High Yield

Tracking a Thousand Stars

We find that rising stars tend to outperform by 60bp in OAS terms in the weeks before their upgrade and just 10bp in the weeks after. Bonds that are shorter dated and those that are not call-constrained lead performance, with larger issuers benefiting as well.

CORE

Bradley Rogoff, CFA
+1 212 412 7921
bradley.rogoff@barclays.com
BCI, US

Scott Schachter
+1 212 526 9716
scott.schachter@barclays.com
BCI, US

Jeff Darfus
+1 212 412 7997
jeff.darfus@barclays.com
BCI, US

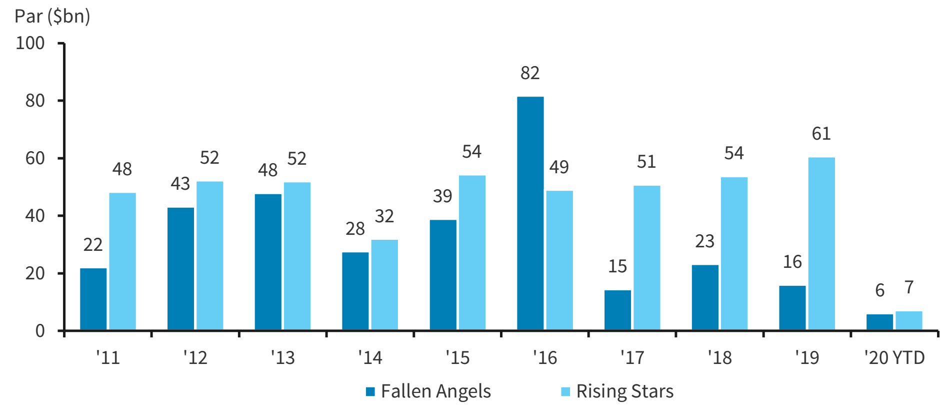
High yield spreads rebounded this week, as coronavirus concerns have eased somewhat and corporate earnings have exceeded expectations, with the market 30bp tighter since last Friday. Much like 2019, higher quality has led performance in 2020, with BB returns outpacing lower-rated cohorts (although last year's outperformance was driven by spread tightening and this year's returns have been the result of the rates move). A tailwind for BB performance in recent years has been rising star volumes, which have outpaced fallen angels in eight of the past nine years, with 2019 posting the largest net rising star volume in history.

We believe that 2020 will be more balanced than recent years in terms of fallen angel and rising star volumes based on the combination of our top-down analysis of fundamental trends and growth expectations and bottom-up views from our fundamental analysts (for more details, see *2020 Rising Star and Fallen Angel Forecast*). That said, rising star performance should continue to have a meaningful effect on portfolio returns, especially in regard to the timing of performance around the upgrade.

To quantify this effect, we evaluate the performance of more than 1,000 rising star bonds dating back to 2006 relative to their respective indices (the US High Yield Index before the upgrade and the US Credit Corporate or US 144A Index following the upgrade). On average, rising star bonds outperform by a total of 70bp over the 24 weeks around the upgrade. While we find no material difference in performance for 144A bonds relative to registered bonds, longer-dated bonds and call-constrained bonds tend to outperform less. Bonds from larger issuers outperform bonds from smaller issuers by nearly double, all of which tends to occur before the downgrade. Rising stars that were issued in the investment grade market saw no material performance difference from those issued with high yield ratings.

With this context of analysis, we provide a list of rising star candidates for 2020 based on research provided by our fundamental analysts.

FIGURE 1. Rising Star Volumes Have Outpaced Fallen Angels in Eight of the Past Nine Years



Source: Bloomberg, Barclays Research

All Rising Star Performance

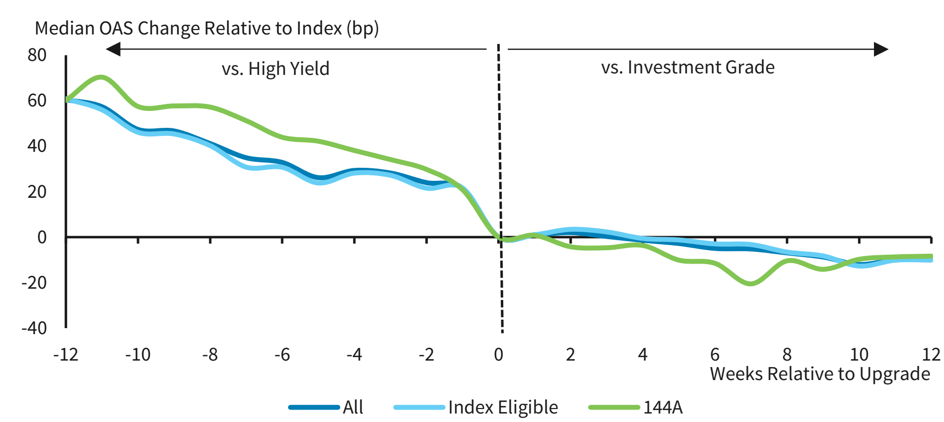
Across all rising stars, we find that bonds tend to tighten by 60bp relative to the high yield index in the twelve weeks leading into the upgrade. In the twelve weeks following the upgrade there is modest outperformance relative to the investment grade index of 10bp (Figure 2). Of these bonds, roughly 58% were still in the IG or 144A indices twelve weeks after the upgrade, meaning that 42% fell out of their index as a result of being called, reaching less than one year to maturity, or not meeting the increased amount outstanding threshold for the investment grade-rated indices.

144A versus Registered Bonds

Somewhat surprisingly, we find no meaningful difference in performance between US Credit Corporate Index-eligible bonds and 144As, which are excluded from the investment grade index, pointing to a similar technical for 144A and registered bonds. Although they represent more than half of the high yield market now, 144As were a small portion of high yield bonds up until a few years ago and, therefore, represent roughly 20% of the rising stars in our study.

The outperformance relative to the high yield index prior to the upgrade tends to be fairly smooth, with a more drastic move only in the week of the upgrade. In fact, aside from a median outperformance of 22bp in the week of the upgrade, no other week saw a move of more than 10bp, implying a fairly stable grind tighter in the months leading into the upgrade.

FIGURE 2. Rising Stars Outperform the High Yield Index by 60bp before Upgrade and Modestly Outperform the Investment Grade Index After



Source: Bloomberg, Barclays Research

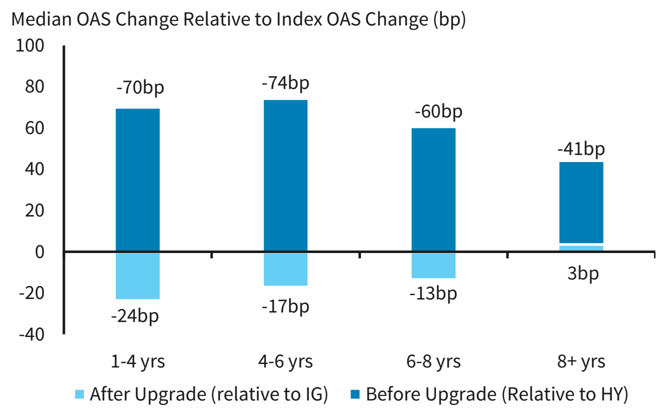
Maturity Buckets

The outperformance of rising stars tends to decline for bonds with longer time to maturity. In Figure 3, we bucket rising star bonds based on years to maturity from the time of their upgrade. Bonds in the 1-4 year and 4-6 year buckets posted similar performance, outperforming by 94bp and 91bp, respectively, across the 24-week period. Conversely, long-dated bonds outperformed the index by only 37bp, with modest underperformance (3bp widening) occurring following the upgrade. The same relationship exists when we run the analysis across duration buckets as well.

Price and Call-Constrained

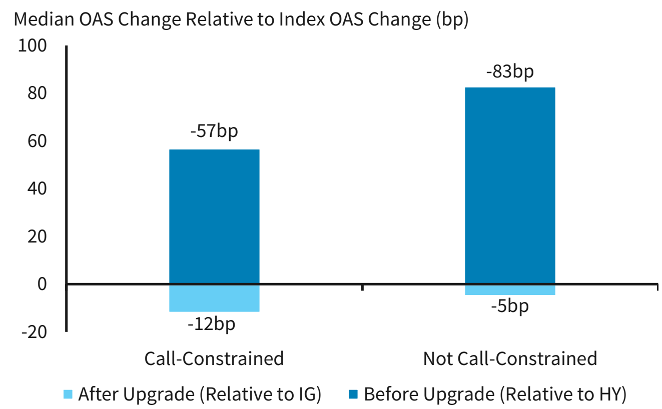
Unlike maturity, the absolute price of a bond at the time of upgrade does not seem to have a strong relationship with performance. That said, the price of the bond relative to its next call price is material. As seen in Figure 4, bonds that were trading above their next call price at the time of the upgrade outperformed by a total of 69bp (57bp before the upgrade and 12bp after the upgrade). Conversely, bonds that were below their next call price or bullet bonds outperformed by 88bp given the lack of cap on upside found in call-constrained bonds.

FIGURE 3. **Rising Stars with More Time to Maturity Experienced the Least Outperformance**



Source: Bloomberg, Barclays Research

FIGURE 4. **Outperformance Is Limited for Call-Constrained Rising Stars**



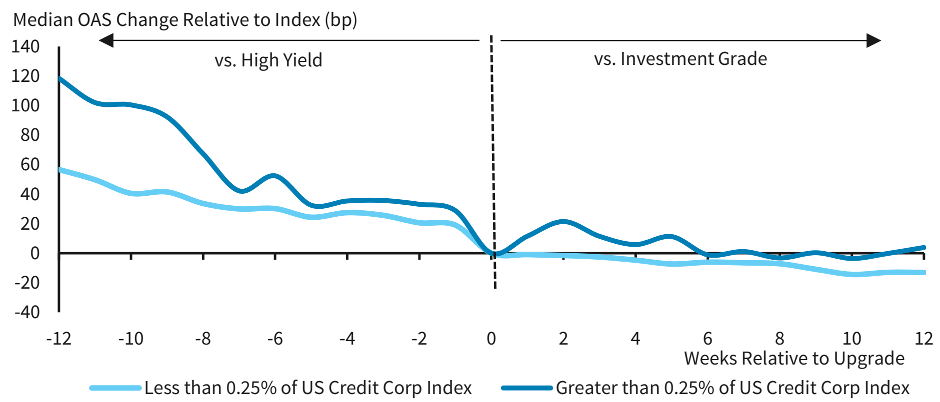
Source: Bloomberg, Barclays Research

Size of Issuer

In addition, the size of the capital structure being upgraded matters in regard to performance. Figure 5 divides the universe of rising stars into two buckets: issuers whose total upgraded bonds represent at least 0.25% of the investment grade index at the time of the upgrade and issuers below that threshold (that divide is roughly $13bn currently). Roughly one-fourth of the upgraded bonds in our study were above this bar and had a median relative spread tightening of almost 120bp – nearly double the level of smaller capital structures. Following the upgrade, though, there is modest outperformance by smaller issuers (13bp), while the large issuers underperform their respective index by a few basis points, on average.

The increased magnitude of performance for large capital structures echoes our fallen angel findings. As discussed in *Large Angels Fall Harder but Bounce Higher*, bigger fallen angels tend to underperform the investment grade index before the downgrade more than the average fallen angel, with greater outperformance relative to high yield after the downgrade.

FIGURE 5. Larger Rising Star Structures Outperform Smaller Structures



Source: Bloomberg, Barclays Research

Originally Issued with Investment Grade or High Yield Ratings

Understandably, many of the rising stars in our analysis were originally issued as investment grade bonds. In fact, 30% of the bonds in the study were fallen angels prior to being rising stars, indicating that they were returning to the investment grade market. Despite the lack of call provisions for the bonds issued as investment grade, which could cap upside, there was no meaningful performance difference between bonds that were originally investment grade and those that were issued in the high yield market.

Issuers took advantage of the chance to refinance debt at investment grade levels in the weeks following the upgrade at roughly the same rate for bonds that were issued in the investment grade and high yield markets. Roughly 55% of the bonds initially issued with investment grade ratings were still in the index after twelve weeks, a rate similar to bonds that were initially high yield rated.

2020 Rising Star Candidates

Using this analysis as a backdrop, we work with our fundamental high yield analysts to highlight an updated list of issuers that they believe could be rising stars in 2020. This list can be seen in Figure 6 and includes commentary focused on the leverage targets provided by the issuers and rating agencies.

FIGURE 6. Rising Star Candidates for 2020

Ticker	Company	Sector	US HY Amount Outstandin g ($ bn)	Analyst	Commentary
AES	AES Corp	Electric Utility	3.9	Not Covered	AES was upgraded to investment grade at Fitch in November, having achieved its deleveraging target (parent leverage of 4x or below), and is on BB+ positive outlook at S&P. We think S&P could upgrade this year if AES retains recourse leverage below 4x and manages challenges at non-recourse opcos (eg, DPL and Argentina) such that there is no change in the recourse leverage profile.
CF	CF Industries	Chemicals	3.0	Brian Lalli	As of early December, both S&P and Fitch now rate CF BB+/Positive – an upgrade will ultimately require sustainable free cash flow generation and an outright commitment from management (which it recently made on the 3Q19 conference call).
CIT	CIT Group	Banking	3.8	Peter Troisi	CIT already has one investment grade rating (Fitch), and its Ba1 rating at Moody's has a positive outlook. CIT has met most of Moody's upgrade criteria, and we believe the agency is waiting for a quarter or two of integration progress with regard to a recently closed acquisition. We see little risk to a smooth integration and expect otherwise stable fundamentals to support an upgrade from Moody's later this year.

Ticker	Company	Sector	US HY Amount Outstanding ($ bn)	Analyst	Commentary
CNC	Centene	Health Insurance	13.9	Not Covered	CNC's pro forma leverage is roughly 3.0x, and debt to cap is roughly 39% (pro forma). Fitch is targeting 2.8x leverage and 36% debt to cap for an upgrade. Moody's targets include leverage below 2.2x, a reduction in Medicaid concentration, and lower reliance on full risk membership. Considering that the company is near Fitch's targets, we believe the agency's focus is on consolidated results and evidence that the integration is going well, implying that it may be 1-2 quarters before an upgrade. Given the strong earnings power of the two entities (CNC and WCG), we believe there is a high probability of upgrade.
RBS	Royal Bank of Scotland	Banking	1.2	Christy Hajiloizou	In-scope securities are legacy T1 hybrids and are subject to idiosyncratic outcomes. Moody's has a positive outlook on the Ba1 rating, which has been in place since July 2018. An upgrade seems likely in the event that the company substantially completes its multi-year restructuring exercise and maintains organic capital generation and sustainable profitability.

Source: Bloomberg, Barclays Research

Analyst(s) Certification(s):
We, Bradley Rogoff, CFA, Scott Schachter and Jeff Darfus, hereby certify (1) that the views expressed in this research report accurately reflect our personal views about any or all of the subject securities or issuers referred to in this research report and (2) no part of our compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this research report.

Important Disclosures:
This document is intended for institutional investors and is not subject to all of the independence and disclosure standards applicable to debt research reports prepared for retail investors under U.S. FINRA Rule 2242. Barclays trades the securities covered in this report for its own account and on a discretionary basis on behalf of certain clients. Such trading interests may be contrary to the recommendations offered in this report.

Barclays Research is produced by the Investment Bank of Barclays Bank PLC and its affiliates (collectively and each individually, "Barclays").

All authors contributing to this research report are Research Analysts unless otherwise indicated. The publication date at the top of the report reflects the local time where the report was produced and may differ from the release date provided in GMT.

Availability of Disclosures:
For current important disclosures regarding any issuers which are the subject of this research report please refer to https://publicresearch.barclays.com or alternatively send a written request to: Barclays Research Compliance, 745 Seventh Avenue, 13th Floor, New York, NY 10019 or call +1-212-526-1072.

Barclays Capital Inc. and/or one of its affiliates does and seeks to do business with companies covered in its research reports. As a result, investors should be aware that Barclays may have a conflict of interest that could affect the objectivity of this report. Barclays Capital Inc. and/or one of its affiliates regularly trades, generally deals as principal and generally provides liquidity (as market maker or otherwise) in the debt securities that are the subject of this research report (and related derivatives thereof). Barclays trading desks may have either a long and / or short position in such securities, other financial instruments and / or derivatives, which may pose a conflict with the interests of investing customers. Where permitted and subject to appropriate information barrier restrictions, Barclays fixed income research analysts regularly interact with its trading desk personnel regarding current market conditions and prices. Barclays fixed income research analysts receive compensation based on various factors including, but not limited to, the quality of their work, the overall performance of the firm (including the profitability of the Investment Banking Department), the profitability and revenues of the Markets business and the potential interest of the firm's investing clients in research with respect to the asset class covered by the analyst. To the extent that any historical pricing information was obtained from Barclays trading desks, the firm makes no representation that it is accurate or complete. All levels, prices and spreads are historical and do not necessarily represent current market levels, prices or spreads, some or all of which may have changed since the publication of this document. Barclays Research Department produces various types of research including, but not limited to, fundamental analysis, equity-linked analysis, quantitative analysis, and trade ideas. Recommendations and trade ideas contained in one type of Barclays Research may differ from those contained in other types of Barclays Research, whether as a result of differing time horizons, methodologies, or otherwise.

In order to access Barclays Statement regarding Research Dissemination Policies and Procedures, please refer to https://publicresearch.barcap.com/S/RD.htm. In order to access Barclays Research Conflict Management Policy Statement, please refer to: https://publicresearch.barcap.com/S/CM.htm.

All pricing information is indicative only. Unless otherwise indicated, prices are sourced from Refinitiv and reflect the closing price in the relevant trading market, which may not be the last available price at the time of publication.

Types of investment recommendations produced by Barclays FICC Research:
In addition to any ratings assigned under Barclays' formal rating systems, this publication may contain investment recommendations in the form of trade ideas, thematic screens, scorecards or portfolio recommendations that have been produced by analysts in FICC Research. Any such investment recommendations produced by non-Credit Research teams shall remain open until they are subsequently amended, rebalanced or closed in a future research report. Any such investment recommendations produced by the Credit Research teams are valid at current market conditions and may not be otherwise relied upon.

Disclosure of other investment recommendations produced by Barclays FICC Research:
Barclays FICC Research may have published other investment recommendations in respect of the same securities/instruments recommended in this research report during the preceding 12 months. To view all investment recommendations published by Barclays FICC Research in the preceding 12 months please refer to https://live.barcap.com/go/research/Recommendations.

Legal entities involved in producing Barclays Research:
Barclays Bank PLC (Barclays, UK)

Barclays Capital Inc. (BCI, US)

Barclays Bank Ireland PLC, Frankfurt Branch (BBI, Frankfurt)

Barclays Bank Ireland PLC, Paris Branch (BBI, Paris)

Barclays Bank Ireland PLC, Milan Branch (BBI, Milan)

Barclays Securities Japan Limited (BSJL, Japan)

Barclays Bank PLC, Hong Kong branch (Barclays Bank, Hong Kong)

Barclays Capital Canada Inc. (BCCI, Canada)

Barclays Bank Mexico, S.A. (BBMX, Mexico)

Barclays Securities (India) Private Limited (BSIPL, India)

Barclays Bank PLC, India branch (Barclays Bank, India)

Barclays Bank PLC, Singapore branch (Barclays Bank, Singapore)

Barclays Bank PLC, DIFC Branch (Barclays Bank, DIFC)

Bank PLC and a registered financial instruments firm regulated by the Financial Services Agency of Japan. Registered Number: Kanto Zaimukyokucho (kinsho) No. 143.

Asia Pacific (excluding Japan): Barclays Bank PLC, Hong Kong Branch is distributing this material in Hong Kong as an authorised institution regulated by the Hong Kong Monetary Authority. Registered Office: 41/F, Cheung Kong Center, 2 Queen's Road Central, Hong Kong.

All Indian securities-related research and other equity research produced by Barclays' Investment Bank are distributed in India by Barclays Securities (India) Private Limited (BSIPL). BSIPL is a company incorporated under the Companies Act, 1956 having CIN U67120MH2006PTC161063. BSIPL is registered and regulated by the Securities and Exchange Board of India (SEBI) as a Research Analyst: INH000001519; Portfolio Manager INP000002585; Stock Broker/Trading and Clearing Member: National Stock Exchange of India Limited (NSE) Capital Market INB231292732, NSE Futures & Options INF231292732, NSE Currency derivatives INE231450334, Bombay Stock Exchange Limited (BSE) Capital Market INB011292738, BSE Futures & Options INF011292738; Depository Participant (DP) with the National Securities & Depositories Limited (NSDL): DP ID: IN-DP-NSDL-299-2008; Investment Adviser: INA000000391. The registered office of BSIPL is at 208, Ceejay House, Shivsagar Estate, Dr. A. Besant Road, Worli, Mumbai – 400 018, India. Telephone No: +91 2267196000. Fax number: +91 22 67196100. Any other reports produced by Barclays' Investment Bank are distributed in India by Barclays Bank PLC, India Branch, an associate of BSIPL in India that is registered with Reserve Bank of India (RBI) as a Banking Company under the provisions of The Banking Regulation Act, 1949 (Regn No BOM43) and registered with SEBI as Merchant Banker (Regn No INM000002129) and also as Banker to the Issue (Regn No INBI00000950). Barclays Investments and Loans (India) Limited, registered with RBI as Non Banking Financial Company (Regn No RBI CoR-07-00258), and Barclays Wealth Trustees (India) Private Limited, registered with Registrar of Companies (CIN U93000MH2008PTC188438), are associates of BSIPL in India that are not authorised to distribute any reports produced by Barclays' Investment Bank.

This material is distributed in Singapore by the Singapore branch of Barclays Bank PLC, a bank licensed in Singapore by the Monetary Authority of Singapore. For matters in connection with this material, recipients in Singapore may contact the Singapore branch of Barclays Bank PLC, whose registered address is 10 Marina Boulevard, #23-01 Marina Bay Financial Centre Tower 2, Singapore 018983.

This material is distributed to persons in Australia by Barclays Bank PLC. None of Barclays Bank PLC, nor any other Barclays group entity, holds an Australian financial services licence and instead relies on an exemption from the requirement to hold such a licence. This material is intended to only be distributed to "wholesale clients" as defined by the Australian Corporations Act 2001. This material is distributed in New Zealand by Barclays Bank PLC, but it has not been registered, filed or approved by any New Zealand regulatory authority or under or in accordance with the Financial Markets Conduct Act of 2013, and this material is not a disclosure document under New Zealand law.

Middle East: Nothing herein should be considered investment advice as defined in the Israeli Regulation of Investment Advisory, Investment Marketing and Portfolio Management Law, 1995 ("Advisory Law"). This document is being made to eligible clients (as defined under the Advisory Law) only. Barclays Israeli branch previously held an investment marketing license with the Israel Securities Authority but it cancelled such license on 30/11/2014 as it solely provides its services to eligible clients pursuant to available exemptions under the Advisory Law, therefore a license with the Israel Securities Authority is not required. Accordingly, Barclays does not maintain an insurance coverage pursuant to the Advisory Law.

This material is distributed in the United Arab Emirates (including the Dubai International Financial Centre) and Qatar by Barclays Bank PLC. Barclays Bank PLC in the Dubai International Financial Centre (Registered No. 0060) is regulated by the Dubai Financial Services Authority (DFSA). Principal place of business in the Dubai International Financial Centre: The Gate Village, Building 4, Level 4, PO Box 506504, Dubai, United Arab Emirates. Barclays Bank PLC-DIFC Branch, may only undertake the financial services activities that fall within the scope of its existing DFSA licence. Related financial products or services are only available to Professional Clients, as defined by the Dubai Financial Services Authority. Barclays Bank PLC in the UAE is regulated by the Central Bank of the UAE and is licensed to conduct business activities as a branch of a commercial bank incorporated outside the UAE in Dubai (Licence No.: 13/1844/2008, Registered Office: Building No. 6, Burj Dubai Business Hub, Sheikh Zayed Road, Dubai City) and Abu Dhabi (Licence No.: 13/952/2008, Registered Office: Al Jazira Towers, Hamdan Street, PO Box 2734, Abu Dhabi). This material does not constitute or form part of any offer to issue or sell, or any solicitation of any offer to subscribe for or purchase, any securities or investment products in the UAE (including the Dubai International Financial Centre) and accordingly should not be construed as such. Furthermore, this information is being made available on the basis that the recipient acknowledges and understands that the entities and securities to which it may relate have not been approved, licensed by or registered with the UAE Central Bank, the Dubai Financial Services Authority or any other relevant licensing authority or governmental agency in the UAE. The content of this report has not been approved by or filed with the UAE Central Bank or Dubai Financial Services Authority. Barclays Bank PLC in the Qatar Financial Centre (Registered No. 00018) is authorised by the Qatar Financial Centre Regulatory Authority (QFCRA). Barclays Bank PLC-QFC Branch may only undertake the regulated activities that fall within the scope of its existing QFCRA licence. Principal place of business in Qatar: Qatar Financial Centre, Office 1002, 10th Floor, QFC Tower, Diplomatic Area, West Bay, PO Box 15891, Doha, Qatar. Related financial products or services are only available to Business Customers as defined by the Qatar Financial Centre Regulatory Authority.

Russia: This material is not intended for investors who are not Qualified Investors according to the laws of the Russian Federation as it might contain information about or description of the features of financial instruments not admitted for public offering and/or circulation in the Russian Federation and thus not eligible for non-Qualified Investors. If you are not a Qualified Investor according to the laws of the Russian Federation, please dispose of any copy of this material in your possession.

IRS Circular 230 Prepared Materials Disclaimer: Barclays does not provide tax advice and nothing contained herein should be construed to be tax advice. Please be advised that any discussion of U.S. tax matters contained herein (including any attachments) (i) is not intended or written to be used, and cannot be used, by you for the purpose of avoiding U.S. tax-related penalties; and (ii) was written to support the promotion or marketing of the transactions or other matters addressed herein. Accordingly, you should seek advice based on your particular circumstances from an independent tax advisor.

BRCF2242