Situation Room

Staying active as you age

- **We published the latest Credit Market Strategist on Friday. Click Not so tight anymore 31 January 2020 or see inside for the key bullets.**

- **Staying active as you age**. With the increasing share of trading in ETFs liquidity in the IG corporate bond market has improved notably. We see this as the share of trading in off-the-run maturities, which we define here as bonds outstanding for three years or longer, increased from about 30% two years ago to roughly 40% currently. On further inspection this increase in trading of illiquid bonds was driven by issues included in the benchmark tracked by the largest IG ETF (LQD). This highlights the importance of the ETF market as it provides a way for dealers to quickly offload risk from constrained balance sheets, which is especially important when transacting in illiquid off-the-run bonds. – *Hans Mikkelsen, Yuri Seliger*

- **January Senior Loan Officer Survey: easier standard & weaker demand for C&I loans**. Banks eased lending standards for C&I and mortgage loans, but tightened standards for CRE, credit card and auto loans in the fourth quarter. Banks also reported weaker demand for C&I, CRE and auto loans, but stronger demand for mortgage and credit card loans. Most banks cited increased competition from other banks or nonbank lenders as the key reasons for easing standards, and lower M&A, capex and refinancing needs as key reasons for weaker C&I loan demand. Finally, banks reported expecting tighter lending standards, deteriorating loan performance and unchanged loan demand on balance over 2020. – *Yunyi Zhang*

- **M&A announcement volume declined in January**. North American M&A announcement volume declined to $124bn in January from $199bn in December. The pipeline value of announced deals with potential IG funding implications decreased to $324bn currently. No US IG M&A issuance in January. – *Yunyi Zhang*

- **Daily credit snapshot**. US IG new issuance totaled $6.3bn across 6 deals today. Average new issue concession increased to 13.1bps today from 3.0bps last week. Average break performance weakened to 0.7bps tighter today from 2.8bps tighter last week. S&P 500 closed up 0.73%, Treasury curve bear-flattened, CDX tightened 0.20bps, CDX HY declined $0.08pt. Cash bond spreads in US banks and industrials traded 2bps tighter to 1bps wider, TMT and consumer flat to 3bps tighter, healthcare flat to 1bps tighter, energy 3bps tighter to 5bps wider. – *Yunyi Zhang*

- **Monthly market reviews.** US IG: Jan '20: Crushed by rates. European credit: Euro Excess Returns, Sterling Excess Returns. Equity and quant: Global Convertibles Chartbook, Global Performance Monitor, US Performance Monitor.

- **Daily foreign demand tracker**. – *Yuri Seliger, Yunyi Zhang*

- **Other reports include:** 1) Week 3 earnings: Touchdown by mega caps, 2) 4Q US GDP tracking 2.2%, 3) ISM manufacturing breaches 50 –first time in six months.

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Refer to important disclosures on page 15 to 16. 12091026

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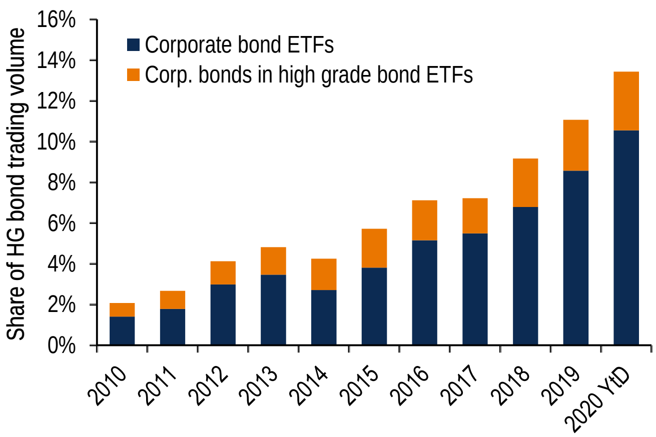
Staying active as you age

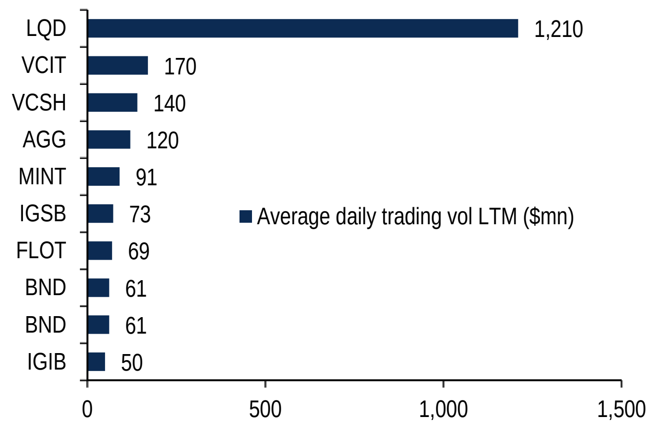
With the increasing share of trading in ETFs (Figure 1, Figure 2) liquidity in the IG corporate bond market has improved notably. We see this as the share of trading in off-the-run maturities, which we define here as bonds outstanding for three years or longer, increased from about 30% two years ago to roughly 40% currently (Figure 3). On further inspection this increase in trading of illiquid bonds was driven by issues included in the benchmark tracked by the largest IG ETF (LQD, Figure 4). This highlights the importance of the ETF market as it provides a way for dealers to quickly offload risk from constrained balance sheets, which is especially important when transacting in illiquid off-the-run bonds.

Figure 1: Increasing share of IG trading in bond ETFs



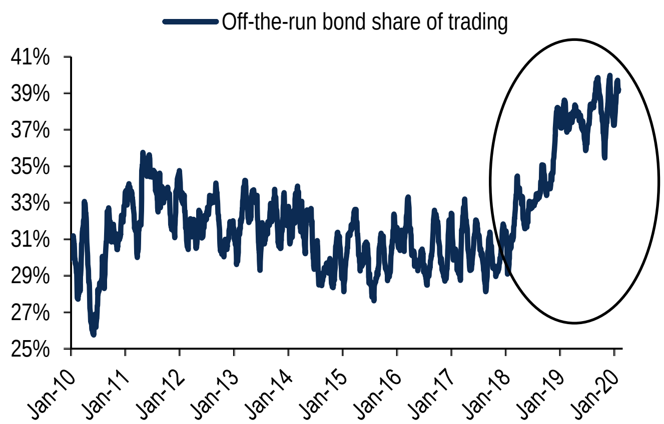
Note: Corp. bonds in HG bond ETFs refers to the corporate bond part of broader HG fixed income ETFs. Based on the top ETFs by AUM, currently 36.
Source: BofA Global Research, EPFR Global, Bloomberg

Figure 2: IG bond trading is very concentrated in LQD



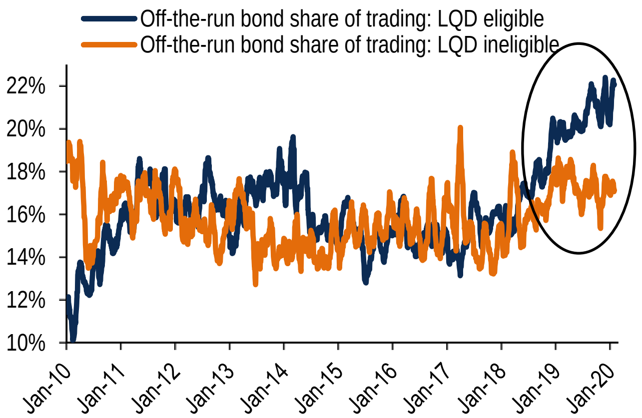
Source: BofA Global Research, Bloomberg,

Figure 3: Increasing share of trading in IG off-the-run bonds ...



Note: based on bonds included in ICE BofA US IG index C0A0. Off-the-run bonds are those outstanding for 3 years or longer. 20-day moving average.
Source: BofA Global Research, TRACE

Figure 4: ... driven by LQD-eligible issues



Note: based on bonds included in ICE BofAML US IG index C0A0. Off-the-run bonds are those outstanding for 3 years or longer. 20-day moving average. LQD-eligible refers to bonds with notional of $750mn or larger, maturity of over 3 years, from issuers with over $2bn of $500mn or larger index bonds, excluding 144A for life issues.
Source: BofA Global Research, TRACE

Bonds eligible to be included in LQD are large ($750mn or larger notional), registered, with maturities 3-year or longer and issued from bigger capital structures ($2bn or more of index bonds with notional of $500mn or more). Currently the LQD ETF holds most of the about 2,000 eligible bonds. The ICE BofA IG corporate bond index includes more than 8,000 bonds.

Credit Strategy

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January Senior Loan Officer Survey: easier standard & weaker demand for C&I loans

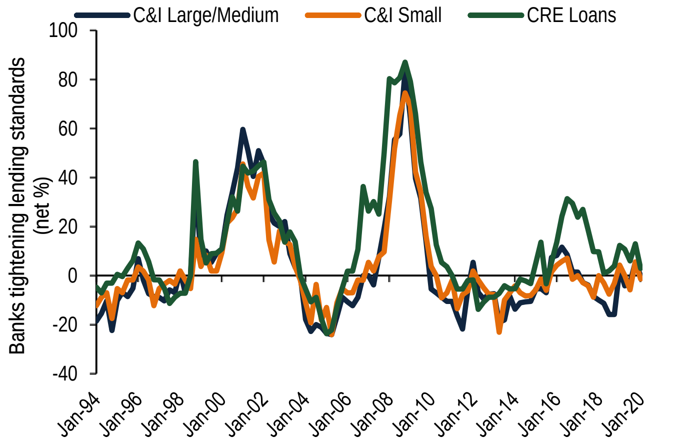
The Fed's January senior loan officer survey released today shows that banks eased lending standards for C&I and mortgage loans, but tightened lending standards for CRE, credit card and auto loans in the fourth quarter. On the other hand, banks reported weaker demand for C&I, CRE and auto loans, but stronger demand for mortgage and credit card loans. Most banks cited increased competition from other banks or nonbank lenders as the key reasons for easing standards, and lower M&A, capex and refinancing needs as key reasons for weaker C&I loan demand. Finally, banks reported expecting tighter lending standards, deteriorating loan performance and unchanged loan demand on balance over 2020.

C&I and CRE loans

Net flat and 1.4% of banks said they eased lending standards for large/medium and small C&I loans in the January survey, respectively, compared with net 5.4% and 5.6% reporting tightening standards in the prior October survey. Meanwhile, the share reporting tighter standards for CRE loans declined to 2.9% in the January survey from 13.0% in the October survey (Figure 5). Note that the CRE value reported here is the average for the three separate questions on loans for construction and land development, loans secured by nonfarm nonresidential structures, and loans secured by multifamily residential structures, which all showed declines in the share reporting tighter lending standards in the January survey compared to the October survey.

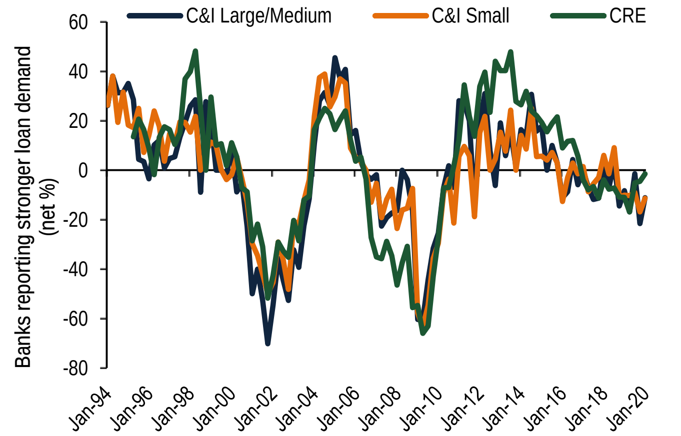
The net share of banks reporting weaker demand for large/median and small C&I loans decreased to 11.1% and 11.4% in the January survey, respectively, from 21.6% and 16.9% in the October survey. On the other hand, the net share reporting weaker CRE loan demand also fell to 1.5% in January from 4.5% in the October survey (Figure 6).

Figure 5: Lending standards: C&I loans



Source: Federal Reserve

Figure 6: Loan demand: C&I loans

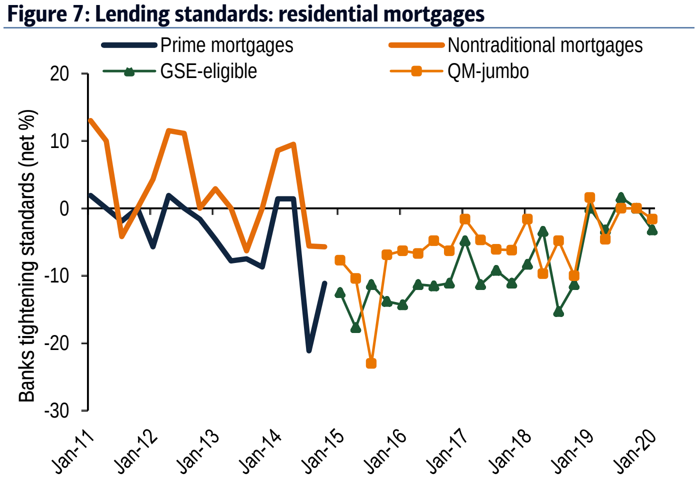


Source: Federal Reserve

Mortgages

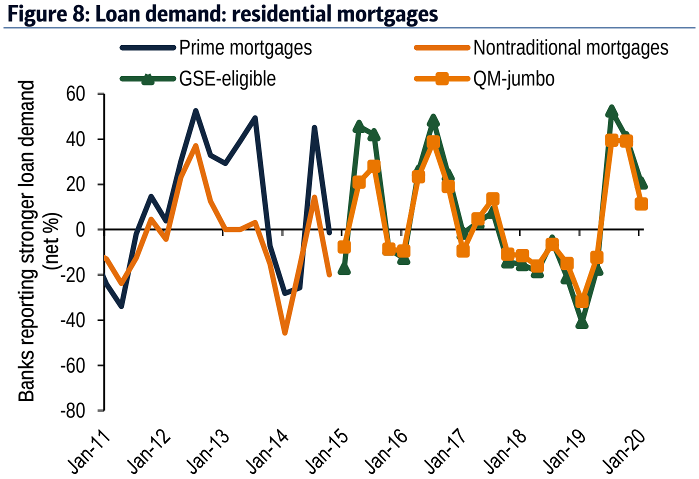
Net 3.2% and 1.4% of banks reported easing lending standards for GSE-eligible and QM-jumbo mortgages in January, respectively, compared with flat readings for both in the prior October survey (Figure 7). The net share of banks reporting stronger demand declined to 20.6% in January from 40.6% in October for GSE-eligible mortgages, and to 11.3% from 39.1% for QM-jumbo mortgage loans, respectively (Figure 8).

Figure 7: Lending standards: residential mortgages



Source: Federal Reserve

Figure 8: Loan demand: residential mortgages

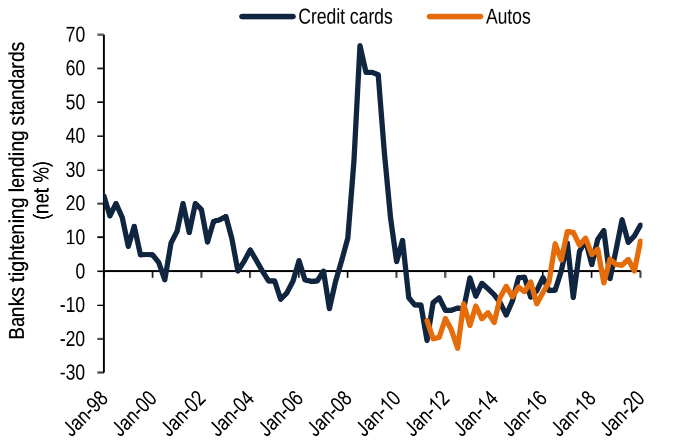


Source: Federal Reserve

Consumer loans

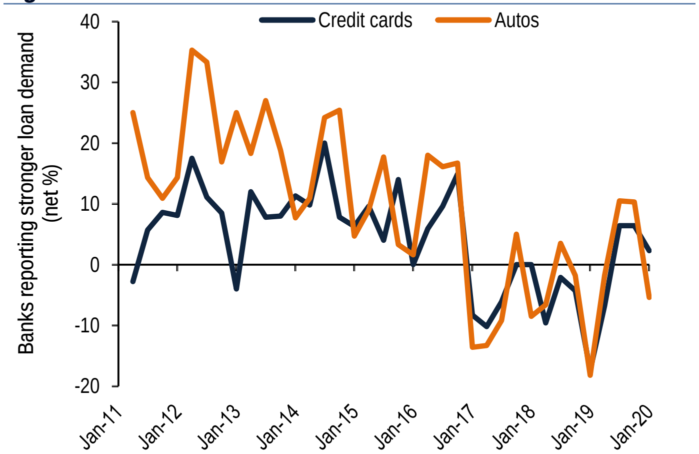
The net share of banks reporting tightening lending standards increased to 13.6% and 8.9% in January from 10.4% and 0% in October for credit card and auto loans, respectively (Figure 9). On the other hand, a net 2.3% of banks reported stronger demand for credit card loans in January, down from 6.4% in October, while the net share reporting stronger auto loan demand dropped to -5.4% in January from 10.3% in October (Figure 10).

Figure 9: Lending standards: consumer loans



Source: Federal Reserve

Figure 10: Loan demand: consumer loans



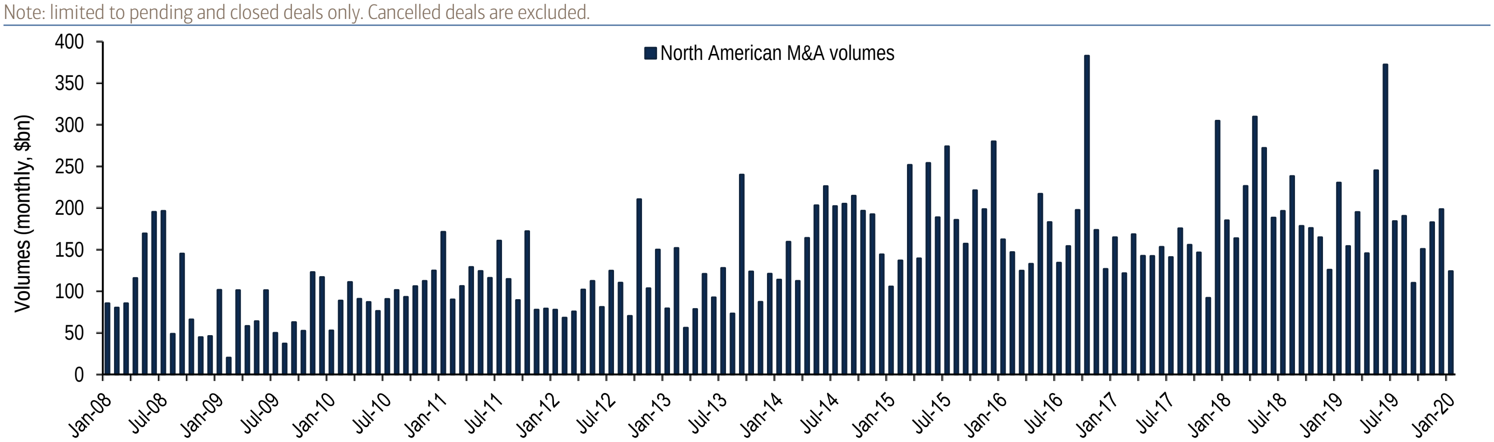
Source: Federal Reserve

M&A announcement volume declined in January

North American M&A announcement volume declined to $124bn in January from $199bn in December (Figure 11), while the pipeline value of announced deals with potential IG funding implications also decreased to $324bn currently from $341bn at the end of December (Figure 12). There was no M&A-related US IG issuance in January or December (Figure 13). See details in the Pipeline of M&A deals with IG issuance implications section below.

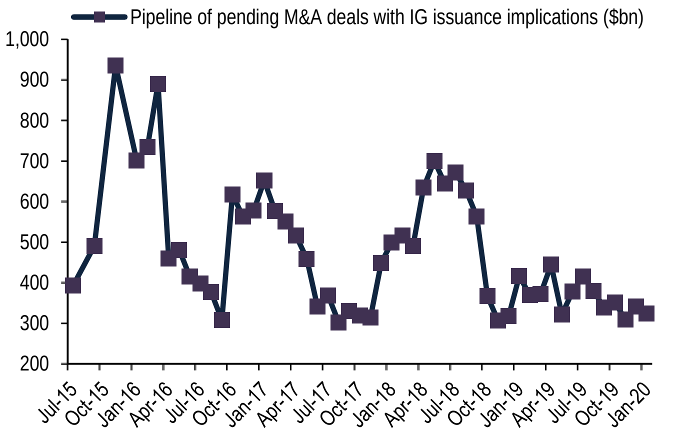
Figure 11: Monthly North American M&A volumes

Note: limited to pending and closed deals only. Cancelled deals are excluded.



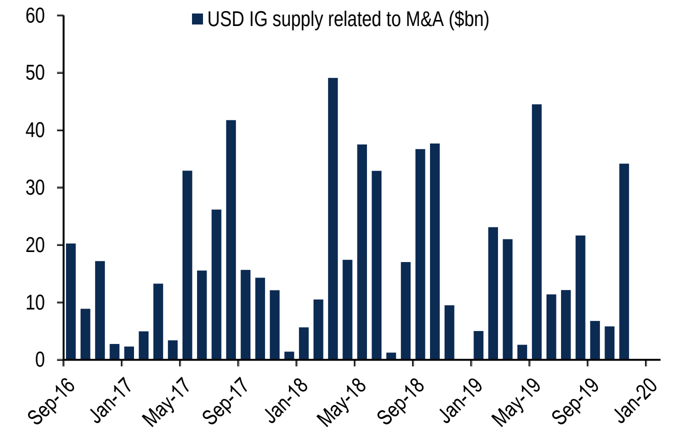
Source: Bloomberg

Figure 12: Pipeline of pending M&A deals with IG issuance implications



BofA Global Research, Bloomberg.

Figure 13: High grade new issue supply primarily related to M&A funding

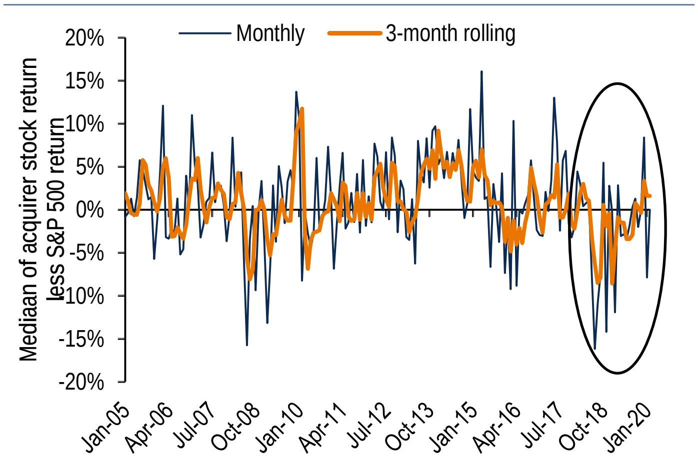


BofA Global Research

Equity investor sentiment towards M&A deal announcements

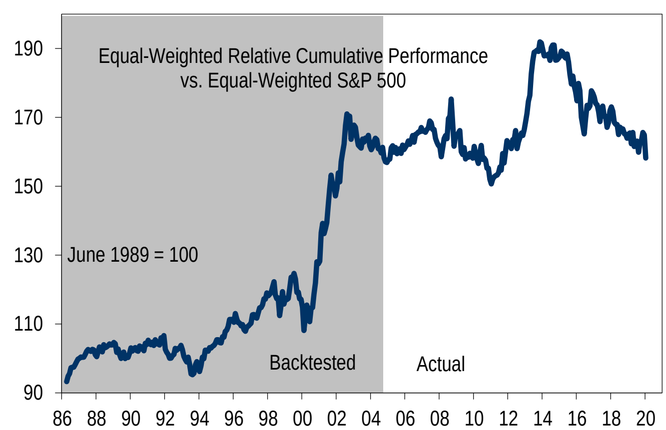
Equity investor sentiment towards M&A deal announcements deteriorated in January. The stock prices of companies announcing larger acquisitions (over 25% of the acquirer's EV) underperformed the S&P 500 by 7.9% in January following an 8.4% outperformance in December (Figure 14). On the other hand, companies repurchasing the most shares in the S&P 500 underperformed the market by 4.07% in January after underperforming by 0.44% in December (Figure 15).

Figure 14: Acquirer stock performance



Note: The stock performance is based on the period from 2 day prior to the deal announcement to 2 days following the deal announcement.
Source: BofA Global Research, Bloomberg.

Figure 15: Cumulative Relative Performance of S&P 500 Top Decile by Share Repurchase (3/31/86-1/31/20)



Note: the shaded area shows backtested results during the period from month-end March 1986 to month-end Dec. 2004. The unshaded portion represents actual performance since Jan. 2005. Backtesting is hypothetical in nature and reflects application of the screen prior to its introduction. It is not actual performance and is not intended to be indicative of future performance. The back-tested performance results are based on criteria applied retroactively with the benefit of hindsight and knowledge of factors that may have positively affected its performance, and cannot account for all financial risks that may affect the performance of the screen going forward. See Appendix for performance data and calculation methodology.
Source: BofA US Equity & US Quant Strategy

Pipeline of M&A deals with IG issuance implications

The IG bond deal related to the T- Mobile and Sprint merger is estimated at $20-23bn in order to refinance outstanding high yield debt, term loans and revolvers. The timing remains uncertain, subject to the ongoing state AG lawsuits and the only remaining state of California's regulatory commission approval, although the company intends to prefund the merger prior to deal close. The company completed US and European fixed income investor meetings in May 2018.

Broadcom announced acquisition of enterprise security business for $10.7bn on August 8th with new debt issuance expected to make up majority of the financing needs. The company has entered into a new term loan facility, which the company could prepay to delever. The bond issuance timing to term out current loans is unclear.

International Flavors & Fragrances announced acquisition of DuPont Nutrition Biosciences ApS on December 15th, 2019 for $24.7bn, to be financed by cash and stocks. The company needs to issue $7.5bn of debt, although the term loan vs bond mix and currency mix are unclear. The deal is expected to close in 1Q21 and our credit analyst expects the bond deal to come in 4Q20.

Mylan N.V. and Upjohn, Pfizer Inc.'s off-patent branded and generic medicine business, entered into a definitive agreement to combine on July 29th, 2019 with the deal expected to close by mid-2020, subject to Mylan's shareholder approval. Upjohn will issue about $12bn of debt at or prior to separation with proceeds retained by Pfizer.

London Stock Exchange announced the acquisition of Refinitiv for $27bn on August 1st, 2019. The company has a $13.5bn bridge loan in place and is expected to refinance Refinitiv's EUR and USD bonds and term loans in full upon deal completion. Recent news articles suggest $10bn of IG issuance needs prior to deal close, subject to obtaining regulatory approvals. The new company is expected to maintain IG ratings.

Pfizer closed the $11.4bn all-cash acquisition of Array BioPharma funded mostly with commercial papers on July 31st, 2019. Management stated that they plan to issue new debt to fund a majority of the deal with the remainder in cash. The company ended 2Q19 with $13bn of cash on hand.

Our criteria for inclusion in the list of announced deals listed in Figure 16 consists of deals at least $1bn in size (in terms of EV) announced by USD high grade issuers. We further restrict the list to deals with a cash component, suggesting to us that the company may choose to fund all or portion of that cash component in the high grade bond market. Finally the list excludes deals that have already been funded in the corporate bond market and deals that have been rejected by regulators.

Figure 16: M&A deals with potential high grade bond funding needs

Deal announcement date	Acquirer Ticker	Acquirer Name	Target Name	Announced deal value ($bn)	Expected completion date
14-Dec-18	MRK US	Merck & Co Inc	Antelliq Holdings France SASU	3.7	Jun-19
9-May-19	NOVN SW	Novartis AG	Xiidra 5%	3.4	Jul-19
1-Apr-19	0852591D LX	Ferrero International SA	Cookies & Fruit Snacks busines	1.3	Jul-19
17-Jun-19	PFE US	Pfizer Inc	Array BioPharma Inc	11.0	Jul-19
21-May-19	MRK US	Merck & Co Inc	Peloton Therapeutics Inc	1.1	Jul-19
2-Jul-19	UGI US	UGI Corp	UGI Appalachia LLC	1.3	Aug-19
29-Jul-19	PH US	Parker-Hannifin Corp	Exotic Metals Forming Co LLC	1.7	Sep-19
11-Jul-19	CL US	Colgate-Palmolive Co	Laboratoires Filorga Cosmetiqu	1.7	Sep-19
7-Aug-19	CRM US	salesforce.com Inc	ClickSoftware Technologies Ltd	1.4	Oct-19
25-Jun-19	1644Z CN	Ontario Power Generation Inc	Cube Hydro Partners LLC	1.1	Oct-19
22-Aug-19	VMW US	VMware Inc	Carbon Black Inc	1.8	Oct-19
8-Aug-19	AVGO US	Broadcom Inc	Enterprise security business/S	10.7	Nov-19
23-Sep-19	VNA GR	Vonovia SE	Hembla AB	3.0	Nov-19
3-Jul-19	UTG LN	UNITE Group PLC/The	Liberty Living Ltd	3.0	Nov-19
29-May-19	NXPI US	NXP Semiconductors NV	Wi-Fi Connectivity business/Ma	1.8	Dec-19
25-Feb-19	ROG SW	Roche Holding AG	Spark Therapeutics Inc	3.7	Dec-19
24-Apr-19	6501 JP	Hitachi Ltd	JR Automation Technologies LLC	1.4	Dec-19
27-Sep-19	DAL US	Delta Air Lines Inc	Latam Airlines Group SA	1.9	Dec-19
3-Sep-19	O US	Realty Income Corp	454 single-tenant retail prope	1.3	Dec-19
6-Jun-19	GOOGL US	Alphabet Inc	Looker Data Sciences Inc	2.6	Dec-19
31-Oct-19	AMGN US	Amgen Inc	BeiGene Ltd	2.2	Jan-20
20-Nov-19	PYPL US	PayPal Holdings Inc	Honey Science Corp	4.0	Jan-20
24-Nov-19	NOVN SW	Novartis AG	Medicines Co/The	7.4	Jan-20

Figure 16: M&A deals with potential high grade bond funding needs

Deal announcement date	Acquirer Ticker	Acquirer Name	Target Name	Announced deal value ($bn)	Expected completion date
3-Dec-19	4503 JP	Astellas Pharma Inc	Audentes Therapeutics Inc	2.6	Jan-20
9-Dec-19	MRK US	Merck & Co Inc	ArQule Inc	2.4	Jan-20
9-Dec-19	SAN FP	Sanofi	Synthorx Inc	2.1	Jan-20
12-Nov-19	SGO FP	Cie de Saint-Gobain	Continental Building Products	1.4	Feb-20
19-Jul-19	PEP US	PepsiCo Inc	Pioneer Foods Group Ltd	1.9	Mar-20
30-Sep-19	600900 CH	China Yangtze Power Co Ltd	Peruvian Opportunity Co, Sempra Americas Bermuda	3.6	Mar-20
3-Oct-19	8766 JP	Tokio Marine Holdings Inc	Privilege Underwriters Inc	3.1	Mar-20
8-Oct-19	FORTUM FH	Fortum Oyj	Uniper SE	4.6	Mar-20
14-Oct-19	CHSGCZ CH	State Grid Corp of China	Chilquinta Energia SA, Tecnored SA	2.2	Mar-20
14-Oct-19	STO AU	Santos Ltd	Darwin LNG Export Terminal, Bayu-Undan LNG	1.4	Mar-20
4-Dec-19	T CN	TELUS Corp	CCC Holding GmbH	1.0	Mar-20
5-Dec-19	T CN	TELUS Corp	Competence Call Center AG	1.0	Mar-20
17-Dec-19	LDOS US	Leidos Holdings Inc	Dynetics Inc	1.7	Mar-20
9-Jan-20	1546973D SS	Heimstaden Bostad AB	Portfolio of homes/Czech Repub	1.4	Mar-20
10-Jan-20	LLY US	Eli Lilly & Co	Dermira Inc	1.0	Mar-20
2-Dec-19	2899 HK	Zijin Mining Group Co Ltd	Continental Gold Inc	1.6	Jun-20
29-Apr-18	TMUS US	T-Mobile US Inc	Sprint Corp	57.8	Jun-20
29-Jul-19	MYL US	Mylan NV	Upjohn medicine business/Pfize	32.7	Jun-20
1-Jul-19	AMAT US	Applied Materials Inc	Hitachi Kokusai Electric Inc	2.2	Jun-20
6-Aug-19	MA US	Mastercard Inc	Corporate Services Businesses	3.2	Jun-20
20-Aug-19	ELAN US	Elanco Animal Health Inc	Animal-health unit/ Bayer AG	7.6	Jun-20
21-Aug-19	PPL CN	Pembina Pipeline Corp	Kinder Morgan Cochin LLC	1.5	Jun-20
31-Oct-19	SPR US	Spirit AeroSystems Holdings In	Bombardier Aerospace /Morocco, Belfast	1.1	Jun-20
4-Nov-19	MOL HB	MOL Hungarian Oil & Gas PLC	Azeri-Chirag-Gunashli field	1.6	Jun-20
24-Dec-19	BVT SJ	Bidvest Group Ltd/The	PHS Group Ltd	1.3	Jun-20
9-Jul-19	CSCO US	Cisco Systems Inc	Acacia Communications Inc	2.5	Jul-20
13-Jan-20	V US	Visa Inc	Plaid Technologies Inc	5.3	Jul-20
18-Dec-19	2141Z US	New York Life Insurance Co	Group benefits insurance busin	6.3	Sep-20
25-Jul-19	SCHW US	Charles Schwab Corp/The	Brokerage And Wealth Managemen	1.8	Dec-20
1-Aug-19	LSE LN	London Stock Exchange Group PL	Refinitiv Holdings Ltd	27.0	Dec-20
1-Nov-19	GOOGL US	Alphabet Inc	Fitbit Inc	1.5	Dec-20
4-Nov-19	SYK US	Stryker Corp	Wright Medical Group NV	4.9	Dec-20
25-Nov-19	MC FP	LVMH Moet Hennessy Louis Vuitt	Tiffany & Co	17.9	Dec-20
23-Dec-19	BIP US	Brookfield Infrastructure Part	Cincinnati Bell Inc	2.5	Dec-20
21-Jan-20	DNFS DC	Danfoss A/S	Hydraulics business/Eaton Corp	3.3	Dec-20
15-Dec-19	IFF US	International Flavors & Fragra	DuPont Nutrition Biosciences A	24.7	Mar-21
21-Jun-19	UNH US	UnitedHealth Group Inc	Equian LLC	3.2	n.a.
22-Jul-19	MSFT US	Microsoft Corp	OpenAI Inc	1.0	n.a.
25-Nov-19	CB US	Chubb Ltd	Huatai Insurance Group Co Ltd	1.5	n.a.
16-Dec-19	BIP US	Brookfield Infrastructure Part	Telecom tower co/India	3.7	n.a.
20-Jan-20	BA/ LN	BAE Systems PLC	Military GPS business/Collins	1.9	n.a.
30-Jan-20	SWK US	Stanley Black & Decker Inc	Consolidated Aerospace Manufac	1.0	n.a.

Source: BofA Global Research, Bloomberg.

Daily credit snapshot

US IG new issuance totaled $6.3bn across 6 deals today. The average new issue concession increased notably to 13.1bps today from 3.0bps last week, while the average break performance also weakened to 0.7bps tighter today compared with 2.8bps tighter last week (Figure 17). In addition, First Republic Bank and Synovus Bank announced fixed income investor calls with potential issuance to follow.

S&P 500 closed up 0.73%, the Treasury curve bear-flattened with 2-year, 5-year, 10-year and 30-year yields up 4bps, 3bps, 2bps and flat, respectively. CDX tightened 0.20bps, while CDX HY declined $0.08pt. Bloomberg TFLO data estimates that dealer inventories rose by $685mn today as of the time of this writing. Liquid cash bond spreads performed in line with CDX with US banks 2bps tighter to 1bps wider, TMT and consumer retail flat to 3bps tighter, healthcare flat to 1bps tighter, energy 3bps tighter to 5bps wider, and industrials 2bps tighter to 1bps wider on the day.

Figure 17: Recent new issue pricing and new issue concessions

Date	Ticker	Name	Tenor	Size ($mm)	Moody's/S&P Rating	Coupon (%)	Px Spread (bps)	New Issue Conc. (bps)	* Break performance	Current spread (bps)

Figure 17: Recent new issue pricing and new issue concessions

Date	Ticker	Name	Tenor	Size ($mm)	Moody's/S&P Rating	Coupon (%)	Px Spread (bps)	New Issue Conc. (bps)	* Break performance	Current spread (bps)
2020-02-03	CCDJ	Federation des Caisses Desjardins du Quebec	5	1,000	A2/A-	2.05	73	n.a.	n.a.	n.a.
2020-02-03	CFG	Citizens Financial Group Inc	10	300	NA/BBB+	2.5	100	4	0	100
2020-02-03	DFS	Discover Bank	10	500	Baa2/BBB	2.7	120	n.a.	0	120
2020-02-03	KEY	KeyCorp	7	800	Baa1/BBB+	2.25	82	6	+2	84
2020-02-03	PLD	Prologis LP	7	500	A3/A	2.125	70	19	-3	67
2020-02-03	PLD	Prologis LP	10	1,000	A3/A	2.25	80	15	-3	87
2020-02-03	PLD	Prologis LP	30	700	A3/A	3	105	21	-3	102
2020-02-03	SWK	Stanley Black & Decker Inc	10	750	Baa1/A	2.3	82	14	0	82
2020-02-03	SWK	Stanley Black & Decker Inc	40	750	Baa2/BBB+	4	n.a.	n.a.	n.a.	n.a.

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

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Credit Market Strategist: Not so tight anymore 31 January 2020

Credit Market Strategist: Not so tight anymore

- **Not so tight anymore**. In terms of the impact of the Wuhan virus our global economists have estimated a baseline scenario of 5.6% and 5.8% Chinese GDP growth this year and next, respectively, a change from 5.8% and 5.6% with no impact on the US economy. The bear scenario has Chinese growth of 5.0% this year and the US economy taking a 0.2-0.4% hit in 2020 with a bounce back in 2021. Not even the bear case scenario is likely to move the needle much for US IG corporate bonds. Index spreads have widened 7bps as of yesterday (Jan 30) from the tights of 99bps as recently as Jan 22 and today's sell-off should add another roughly 2bps. In order to outperform this year investors will have to trade situations like this and take the other side. Hence we want to be tactically overweight US IG as a trade, owning non-Energy liquid structures that have sold off much more than the index.

- **SARS comparison**. The CDC has a timeline for the 2002-2003 SARS outbreak here: https://www.cdc.gov/about/history/sars/timeline.htm. The most obvious conclusion - if one can draw any parallels - is that we are in for more weeks/months of news flow. However, in terms of financial markets the period after SARS related headlines began to emerge in mid-March 2003 was generally very positive for risk assets, although there was some volatility with equities at one point down 5% (not clear if SARS related). If that can be used as a guideline financial market volatility should be relatively short lived.

- **Coming up short in the long end**. Record low 30-year IG corporate yields of 3.43% (as of Jan 30). While this is a tough one to overcome for IG spreads we continue to see near-record inflows to IG bond funds and ETFs.
- **Taxable munis for corporate bond investors**. Taxable muni bonds offer wider spreads, better credit quality and diversification benefits to corporate bond investors. Taxable muni market is expected to grow significantly this year as issuers sell taxable bonds to refund tax-exempt munis. We provide a brief introduction to taxable munis and show some recent deal structures.
- **Rerating debt and equity**. The FOMC statement read marginally dovish as they replaced the word "near" with "returning to" in front of "the Committee's symmetric 2 percent objective". Fed Chair Powell repeated in his press conference the Fed's concern that business debt is moving up. We take the other side.
- **4Q-19 earnings half-time update**. 57% of US IG index market value has reported. Based on actual values when available, and consensus estimates otherwise, earnings (revenue) growth is currently tracking -0.2% (+4.5%) YoY.
- **Flow: Flows turn defensive**. $6.82bn US IG fund/ETF inflow.
- **Supply: Issuance volumes to remain subdued**. $12.2bn this week, $5-15bn next week, $95-105bn in February.

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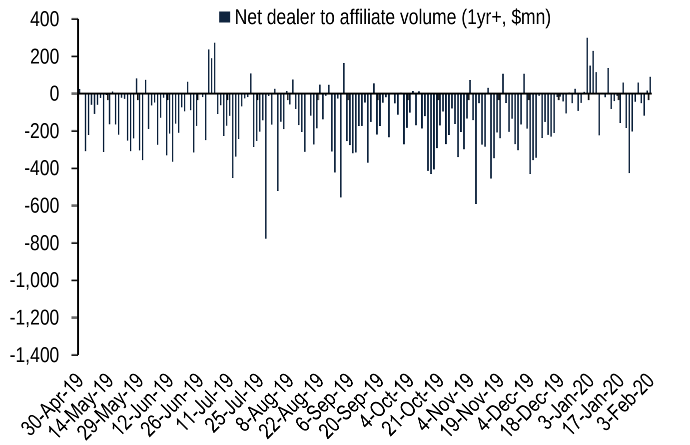
Daily foreign demand tracker

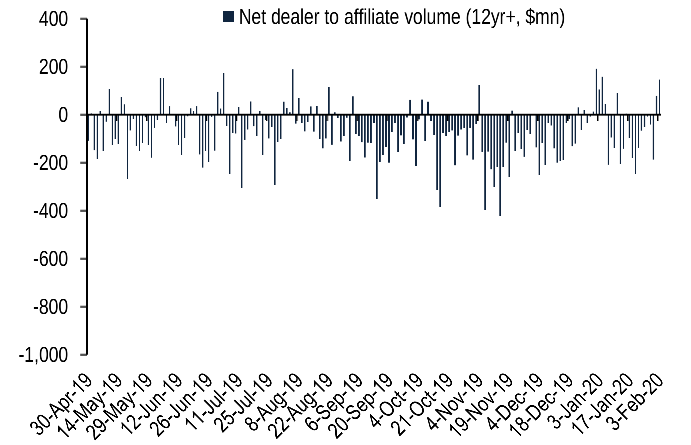
We believe net dealer-to-affiliate volumes from Trace are correlated with foreign buying of US HG corporate bonds - i.e., negative numbers mean foreign investor buying (US dealers taking down inventory in favor of foreign affiliates). For supporting material see our “primer” on tracking foreign inflows (See: Credit Market Strategist: One year round-trip in spreads 15 July 2016). Figure 18 shows the overall daily dealer-to-affiliate volumes while Figure 19, Figure 20 and Figure 21 show subsets of this data. In particular Figure 19 shows net dealer-to-affiliate volumes for longer maturity (12+ years) bonds, Figure 20 displays volumes reported to Trace before 8am NY time (biased toward Asian buying) and Figure 21shows the subset of net trades reported between 8am and noon (biased toward European buying). Figure 18 and Figure 19 include data from today, whereas Figure 20 and Figure 21 run through the previous business day.

Figure 18: Net dealer buying from affiliate (1yr+)



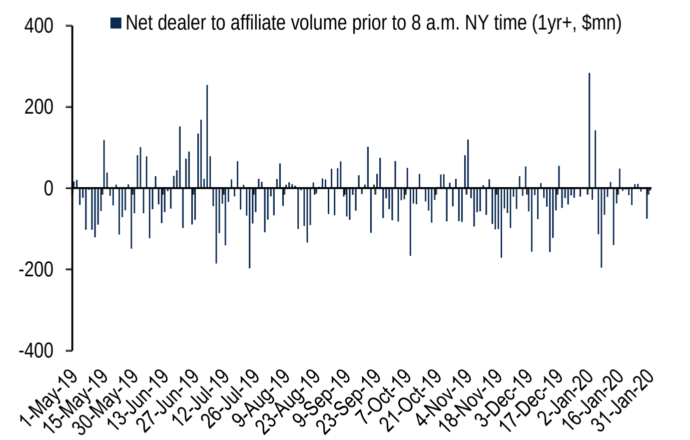
Note: Net dealer-to-affiliate volumes are correlated with foreign buying/selling. Negative numbers indicate foreign buying.
Source: Bloomberg, TRACE

Figure 19: Net dealer buying from affiliate (12yr+)



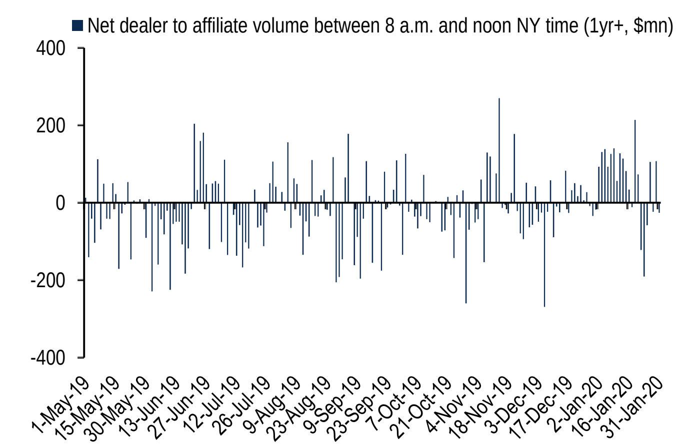
Note: Net dealer-to-affiliate volumes are correlated with foreign buying/selling. Negative numbers indicate foreign buying.
Source: Bloomberg, TRACE

Figure 20: Net dealer-to-affiliate trading volumes before 8 a.m. NY time



Note: Morning share of daily trading volume is correlated with secondary market activity of foreign investors due to different time zones.
Source: BofA Global Research, TRACE

Figure 21: Net dealer-to-affiliate trading volumes 8 a.m. - noon NY time



Note: Morning share of daily trading volume is correlated with secondary market activity of foreign investors due to different time zones.
Source: BofA Global Research, TRACE

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Earnings Tracker: Week 3: Touchdown by mega caps 03 February 2020

Week 3 earnings: Touchdown by mega caps

Mega-caps carry; on track for a 2% beat

Following Week 3, the busiest week of earnings season, 225 companies (64% of S&P 500 earnings) have reported. Bottom-up consensus EPS rose to $41.42 last week (+0.6% YoY, and close to our $41.50 estimate), 2% above vs. where consensus stood on Jan. 1. Reported earnings so far have come in 3% above consensus, led by mega-cap companies - Apple, Microsoft, Intel and Amazon drove nearly 90% of the beat. Sales are beating by <1%, implying better margins drove the EPS beat. 45% of companies have beaten on both sales and EPS, better than the post-Week-3 avg. of 40% and the best since 3Q18.

What are companies saying about the Wuhan virus?

Amid rising concerns around the Wuhan coronavirus, nearly 70 companies have so far mentioned the virus on earnings calls. Most said it was too early to gauge the impact as the situation remains fluid, but a few expected to see some rev./production hit as most regions are shut down until Feb 10. Travel-exposed companies are most at risk (e.g. airlines, gaming, restaurants, online travel agencies), and both Delta and American Airlines announced that they would suspend flights to China until April 30 and March 27, respectively. Our house base case is that the virus will have a large but short-lived effect on China, with very little spill-over into the global economy, but if the contagion becomes worse than expected, global GDP growth could fall below 3% (vs. base case of 3.1%). We note the S&P consensus EPS saw a 3% cut during SARS in 1H03, but was largely recovered by year-end. We include company commentary inside.

Little reward for beats following strong market rally

Given the rally we have seen since 4Q and the multiple-expansion-led returns in 2019 the bar has been set high for companies to deliver on earnings, and beats have so far seen limited reward. Companies that beat on EPS and sales have outperformed by just 0.8ppt the following day (vs. the long-term average of 1.6ppt), and by just 0.1ppt over the next five days. The last time beats were not met with rewards was in 1Q18, following the big rally amid tax reform. Companies that missed on both metrics have underperformed by 1.5ppt the next day (vs. the historical average of 2.4ppt).

Seasonally weak guidance, but optimism building

The ratio of above- vs. below-consensus EPS guidance slipped to 0.61 in Jan. from 0.77 in Dec., dragged down by Industrials and Materials. But guidance is typically more conservative in 1Q, with the ratio still tracking better than the typical 1Q average. And mentions of optimism on earnings calls are the highest since 4Q17. Meanwhile, the capex guidance ratio - which hit post-crisis lows in Nov. - ticked up for the second month to its highest since Sept. While still below avg. (1.1x vs. 1.4x) - and while capex for reported companies so far remains weak (+1% YoY) - improving guidance may indicate a pickup in the manufacturing economy, evidenced by BofA macro indicators.

Up next: 17% of S&P reports in Week 4

17% of earnings are slated to report this week, with results across all sectors. ~40% of Comm. Services earnings (incl. Alphabet and Disney) and Health Care earnings are due. See our preview for positive/negative surprise screens, plus our Derivatives team's earnings straddle screens for stocks that could move more/less on results than implied.

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US Economic Watch: 4Q GDP tracking inches up on construction spending
03 February 2020

4Q US GDP tracking 2.2%

December disappoints but positive revisions

Construction spending fell 0.2% mom in December, missing expectations of a 0.5% increase. A 1.2% plunge in nonresidential spending offset a 1.4% pop in residential spending. Within residential, private single family surged 2.7% mom while multifamily tumbled 1.8% mom. Home improvement spending increased 0.5% mom. On the nonresidential side, private spending collapsed 1.8% mom and public spending declined 0.4% mom.

While December missed, there were notable positive revisions. November was revised up to 0.7% from 0.6% and October was revised up to 0.4% from 0.1%. In particular, nonresidential was revised up in November to +0.2% from -0.3% and in October to +0.3% from -0.3%. Residential ended up lower in November to 1.5% from 1.8% and in October to 0.6% from 0.8%.

On balance, the data resulted in a 0.1pp increase to our 4Q GDP tracking estimate, leaving us at 2.2% qoq saar. Table 1 shows a breakout for growth, with the latest changes highlighted.

Figure 22: GDP tracking summary

	4Q 2019			
	% qoq saar	Revision	Contrib. to GDP	Revision
Consumer spending	1.8	0.0	1.2	0.0
Residential Investment	6.0	0.2	0.2	0.0
Structures	-6.2	3.9	-0.2	0.1
Equipment	-2.9	0.0	-0.2	0.0
Intellectual Property	5.9	0.0	0.3	0.0
Government	2.6	-0.1	0.4	0.0
Exports	1.4	0.0	0.2	0.0
Imports	-8.7	0.0	1.3	0.0
Net Exports (Bil 12$)	-900	0	1.5	0.0

Figure 22: GDP tracking summary

Inventory (Bil 12$)	7	0	-0.8	0.0
Domestic Final Sales			1.8	0.1
Final Sales			3.2	0.0
GDP			2.2	0.1

Note: This is not our official forecast, as GDP trackers will evolve alongside the real-time data flow. When large deviations occur, official forecasts may adjust to be consistent with tracking estimates.
We compute our GDP tracking estimates using a build-up methodology that utilizes various monthly high frequency economic data series to "nowcast" the major subcomponents of GDP listed in the table. We discuss this and other "nowcasting" approaches in our US Economic Weekly "Supermodels." Source: BofA Global Research

ISM manufacturing breaches 50 –first time in six months

ISM manufacturing index rose to 50.9 in January from 47.8, beating expectations of 48.5. This is the first expansionary reading since July 2019. Looking at the details, there were notable increases to production and new orders components, the former rising to 54.3 from 44.8 and the latter climbing to 52.0 from 47.6. Employment edged up to 46.6 from 45.2, although this is still a contractionary reading. Meanwhile, supplier deliveries decreased to 52.9 from 54.6 and inventories edged down to 48.8 from 49.2.

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