Investment Grade

# Reassessing at Wider Levels

IG bonds were not immune to the risk-off sentiment this week. Although BBBs outpaced As beta-adjusted, the sell-off was relatively duration agnostic. We estimate which sectors are most vulnerable to a slowdown in demand and/or disruption in the supply chain due to the spread of COVID-19 and highlight rel val opportunities.

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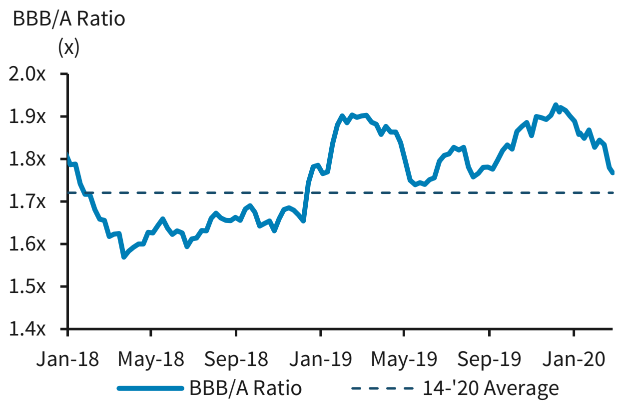
Concerns about the spread of COVID-19 have spurred a five-day sell-off in both equity and credit markets, with the S&P 500 down 12% and US corporate spreads wider by 10bp as of midday Thursday. Heightened worries of a slowdown in global economic activity have also led to a rally in safe haven assets, with 10y and 30y Treasury yields declining more than 20bp and both reaching all-time lows. BBB debt has widened more than A paper in nominal terms, but has actually outperformed on a beta-adjusted basis. In fact, the compression seen in the BBB/A ratio as index spreads remained range-round for the previous two months only accelerated during the recent rout in valuations. Figure 1 shows the BBB/A ratio for industrial corporate debt, which is now at the lowest level since June 2019 and closer to longer-term averages.

When sell-offs of this magnitude occur in a short period of time, the aggregate indices are unlikely to fully reflect the magnitude of the move given that only a subset of bonds trade actively on any day. Therefore, in order to garner a better understanding of market moves we focus on securities that have traded actively in the past week. This cohort, which comprises about 30% of the index by market value but has a similar rating/duration breakdown, has widened 12bp w/w, compared with a 10bp move in the US Corporate Index over the same period. Note that all spreads moves are through Wednesday's close.

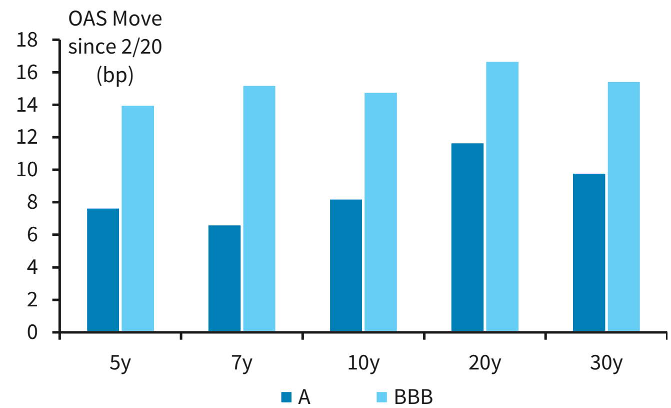
Figure 2 shows the spread move since Thursday of the most actively traded bonds across the curve, broken down by ratings bucket. Across maturity buckets, BBB spreads have widened 14-17bp, outperforming single-As, which are 8-12bp wider, on a beta-adjusted basis. The sell-off has been relatively duration agnostic, with 10s30s curves less than 2bp steeper for both As and BBBs. Historically, curves steepen when yields decline, although this effect has been subdued recently, as yield-focused demand from domestic insurance and international has remained elevated even as yields have decreased (see *Demand in the Face of Lower Yields*). However, we expect the magnitude and pace of the Treasury rally to weigh on long-dated demand, at least in the near term. In addition, once primary markets re-open, there is an increased likelihood that 30y issuance will pick up at historically low all-in yield levels, further reducing the attractiveness of long-dated debt. Therefore, we recommend rotating out of 30y debt and into the 5-7y bucket, especially for A rated paper, where 5s30s curves are flatter.

**FIGURE 1. BBB/A Ratio Compression Accelerated during the Recent Sell-off**




Note: Industial debt only.
Source: Bloomberg, Barclays Research

**FIGURE 2. Non-financial OAS Move since February 20 by Maturity**




Source: Bloomberg, Barclays Research

Figure 3 highlights the worst and best performing sectors since the market close on Thursday. The sectors most susceptible to a global slowdown in demand and/or significant supply chain disruptions appear to have underperformed. Automotive companies are broadly affected from both a demand and a supply perspective, and Barclays fundamental analysts recently detailed which companies are most exposed (see *Global Autos & Auto Parts: Coronavirus impact on global autos*). Leisure and gaming sectors have underperformed largely because of worries about a decline in consumer demand for cruises and casino trips. Energy sectors have reacted to the approximately 25% decline in oil, and although metals prices have held in, the metals and chemicals sectors have underperformed because of their higher exposure to China (see *Swap Opportunities Amid Volatility*).

Turning to the best performing sectors, non-cyclicals have led the way, as investors have preferred companies with more stable business models. While the outperformance is justified in some cases, four sectors stand out. In particular, consumer products, food & beverage, retail, and aerospace & defense have performed well, with their perceived defensiveness likely supporting valuations. While these are, in fact, more insulated from the direct effects of the virus, many of these sectors were facing significant headwinds before virus concerns took over market sentiment. Retail, consumer products, and food & beverage companies are in the midst of secular shifts in their industries, which should limit their defensiveness in a broader market sell-off. Risks in aerospace & defense are more idiosyncratic, with uncertainty surrounding the return of the Boeing 737 Max dampening sentiment in the sector (see *HG Aerospace & Defense: High Quality Problems*). On balance, we believe these sectors are at risk of underperforming the broader index.

**FIGURE 3. Worst and Best Performing Sectors**

| Worst Performing Sectors | | | Best Performing Sectors | | |
|---|---|---|---|---|---|
| Sector | 4-day OAS chg (bp) | YTD OAS chg* | Sector | 4-day OAS chg (bp) | YTD OAS chg* |
| Leisure | 81 | 45 | Food and Beverage | 4 | 7 |
| Automotive | 23 | 24 | Pharmaceuticals | 9 | 13 |
| Independent | 23 | 37 | Supermarkets | 9 | 24 |
| Chemicals | 23 | 17 | Retailers | 10 | 16 |
| Paper | 22 | 13 | Consumer Cyc Serv. | 10 | 15 |
| Midstream | 22 | 25 | Consumer Products | 10 | 13 |
| Gaming | 20 | 16 | Wireless | 10 | 13 |

| Worst Performing Sectors | | | Best Performing Sectors | | |
|---|---|---|---|---|---|
| Sector | 4-day OAS chg (bp) | YTD OAS chg* | Sector | 4-day OAS chg (bp) | YTD OAS chg* |
| Oil Field Services | 20 | 25 | Technology | 10 | 15 |
| Metals and Mining | 19 | 16 | Wirelines | 10 | 22 |

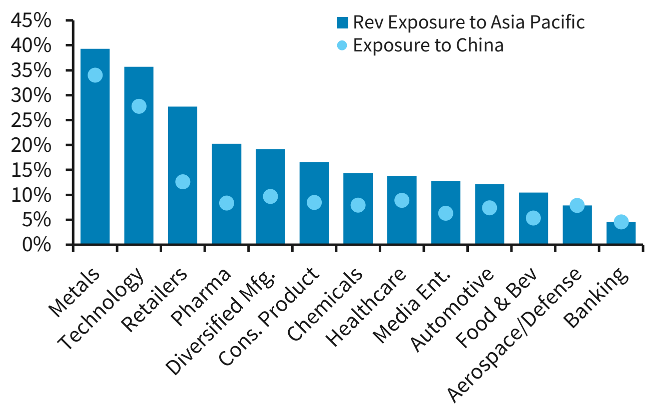
* US Corporate Index average.
Source: Bloomberg, Barclays Research

Extending the analysis to single names, quantifying the effect of the virus, and determining the most vulnerable companies is not a straight-forward exercise. The effect on companies is two-pronged, through the demand side of the economy as households cut back on consumption and spending and the through global supply chains as factories shut down and production capacity is underutilized.

- First, to identify the companies most exposed to weakened demand, we look at the aggregated revenue exposure to China and the Asia Pacific region. Where available, we identify revenue exposure for individual companies and aggregate it at a sector level (Figure 4). Not surprisingly, metals & mining and technology companies screen as having the highest revenue exposure to the region, while the banking, aerospace & defense, and food & beverage sectors are most insulated.

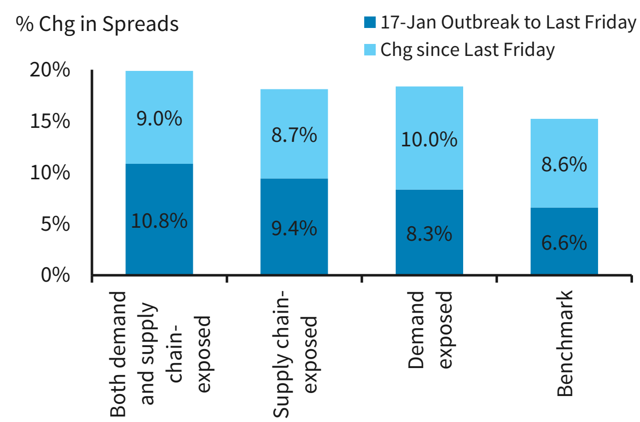
- Second, using sector level import/export data from China, we estimate which sectors are most vulnerable to a potential disruption in the global supply chain. Because these data are usually not available at the ticker level, we use aggregate data from the US Census Bureau and the Bureau of Economic Analysis, combined with qualitative opinions from Barclays' fundamental analysts, to fine-tune the supply-chain exposure estimates (see *There's a New Tariff in Town* for more details on the methodology).

FIGURE 4. **Investment Grade Corporate Aggregate Sector Revenue Exposure to Asia Pacific Region**




Note: Data limited by availability of geographical revenue breakdown. Also exclude sectors where less than three data points.
Source: Bloomberg, Factset, Barclays Research

FIGURE 5. **Spread Performance of Companies with Supply and Demand Exposure to Asia**




Source: Bloomberg, Factset, Barclays Research

Combining the two factors, we construct a list of US investment grade companies that are vulnerable from a demand or supply perspective, or both. Figure 5 shows the relative performance of these three cohorts versus the index. Companies with heightened exposure to both demand and supply-chain disruptions have fared the worst since the outbreak, widening 16bp, or about 20% of their starting spread, from levels on January 17, when the outbreak began.

Zooming in on the sell-off this week in particular, demand-exposed names have fared worse than supply chain-exposed names, a marked contrast from their performance from January 17 to last Friday. With the number of new cases in China on the decline, the risk of meaningful supply chain disruptions have decreased and been superseded by concerns that a global outbreak will weigh on demand.

Figure 6 highlights single names that are exposed to both of the above factors, ie, from a supply-chain and a demand perspective. Across the investment grade market, these should be the companies most vulnerable to a continued worsening of the virus outbreak and can serve as a starting point for investors assessing their exposure to this risk.

**FIGURE 6. Tickers Exposed from a Supply and Demand Perspective**

| Ticker | Mkt. Value ($bn) | Rating | Sector | APAC Rev % | China Export/Sales | China Import/Sales | 3-day chg vs Index (bp) | Chg as a % of Starting Spread |
|---|---|---|---|---|---|---|---|---|
| STX | 4.0 | BAA3 | Technology | 23% | 1% | 12% | 26 | 14% |
| SWK | 5.1 | A3/BAA1 | Building Materials | 9% | 1% | 24% | 12 | 12% |
| ETN | 4.8 | BAA1 | Diversified Manuf. | 12% | 1% | 8% | 8 | 11% |
| INTC | 27.0 | A1 | Technology | 28% | 5% | 4% | 7 | 11% |
| NKE | 4.0 | A1 | Retailers | 29% | 1% | 46% | 6 | 10% |
| AAPL | 75.8 | AA1 | Technology | 32% | 2% | 46% | 6 | 10% |
| QCOM | 14.6 | A3 | Technology | 65% | 2% | 46% | 8 | 10% |
| TPR | 1.7 | BAA3 | Retailers | 27% | 1% | 46% | 14 | 10% |
| AVGO | 26.6 | BAA3 | Technology | 66% | 5% | 4% | 11 | 10% |
| TEL | 2.5 | A3 | Technology | 33% | 1% | 11% | 8 | 9% |
| MMM | 14.3 | A1 | Diversified Manuf. | 31% | 0% | 9% | 6 | 9% |
| BDX | 11.3 | BAA3 | Healthcare | 16% | 1% | 4% | 8 | 9% |
| APH | 2.3 | BAA1 | Technology | 42% | 1% | 11% | 7 | 8% |
| TRMB | 1.5 | BAA3 | Technology | 13% | 2% | 46% | 10 | 8% |
| BA | 19.5 | A3 | Aerospace/Defense | 26% | 5% | 0% | 9 | 8% |
| LEG | 1.7 | BAA2 | Diversified Manuf. | 12% | 0% | 20% | 8 | 7% |
| TMO | 7.0 | BAA1 | Healthcare | 14% | 4% | 2% | 5 | 7% |
| GLW | 5.5 | BAA1 | Technology | 32% | 1% | 12% | 14 | 7% |
| MOS | 4.4 | BAA3 | Chemicals | 3% | 0% | 1% | 10 | 7% |
| JNPR | 1.9 | BAA2 | Technology | 18% | 0% | 16% | 9 | 7% |
| DHR | 5.4 | A3/BAA1 | Healthcare | 16% | 3% | 7% | 5 | 7% |
| WHR | 2.7 | BAA2 | Consumer Products | 8% | 3% | 61% | 7 | 6% |
| WY | 5.0 | BAA2 | Paper | 7% | 0% | 0% | 6 | 6% |
| ROK | 1.6 | A2 | Diversified Manuf. | 14% | 4% | 5% | 3 | 4% |
| A | 1.9 | BAA1 | Healthcare | 20% | 6% | 5% | 2 | 3% |
| FTV | 2.4 | BAA2 | Diversified Manuf. | 11% | 3% | 7% | 2 | 2% |

Source: Factset, U.S. Census Bureau and Bureau of Economic Analysis, Bloomberg, Barclays Research

Separately, we identify tickers whose recent spread performance appears dislocated compared with their exposure to virus risk, in our opinion. Specifically, Figure 7 highlights long ideas in 10y debt that has underperformed as a percent of starting spread but is from issuers with little revenue or supply chain exposure to the Asia Pacific region. On the flip side, some tickers have outperformed despite significant exposure to the region from either a demand or a supply perspective (the credits highlighted in blue) and appear rich.

**FIGURE 7. Long and Short Ideas Based on Supply and Demand from APAC**

| Ticker | Mkt. Value ($bn) | Rating | Sector | APAC Rev % | 10y OAS chg as % of Starting Spread |
|---|---|---|---|---|---|
| **Long Ideas** | | | | | |
| GD | 8.9 | A2 | Aerospace/Defense | 6% | 26% |

| Ticker | Mkt. Value ($bn) | Rating | Sector | APAC Rev % | 10y OAS chg as % of Starting Spread |
|---|---|---|---|---|---|
| CRM | 2.7 | A3 | Technology | 10% | 21% |
| UTX | 31.2 | BAA1/BAA2 | Diversified Manufacturing | 7% | 21% |
| OMC | 3.6 | BAA1 | Media Entertainment | 11% | 14% |
| ADBE | 1.1 | A2 | Technology | 15% | 12% |
| **Short Ideas** | | | | | |
| MU | 4.3 | BAA3 | Technology | 51% | 10% |
| KEYS | 1.4 | BAA2 | Technology | 43% | 10% |
| DHR | 1.6 | A3/BAA1 | Healthcare | 16% | 9% |
| NXPI | 4.1 | BAA3 | Technology | 48% | 8% |
| BIDU | 5.8 | A3 | Technology | 100% | 5% |
| TGT | 10.2 | A2 | Retailers | N/A | 10% |
| DLTR | 3.8 | BAA3 | Retailers | N/A | 8% |
| JWN | 2.1 | BAA1 | Retailers | N/A | 5% |

Source: Factset, Bloomberg, Barclays Research

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Representative Bond: ADBE 2.15 02/01/27 (USD 101.82, 26-Feb-2020)

**BAIDU INC**, Market Weight, CD/CE/FC/J

Representative Bond: BIDU 3 5/8 07/06/27 (USD 107.81, 26-Feb-2020)

**DANAHER CORP**, A/CD/CE/D/E/J/K/L/M/N

Representative Bond: DHR 3.35 09/15/25 (USD 108.45, 26-Feb-2020)

**DOLLAR TREE INC**, CD/CE/J

Representative Bond: DLTR 4.2 05/15/28 (USD 110.53, 26-Feb-2020)

**GENERAL DYNAMICS CORP**, CD/CE/J/K/M/N

Representative Bond: GD 3 3/4 05/15/28 (USD 112.56, 26-Feb-2020)

**KEYSIGHT TECHNOLOGIES INC**, A/CD/CE/D/J/K/L/M/N

Representative Bond: KEYS 3 10/30/29 (USD 104.38, 26-Feb-2020)

**MICRON TECHNOLOGY INC**, CD/CE/J

Representative Bond: MU 5.327 02/06/29 (USD 116.25, 26-Feb-2020)

**NORDSTROM INC**, Market Weight, CD/CE/J

Representative Bond: JWN 4.0 10/15/2021 (USD 102.91, 26-Feb-2020)

**NXP BV / NXP FUNDING LLC / NXP USA INC**, Market Weight, A/CD/D/E/J/K/L/M

Representative Bond: NXPI 3 7/8 06/18/26 (USD 107.75, 26-Feb-2020)

Representative Bond: NXPI 3 7/8 06/18/26 (USD 108.13, 26-Feb-2020)

Representative Bond: NXPI 4.3 06/18/29 (USD 111.88, 26-Feb-2020)

Representative Bond: NXPI 4.3 06/18/29 (USD 111.88, 26-Feb-2020)

**OMNICOM GROUP INC**, A/CD/CE/D/FB/J/K/L/M/N

Representative Bond: OMC 2.45 04/30/30 (USD 100.02, 26-Feb-2020)

**SALESFORCE.COM INC**, CD/CE/D/J/K/L/M

Representative Bond: CRM 3.7 04/11/28 (USD 111.88, 26-Feb-2020)

**TARGET CORP**, Market Weight, A/CD/CE/D/J/K/L/M/N

Representative Bond: TGT 3 1/2 07/01/24 (USD 108.74, 26-Feb-2020)

**UNITED TECHNOLOGIES CORP**, Overweight, A/CD/CE/D/FA/FB/J/K/L/M/N

Representative Bond: UTX 4 5/8 11/16/48 (USD 131.96, 26-Feb-2020)

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