86.66	6.46	483	5.4	6.7	45
TCKBCN 6.13 '35	B3	93.91	6.70	512	5.2	5.9	21
VNR 7.88 '20	CC	48.19	34.56	3349	2.6	5.8	37
SVR 9.13 '19	CCC2	76.00	23.23	2219	3.9	5.4	5
TCKBCN 6 '40	B3	91.74	6.70	509	4.6	5.3	34
CLD 8.5 '19	B3	80.70	16.49	1543	3.9	5.1	27
CHK 6.13 '21	CCC3	91.56	8.48	733	3.9	4.5	20
DNR 5.5 '22	CCC2	71.63	12.76	1158	2.8	4.1	18

Source: BofA Merrill Lynch Global Research, Bloomberg. Performance and volume data from FINRA TRACE.

Bottom performers

The BRS 6 ¼'s were last week's bottom performer with a 3.7% decline after the company disclosed an amended and restated revolving credit facility and term loan agreement related to the Change in Control provision. Also making their way into last week's list of bottom performers were 5 different series of FTR notes, which each fell roughly 1.5% to 2% due to their liquidity and generic use as a market hedge. Other bottom performers include the HOS 5 7/8's (-2.6%), the IHRT 9's (-2.4%), and the FGP 8 5/8's (-1.9%).

Table 11: Bottom 10 performers, September 22nd – September 29th

Issue	Rating	Price	Yield	ZSpread	Px Chg	Pct Chg	Volume
BRS 6.25 '22	B1	72.34	13.01	1179	-2.8	-3.7	15
HOS 5.88 '20	CCC1	61.79	22.16	2107	-1.6	-2.6	14
FTR 6.88 '25	BB3	88.79	8.81	748	-2.2	-2.5	24
IHRT 9 '19	CCC2	79.34	17.72	1664	-2.0	-2.4	45
FTR 10.5 '22	BB3	106.17	9.09	793	-2.4	-2.2	165
FTR 11 '25	BB3	104.32	10.24	892	-2.3	-2.1	201
FGP 8.63 '20	B3	98.17	9.21	813	-1.9	-1.9	10
FTR 9 '31	BB3	92.61	9.96	848	-1.8	-1.9	21
FTR 8.75 '22	BB3	102.48	8.18	699	-1.5	-1.4	13
FTR 7.63 '24	BB3	93.53	8.82	754	-1.3	-1.4	23

Source: BofA Merrill Lynch Global Research, Bloomberg. Performance and volume data from FINRA TRACE.

Rating Actions

Last week we saw 15 downgrades and 14 upgrades on high yield issuers, including 1 rising star and 1 selective default. Notably, Lear Corp was upgraded to Baa3 from Ba1 by Moody's, reflecting the company's improved profit margins through ongoing cost reductions. The rating agency believes that Lear has sufficient flexibility in its operating costs, and with its low financial leverage the company should be able to manage through a reasonable down cycle to remain profitable.

Also of note, Cloud Peak Energy Resources LLC was lowered to SD by S&P after the company announced an exchange offer of its $300mn senior unsecured notes due 2019 and its $200mn senior unsecured notes due 2024. The rating agency views this transaction as distressed because the cash and principal amount of the new securities offered is less than the original par amount. Additionally, according to S&P the deterioration in the company's operating performance and reduced liquidity over the past several quarters offers uncertainty over the company's ability to generate positive operating cash flow in the near future.

On downgrades, Freeport-McMoran had its LT local issuer credit rating lowered to BB- from BB by S&P because of continued lower copper and oil and gas prices, which contributed to adjusted leverage above 6x for the company in Q2 2016. However, S&P anticipates a stronger financial risk profile by year end due to the company's ongoing efforts to reduce debt.

Table 12: Ratings actions on high yield issuers, September 22nd – September 29th

Date	Action	Company Name	Rating Type	Agency	Curr Rtg	Last Rtg
09/29/2016	Upgrade	Chesapeake Energy Corp	LT Local Issuer Credit	S&P	CCC+	SD
09/29/2016	Upgrade	CRGT Inc	LT Local Issuer Credit	S&P	B	B-
09/28/2016	Upgrade	Radian Group Inc	LT Local Issuer Credit	S&P	BB	BB-
09/27/2016	Upgrade	Alliance One International Inc	LT Local Issuer Credit	S&P	CCC+	CCC
09/27/2016	Upgrade	Pactiv LLC	LT Local Issuer Credit	S&P	B+	B
09/27/2016	Upgrade	Simmons Foods Inc	LT Local Issuer Credit	S&P	B	B-
09/26/2016	Upgrade	Pike Corp	LT Local Issuer Credit	S&P	B+	B
09/23/2016	Upgrade	Memorial Resource Development LLC	LT Local Issuer Credit	S&P	BB+	B *+
09/23/2016	Upgrade	Range Resources-Louisiana Inc	LT Local Issuer Credit	S&P	BB+	B *+
09/28/2016	Upgrade	Alliance One International Inc	Senior Secured Debt	Moody's	B1	Caa3
09/28/2016	Upgrade	JC Penney Corp Inc	Senior Secured Debt	Moody's	Ba2	B1
09/28/2016	Upgrade	JC Penney Corp Inc	Senior Unsecured Debt	Moody's	B3	Caa2
09/26/2016	Upgrade	Tenaska Alabama Partners LP	Senior Secured Debt	Moody's	Ba1	Ba2
09/22/2016	**Upgrade**	**Lear Corp**	**Senior Unsecured Debt**	**Moody's**	**Baa3**	**Ba1**
09/28/2016	Initiated	CBS Radio Inc	LT Local Issuer Credit	S&P	B+	
09/28/2016	Initiated	PAE Holding Corp	LT Local Issuer Credit	S&P	B	
09/22/2016	Initiated	Chobani Global Holdings Inc	LT Local Issuer Credit	S&P	B	
09/22/2016	Initiated	Chobani LLC	LT Local Issuer Credit	S&P	B	
09/27/2016	Initiated	St Marys Cement Inc	Senior Unsecured Debt	Moody's	Ba2	
09/27/2016	Dropped	Mattress Firm Holding Corp	LT Local Issuer Credit	S&P	NR	B+ *+
09/26/2016	Dropped	Allison Transmission Inc	LT Local Issuer Credit	S&P	NR	BB
09/26/2016	Dropped	American Media Inc	LT Local Issuer Credit	S&P	NR	CCC
09/26/2016	Dropped	Memorial Resource Development LLC	LT Local Issuer Credit	S&P	NR	BB+
09/26/2016	Dropped	Range Resources-Louisiana Inc	LT Local Issuer Credit	S&P	NR	BB+
09/29/2016	Downgrade	ACE Cash Express Inc	LT Local Issuer Credit	S&P	CC *-	B-
09/29/2016	Downgrade	Compass Minerals International Inc	LT Local Issuer Credit	S&P	BB	BB+

Table 12: Ratings actions on high yield issuers, September 22nd – September 29th

Date	Action	Company Name	Rating Type	Agency	Curr Rtg	Last Rtg
09/29/2016	Downgrade	Emmis Communications Corp	LT Local Issuer Credit	S&P	CCC	B-
09/29/2016	Downgrade	Steinway Musical Instruments Inc	LT Local Issuer Credit	S&P	B-	B
09/28/2016	Downgrade	Cyprus Amax Minerals Co	LT Local Issuer Credit	S&P	BB-	BB
09/28/2016	Downgrade	ECI Holdco Inc	LT Local Issuer Credit	S&P	B	B+
09/28/2016	Downgrade	Freeport-McMoRan Corp	LT Local Issuer Credit	S&P	BB-	BB
09/27/2016	Downgrade	Legacy Reserves LP	LT Local Issuer Credit	S&P	CCC	B-
09/23/2016	Downgrade	Lions Gate Entertainment Corp	LT Local Issuer Credit	S&P	B+	BB- *-
09/23/2016	Downgrade	Pinnacle Operating Corp	LT Local Issuer Credit	S&P	CCC	CCC+
09/23/2016	Downgrade	Sonic Automotive Inc	LT Local Issuer Credit	S&P	BB-	BB
09/22/2016	Downgrade	Sequa Corp	LT Local Issuer Credit	S&P	CCC	CCC+
09/28/2016	Downgrade	Compass Minerals International Inc	Senior Unsecured Debt	Moody's	B1	Ba2 *-
09/26/2016	Downgrade	Bristow Group Inc	Senior Unsecured Debt	Moody's	B2	B1
09/24/2016	Downgrade	Pinnacle Operating Corp	Senior Secured Debt	Moody's	Caa3	Caa2
09/23/2016	Default (selective)	Cloud Peak Energy Resources LLC	LT Local Issuer Credit	S&P	SD	B+

Source: Bloomberg, S&P, Moody's. Rising stars and fallen angels bolded.

Relative Value

Cash v. CDS

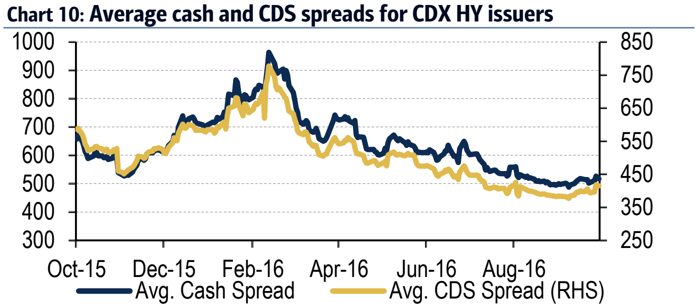
Within our HG universe cash and synthetic indices performed similarly with 2bps of widening each. However, in HY cash outperformed with no change in spread, compared to 6bps of widening for CDX HY (Table 13). On an issuer matched level, the average HY basis increased by 2bps i.e. CDS spreads lagged cash performance (Chart 11). The average basis for CDX HY issuers we track now stands at -102bps, 7bps less negative since the roll into S27 last Tuesday.

Table 13: CDX vs. ML Cash Indices

Index	Spread	1W-Chng	1M-Chng	3M-Chng
CDX IG	78	2	1	-5
HG Cash	143	2	5	-19
CDX HY	415	6	1	-35
HY Cash	509	0	-1	-117

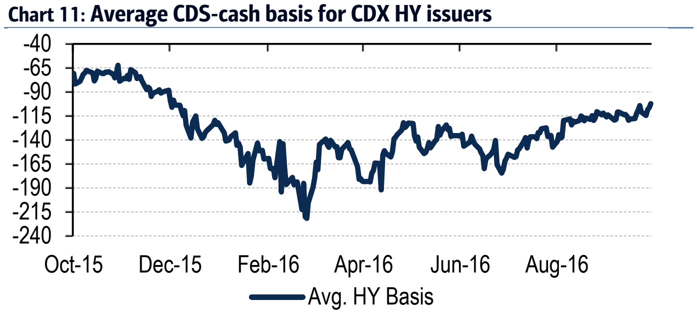
Source: BofAML Global Research, 5y spreads for CDX, OAS for cash

Chart 10: 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 11: Average CDS-cash 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

CDS indices in the US and Europe widened over the week (Table 14). For the most part, single-names outperformed indexes as skews increased in CDX IG, CDX HY, and iTraxx XO, although single names lagged in iTraxx Main with a 1bp decline in its skew. The HY/IG spread ratio has fallen 5bps since the HY roll and currently stands at 529bps. Meanwhile, the XO-HY spread differential fell 5bps and currently stands at -82bps as European HY outperformed its US counterpart.

Table 14: CDS Indices – spread, intrinsic and skew

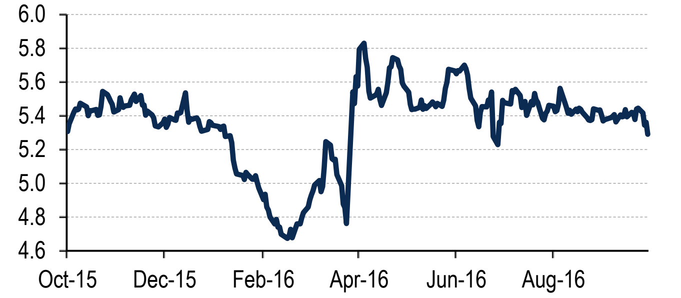
Index	5y Spread	1W-Chng	1M-Chng	3M-Chng	5y Intrinsic	1W-Chng	1M-Chng	3M-Chng	Skew	1W-Chng	1M-Chng	3M-Chng
CDX IG	78	2	1	-5	82	-1	-2	-15	-4	3	3	10
CDX HY	415	6	1	-35	400	-7	-7	-77	15	13	8	42
iTraxx Main	73	3	-1	-13	76	3	0	-15	-3	-1	-1	2
iTraxx XO	333	5	11	-30	334	2	7	-55	-2	3	3	25

Source: BofA Merrill Lynch Global Research

Table 14: CDS Indices – spread, intrinsic and skew

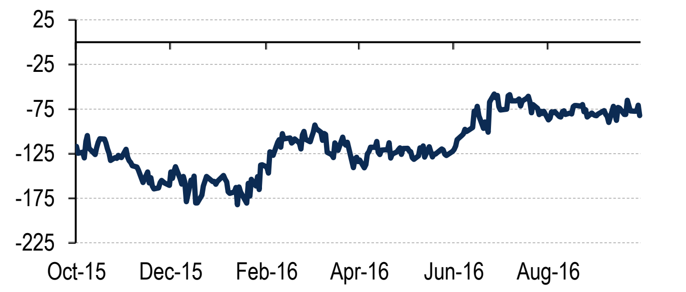
Index	5y Spread	1W-Chng	1M-Chng	3M-Chng	5y Intrinsic	1W-Chng	1M-Chng	3M-Chng	Skew	1W-Chng	1M-Chng	3M-Chng

Chart 12: HY/IG



Source: BofA Merrill Lynch Global Research

Chart 13: XO-HY

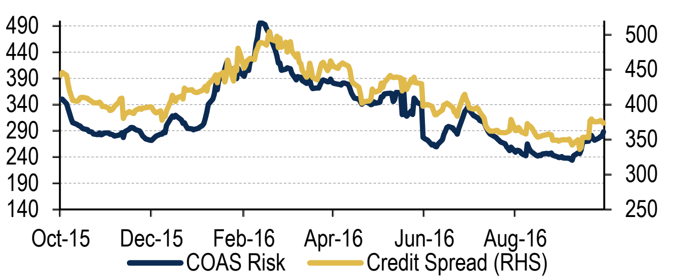


Source: BofA Merrill Lynch Global Research

Credit v. Equities

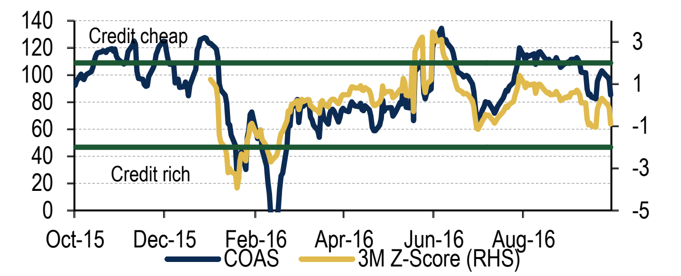
The average credit spread for our HY universe tightened by 3bps compared to a 13bp increase in the equity implied credit risk (Chart 14). The US HY COAS value accordingly fell by 16bps and its 3m z-score is now at -0.90, indicating that credit looks somewhat rich relative to its equity implied risk (Chart 15).

Chart 14: US HY COAS Risk vs. Spread



Source: BofA Merrill Lynch Global Research

Chart 15: US HY COAS & Z-Score



Source: BofA Merrill Lynch Global Research

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