

## Finding the Right Security Blanket

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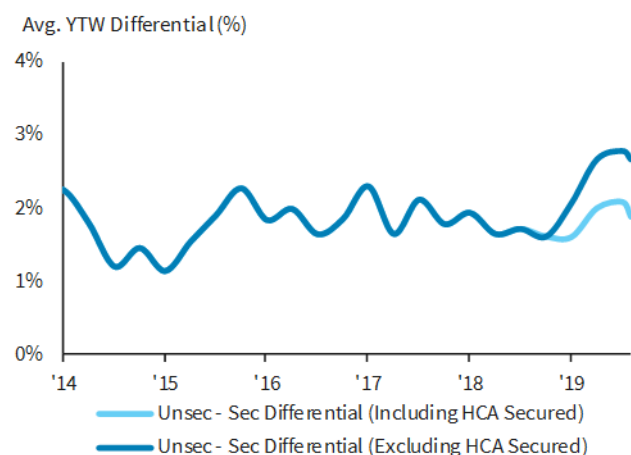
The big story for 2019 in the leveraged finance market has been a clear preference for higher quality in general and much stronger demand for high yield than for leveraged loans. A smaller theme has been an increase in idiosyncratic risk as single-name dispersion has picked up. While we do not expect a significant increase in demand for loans or lower-quality credit, we believe that looking for credits that have been beaten up because of these themes, but where there are idiosyncratic reasons to move down in the capital structure within high yield or to add loan exposure, could help generate alpha.

### Secured versus Unsecured Bonds

The preference for higher quality has been significant within high yield, with year-to-date returns for BBs at 13.7%, compared with B and CCC returns of 12.3% and 5.5%, respectively. When we consider secured bonds, the sample set of BBs is limited, so examining the relationship between unsecured and secured bonds broadly is fairly pointless without normalizing the ratings of the sample sets, as secured bonds appear to trade wide since they are typically issued by more vulnerable issuers. To isolate the credit risk related to the secured/unsecured relationship in the high yield bond market more accurately, we look at the yield basis between matched pairs of bonds from the same issuer.

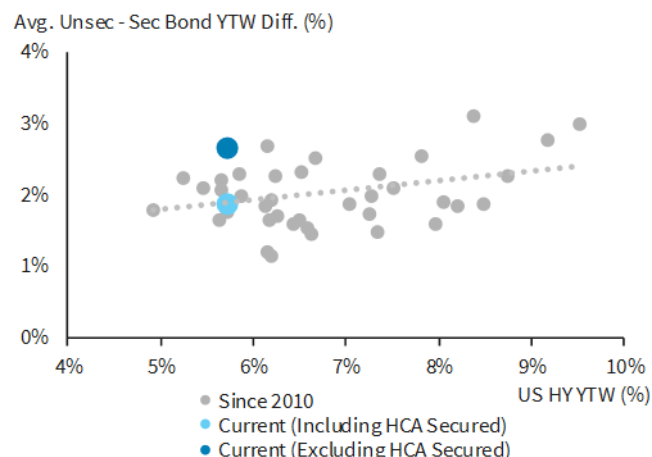
As seen in Figure 1, the unsecured to secured basis has widened significantly in 2019 after having been fairly range-bound in recent years. Nearly all of the widening was driven by the upgrade of HCA's secured notes to investment grade in January, which removed the company from our analysis of secured/unsecured pairs in the High Yield Index. If we were to include HCA in 2019's analysis, the yield differential between the matched pairs would be more in line with historical averages, suggesting that there is not a major dislocation in the unsecured/secured relationship at a market level.

**FIGURE 1**  
The Matched Secured/Unsecured Bond Pair Basis Is in Line with Recent Levels When HCA Bonds Are Included



Note: Excludes bonds trading below \$70 and with less than \$200mn outstanding. Source: Bloomberg Barclays Indices

**FIGURE 2**  
The Unsecured to Secured Bond Spread Basis Is in Line with the Level Implied by the High Yield Index Spread



Note: Excludes bonds trading below \$70 and with less than \$200mn outstanding. Source: Bloomberg Barclays Indices

FIGURE 3

## Select Swaps from Secured to Unsecured Bonds

Ticker	Issuer	Analyst	Secured Bond					Unsecured Bond				
			Coupon	Maturity Date	Rating	Price (\$)	YTW (%)	Coupon	Maturity Date	Rating	Price (\$)	YTW (%)
ARGID	Ardagh Packaging	Brian Lalli	4.125	8/15/2026	UW	102	3.71	5.25	8/15/2027	MW	103	4.56
BHCCN	Bausch Health	Rishi Parekh	5.75	8/15/2027	MW	109	3.40	7	1/15/2028	MW	109	4.99
INTEL	Intelsat Jackson	Vincent Foley	9.50	9/30/2022	MW	116	3.65	9.75	7/15/2025	MW	104	8.34
THC	Tenet Healthcare	Rishi Parekh	5.125	5/1/2025	MW	103	4.03	7	8/1/2025	MW	104	5.42
TLN	Talen Energy	Srinjoy Banerjee, CFA	7.25	5/15/2027	OW	101	7.04	6.5	6/1/2025	OW	75	12.94
TLN	Talen Energy	Srinjoy Banerjee, CFA	6.625	1/15/2028	OW	97	7.05	6.5	6/1/2025	OW	75	12.94

Source: Bloomberg Barclays Indices

Understandably, the premium for moving from a secured bond to an unsecured bond from the same issuer is dependent on broader high yield market conditions. Figure 2 shows the relationship between the yield to worst for the High Yield Index and for matched unsecured/secured bond pairs. When we include HCA secured bonds, the current unsecured/secured basis is in line with the level implied by the market.

While this does not mean that investors should broadly move from secured to unsecured bonds, select swaps into unsecured are attractive, especially for credits that investors are constructive on. Figure 3 highlights select swaps in which our fundamental analysts either have an Overweight rating on the unsecured or an Underweight rating on the secured bond. We also include swaps from Market Weight-rated secured bonds to Market Weight unsecured bonds where the pickup in yield is attractive.

### Bonds versus Loans

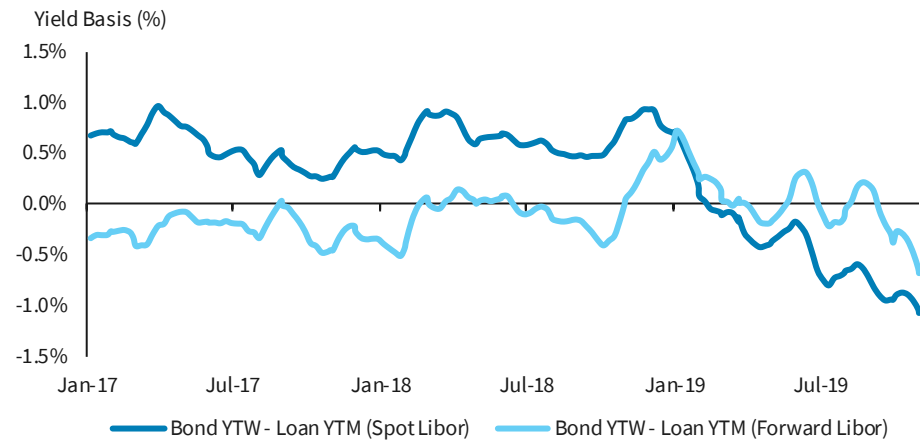
While the high yield market has had robust technicals this year with the exception of the lowest quality segment, the loan market has struggled in the face of decreasing demand for floating-rate exposure and negative headlines on structural changes to the market. To see if the difference in technicals has resulted in interesting single-name opportunities, we look at the loan market versus high yield. Once again, looking at things at a market level tells a different story than examining pairs of bonds and loans from the same issuer. As seen in Figure 4, the rally in bonds has caused bond yields to trade significantly through loan yields, giving the impression of significant cheapness in the loan market.

As outlined in *Rates Take Their Toll on Yields*, this analysis is further complicated by deciding on the appropriate yield level for loans. Because of the current inversion of the Libor forward curve, the realized loan yield using the curve would be roughly 40bp lower than the current spot Libor yield implies. Even when making this adjustment in Figure 4, we find that loan yields still look relatively cheap to bond yields.

This is not surprising considering the overall decline in quality of the loan market from a ratings standpoint and the increase in quality of the bond market. To make a more accurate comparison between bond and loan yields, we need to isolate matched pairs from the same issuers. As seen in Figure 5, our pairs of matched bonds and loans show that the yield premium for collateral declined in recent years before increasing this year (Figure 5). Especially when considering the forward curve, the pickup in yield suggests that bonds are more attractive.

FIGURE 4

### Loan Yields Are Higher Than Bond Yields on a Spot Basis and When Adjusting for the Forward Libor Curve



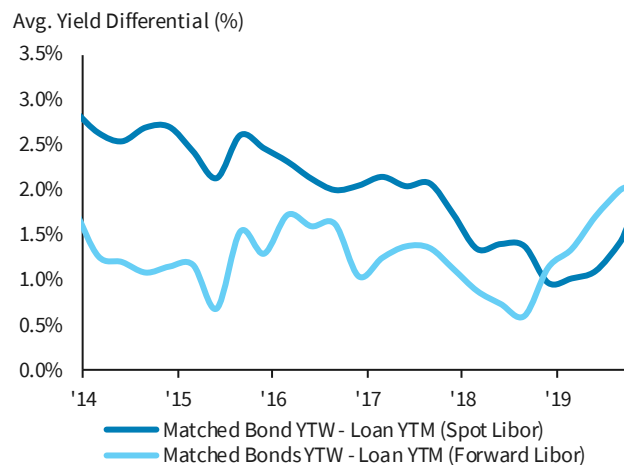
Source: Bloomberg Barclays Indices, S&P LCD

However, the price dynamic between these matched pairs tells a different story. As seen in Figure 6, the average price difference (bond price net of loan price) has risen significantly this year entirely because of an increase in bond prices. Currently, 87% of the matched bond/loan pairs have bonds that trade at a higher dollar price than the loans. In fact, 46% of these pairs have bonds that trade at least \$5 above the loans – the highest level since mid-2014. More specifically, 65% of the bonds in these pairs are trading above next call, while just 34% of loans are trading above par, pointing to limited upside for the bonds relative to loans.

Although the universe of secured bond/loan pairs is more limited than that of unsecured bond/loan pairs, the same dynamic exists for both. As seen in Figure 7, when we apply the same forward Libor adjustment that we did for the entire market in Figure 5, we find that the yield differentials for both universes have increased significantly this year.

FIGURE 5

### The Yield Differential between Bonds and Loan Pairs Has Increased This Year...

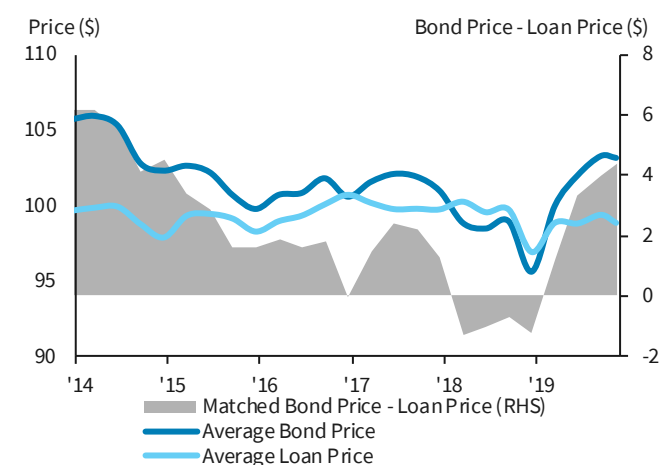


Note: Unsecured bond and first-lien loan pairs only.

Source: Bloomberg Barclays Indices, S&P LCD

FIGURE 6

### ...But the Average Price Difference for Bond and Loan Pairs Has Increased as Well



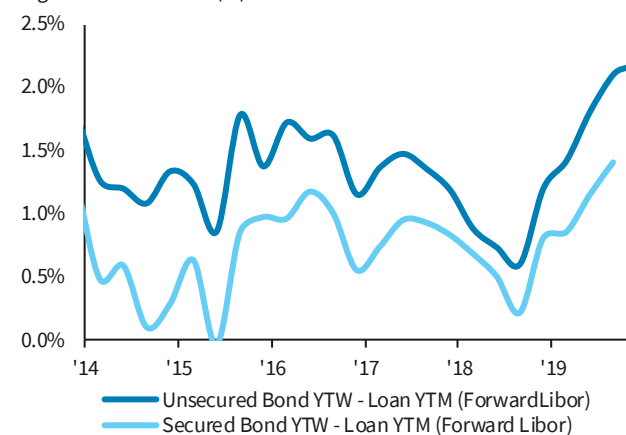
Note: Unsecured bond and first-lien loan pairs only.

Source: Bloomberg Barclays Indices, S&P LCD

FIGURE 7

### The Forward Libor-Adjusted Yield Differential Trend is Similar for Both Unsecured and Secured Bond/Loan Pairs...

Avg. Yield Differential (%)



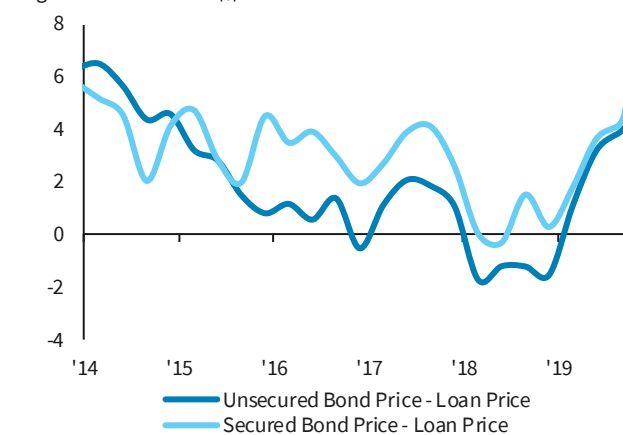
Note: Unsecured bond and first-lien loan pairs only.

Source: Bloomberg Barclays Indices, S&amp;P LCD

FIGURE 8

### ...But Loans Look Attractive on a Price Differential Basis Compared with Both Unsecured and Secured Bonds

Avg. Price Differential (\$)



Note: Unsecured bond and first-lien loan pairs only.

Source: Bloomberg Barclays Indices, S&amp;P LCD

Despite this, the increased price differential between the pairs provides more significant upside for switching from bonds to loans in specific instances where there is a relatively modest give in yield (Figure 8).

For swaps from unsecured bonds to loans, we screen our list of pairs for bonds that are call constrained (yield to worst is less than yield to maturity) and loans that are trading at or below \$98. We also limit the swaps to pairs where the give-up in yield is less than the current average for all pairs of 2.04% when adjusted for the roughly 40bp headwind related to the forward Libor curve (light blue line in Figure 5). Figure 9 lists these unsecured bond to loan swaps.

For swaps from secured bonds to loans, we run the same screen but include an additional filter given the similar security of the two. We limit our results to pairs where the yield between the two is roughly flat or there is a pickup when swapping from the secured bond to the loan even when the loan yield is adjusted for the forward Libor curve. Figure 10 lists these secured bond to loan swaps.

FIGURE 9

### Select Swaps from Unsecured Bonds to Loans

Ticker	Issuer	Coupon	Maturity Date	Unsecured Bond			Loan		
				Price (\$)	YTW (%)	Original Spread to Libor	Maturity Date	Price (\$)	Forward Adj. YTM (%)
ALiant	Alliant	6.75	10/15/2027	105	5.7	300	5/9/2025	97	5.0
CMLP	Crestwood	6.25	4/1/2023	102	4.9	750	3/6/2023	95	11.0
CMLP	Crestwood	5.75	4/1/2025	103	4.8	750	3/6/2023	95	11.0
COMINV	USI Inc	6.875	5/1/2025	102	5.8	300	5/16/2024	97	5.2
COTY	Coty	6.5	4/15/2026	103	5.8	225	4/7/2025	97	4.3
HBGCN	HUB International	7	5/1/2026	103	6.1	300	4/25/2025	98	4.9
HDSUWA	Core & Main	6.125	8/15/2025	102	5.3	300	8/1/2024	98	5.0
IBP	Installed Building Products	5.75	2/1/2028	105	4.6	250	4/15/2025	98	4.4
SBH	Sally Beauty	5.625	12/1/2025	104	4.3	225	7/5/2024	97	4.3
SPCHEM	SP Chemicals	8	10/1/2026	103	7.2	325	10/1/2025	98	5.2

Source: Bloomberg Barclays Indices, S&amp;P LCD

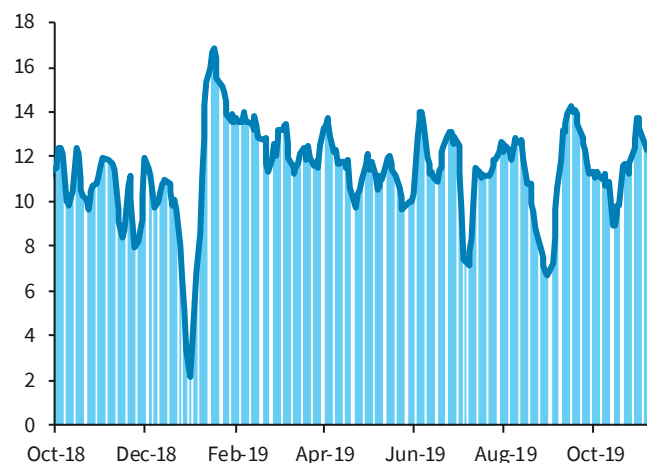
FIGURE 10

## Select Swaps from Secured Bonds to Loans

Ticker	Issuer	Secured Bond				Loan			
		Coupon	Maturity Date	Price (\$)	YTW (%)	Original Spread to Libor	Maturity Date	Price (\$)	Forward Adj. YTM (%)
ACRISU	Acrisure	8.125	2/15/2024	106	6.0	375	11/22/2023	97	6.1
BWY	Mauser Packaging	5.5	4/15/2024	103	4.1	325	4/3/2024	97	5.4
COMM	CommScope	5.5	3/1/2024	101	5.2	325	4/6/2026	98	5.1
UVN	Univision	5.125	5/15/2023	100	5.2	275	3/15/2024	97	5.1

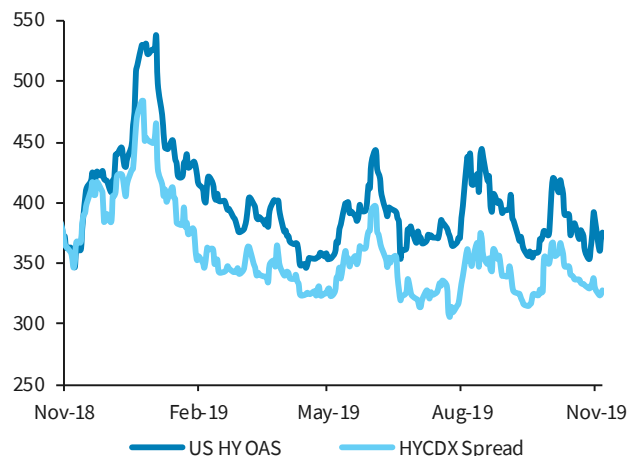
Source: Bloomberg Barclays Indices, S&amp;P LCD

### High Yield Average Institutional Trade Volume (\$bn)



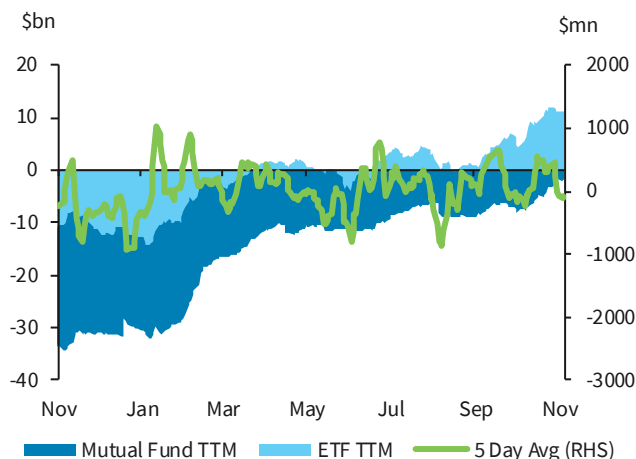
Note: Includes both registered and 144A volumes. Source: FINRA TRACE

### On-the-Run HYCDX versus US High Yield Index (bp)



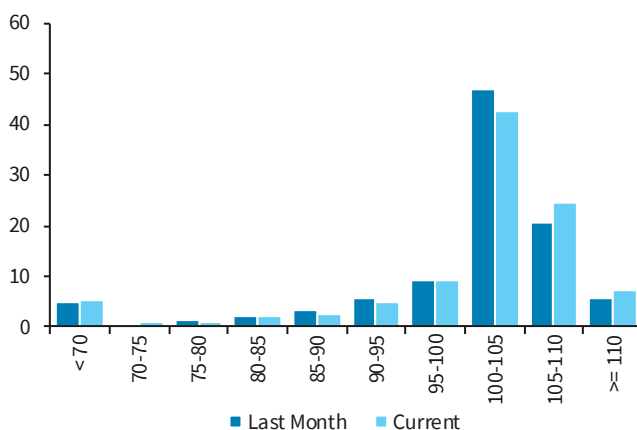
Source: Barclays Research

### Flows to High Yield Mutual Funds and ETFs



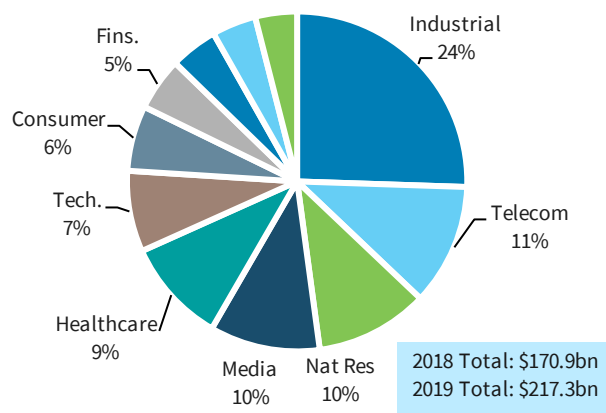
Note: Daily reporters only. Source: EPFR

### High Yield Index Price Distribution by Par (%)



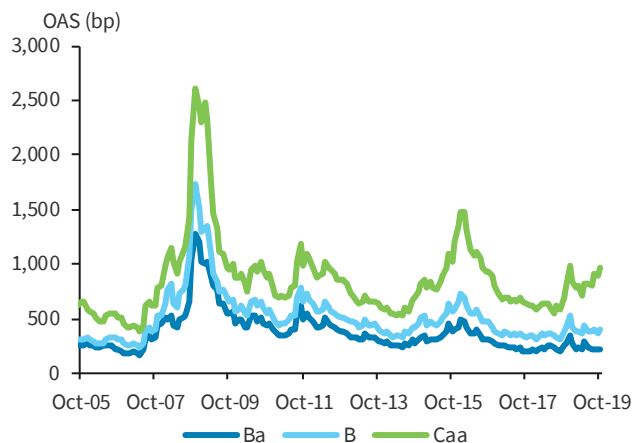
Source: Barclays Research

### High Yield Supply by Sector



Note: 2019 new issue data as of November 6.  
Source: Bloomberg Barclays Indices

### High Yield Spreads by Credit Quality



Source: Bloomberg Barclays Indices

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ACRISU 8 1/8 02/15/24 (USD 106.25, 06-Nov-2019)

ALLIANT HOLDINGS INTERMEDIATE LLC / ALLIANT HOLDINGS CO-ISSUER, CD/J  
ALIAN 6 3/4 10/15/27 (USD 104.50, 06-Nov-2019)

ARDAGH PACKAGING FINANCE PLC / ARDAGH HOLDINGS USA INC, A/CD/D/E/J/K/L/M  
ARGID 5 1/4 08/15/27, Market Weight (USD 103.13, 06-Nov-2019)  
ARGID 4 1/8 08/15/26, Underweight (USD 101.50, 06-Nov-2019)

BAUSCH HEALTH COS INC, A/CD/CE/D/J/K/L/M  
BHCCN 7 01/15/28, Market Weight (USD 108.75, 06-Nov-2019)  
BHCCN 5 3/4 08/15/27, Market Weight (USD 108.75, 06-Nov-2019)

COMMScope INC, CD/D/J/K/L/M/N  
COMM 5 1/2 03/01/24, Market Weight (USD 100.88, 06-Nov-2019)

CORE & MAIN LP, A/CD/D/J/K/L/M  
HDSUWA 6 1/8 08/15/25 (USD 102.00, 06-Nov-2019)

COTY INC, CD/CE/J/K/M  
COTY 6 1/2 04/15/26 (USD 102.75, 06-Nov-2019)

CRESTWOOD MIDSTREAM PARTNERS LP / CRESTWOOD MIDSTREAM FINANCE CORP, A/CD/D/J/L  
CMLP 5 3/4 04/01/25 (USD 102.50, 06-Nov-2019)  
CMLP 6 1/4 04/01/23 (USD 101.88, 06-Nov-2019)

HUB INTERNATIONAL LTD, CD/E/J/K/L/M  
HBGCN 7 05/01/26 (USD 102.75, 06-Nov-2019)

INSTALLED BUILDING PRODUCTS INC, CD/CE/J  
IBP 5 3/4 02/01/28 (USD 105.13, 06-Nov-2019)

**INTELSAT JACKSON HOLDINGS SA, CD/D/E/J/K/L/M/N**  
INTEL 9 1/2 09/30/22, Market Weight (USD 115.88, 06-Nov-2019)  
INTEL 9 3/4 07/15/25, Market Weight (USD 104.25, 06-Nov-2019)

**MAUSER PACKAGING SOLUTIONS HOLDING CO, CD/J/K/M**  
BWY 5 1/2 04/15/24, Market Weight (USD 103.13, 06-Nov-2019)

**SALLY HOLDINGS LLC / SALLY CAPITAL INC, CD/J**  
SBH 5 5/8 12/01/25, Underweight (USD 103.50, 06-Nov-2019)

**STARFRUIT FINCO BV / STARFRUIT US HOLDCO LLC, CD/J/K/M**  
SPCHEM 8 10/01/26, Overweight (USD 102.75, 06-Nov-2019)

**TALEN ENERGY SUPPLY LLC, A/CD/D/J/K/L/M**  
TLN 6 5/8 01/15/28, Overweight (USD 97.25, 06-Nov-2019)  
TLN 7 1/4 05/15/27, Overweight (USD 100.75, 06-Nov-2019)  
TLN 6 1/2 06/01/25, Overweight (USD 76.00, 06-Nov-2019)

**TENET HEALTHCARE CORP, A/CD/CE/D/J/K/L/M**  
THC 5 1/8 05/01/25, Market Weight (USD 102.50, 06-Nov-2019)  
THC 7 08/01/25, Market Weight (USD 103.75, 06-Nov-2019)

**UNIVISION COMMUNICATIONS INC, CD/J/K/M**  
UVN 5 1/8 05/15/23 (USD 99.75, 06-Nov-2019)

**USI INC/NY, CD/E/J/K/L/M**  
COMINV 6 7/8 05/01/25 (USD 102.13, 06-Nov-2019)

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To view sector definitions and monthly sector returns for Asia, EEMEA and Latin America Research, go to <https://live.barcap.com/go/research/EMSectorReturns> on Barclays Live.

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For all High Grade issuers covered in the US, Europe or Asia, and for all issuers in Latin America and EEMEA, the credit rating system is based on the analyst's view of the expected excess return over a six-month period of the issuer's index-eligible corporate debt securities\* relative to the expected excess return of the relevant sector, as specified on the report.

**Overweight (OW):** The analyst expects the six-month excess return of the issuer's index-eligible corporate debt securities to exceed the six-month expected

excess return of the relevant sector.

**Market Weight (MW):** The analyst expects the six-month excess return of the issuer's index-eligible corporate debt securities to be in line with the six-month expected excess return of the relevant sector.

**Underweight (UW):** The analyst expects the six-month excess return of the issuer's index-eligible corporate debt securities to be less than the six-month expected excess return of the relevant sector.

**Rating Suspended (RS):** The rating has been suspended temporarily due to market events that make coverage impracticable or to comply with applicable regulations and/or firm policies in certain circumstances including where the Investment Bank of Barclays Bank PLC is acting in an advisory capacity in a merger or strategic transaction involving the company.

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For all High Yield issuers (excluding those covered in EEMEA or Latin America), the credit rating system is based on the analyst's view of the expected total returns over a six-month period of the rated debt security relative to the expected total return of the relevant sector, as specified on the report.

**Overweight (OW):** The analyst expects the six-month total return of the debt security subject to this rating to exceed the six-month expected total return of the relevant sector.

**Market Weight (MW):** The analyst expects the six-month total return of the debt security subject to this rating to be in line with the six-month expected total return of the relevant sector.

**Underweight (UW):** The analyst expects the six-month total return of the rated debt security subject to this rating to be less than the six-month expected total return of the relevant sector.

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Where a recommendation is made at the issuer level, it does not apply to any sanctioned securities, where trading in such securities would be prohibited under applicable law, including sanctions laws and regulations.

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#### **Distribution of ratings assigned by Barclays Corporate Credit Research at the bond level:**

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52% have been assigned Market Weight rating which, for purposes of mandatory regulatory disclosures, is classified as a Hold rating; 55% of bonds with this rating category are investment banking clients of the Firm; 75% of the issuers with this rating have received financial services from the Firm.

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#### **Explanation of the Barclays EM Sovereign Credit Issuer Rating System**

##### **Overweight (OW):**

The analyst expects the six-month excess return of the country's index eligible bonds to exceed the six-month excess return of the Bloomberg Barclays EM USD Sovereign Index.

##### **Market Weight (MW):**

The analyst expects the six-month excess return of the country's index eligible bonds to be in line with the six-month excess return of the Bloomberg Barclays EM USD Sovereign Index.

##### **Underweight (UW):**

The analyst expects the six-month excess return of the country's index eligible bonds to be less than the six-month excess return of the Bloomberg Barclays EM USD Sovereign Index.

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