Credit Investor Survey

When FOMO meets "oh no"

Credit Analysis

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Credit Strategy
Europe

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FOMO-Fear Of Missing Out

2020: hubris vs. humiliation

The 2020 bottom-line: investors are bullish, have inflows, and see a goldilocks combination of QE "infinity" and inflecting macro data pushing spreads tighter…for now. But consensus feels shaky and views are polarized. Valuations are increasingly becoming the sticking point: note, for instance, that as many investors say *cash* will be the best performing asset of 2020, as those saying *high-yield* bonds will be. Investors see IG spreads hitting a tight of 80bp in early '20…and then widening back to 95bp by year-end.

On the 2020 biggest risk: investors now say that *market liquidity* is their #1 worry (only second time ever) given that spreads are tightening fast and FOMO behaviour has been conspicuous of late (note single-B and CCC spreads are now ripping). But there are almost no investor concerns next year on inflation, rising yields, or an equity market correction.

Yet, on the biggest underappreciated risk for 2020: investors say a "whiff" of inflation would be a game-changer for fixed-income…empowering central banks to hike irrespective of the consequence in market volatility.

Fiscal "frenzy" or "fantasy"?

One secular theme for the 2020s will be how markets navigate the hand-off from monetary to fiscal policy. And investors say that fiscal policy holds the greatest hope of solving the lowflation puzzle: 35% say fiscal spending will drive higher European inflation (note 17% say Brexit will be inflationary). For now, big fiscal loosening in Europe remains a pipe dream – government budgets next year have little new spending pencilled in. But the fiscal "noise" across Europe will only grow down the line…and note Germany's current account surplus today is of historic proportions (chart 3).

Tantrum makers?

As the final quarter of 2018 showed, there can be no big sell-off in credit without a "bear market" in central banks. But which central bank might be the first to step out of line? Investors say the ECB is most likely to surprise *hawkishly* in '20 as the bank's strategy review could be a constant source of confusing newsflow. Conversely, investors say the Fed is most likely to surprise *dovishly* given Dollar strength.

The great barbell

December's survey shows that investors are becoming torn between leaning further on the risk-on trade and ploughing back into risk-free assets in anticipation of a correction. Thus, investors say that their top trade next year is a barbell of high-beta credit (Euro HY and AT1s, in particular) and cash. Note that there could be very little love from investors in '20 for either higher-quality assets (IG) or credit duration (€10+yr and $30yr).

The contrarian trades to start the roaring '20s

Investors have aggressively covered shorts in unloved sectors of late, with better US-China trade noise encouraging a cyclical thirst across the market. Thus, contrarian shorts over the next few months look to be: retail, autos, Crossovers and industrials. Utilities (and to some extent senior banks) look the contrarian longs here.

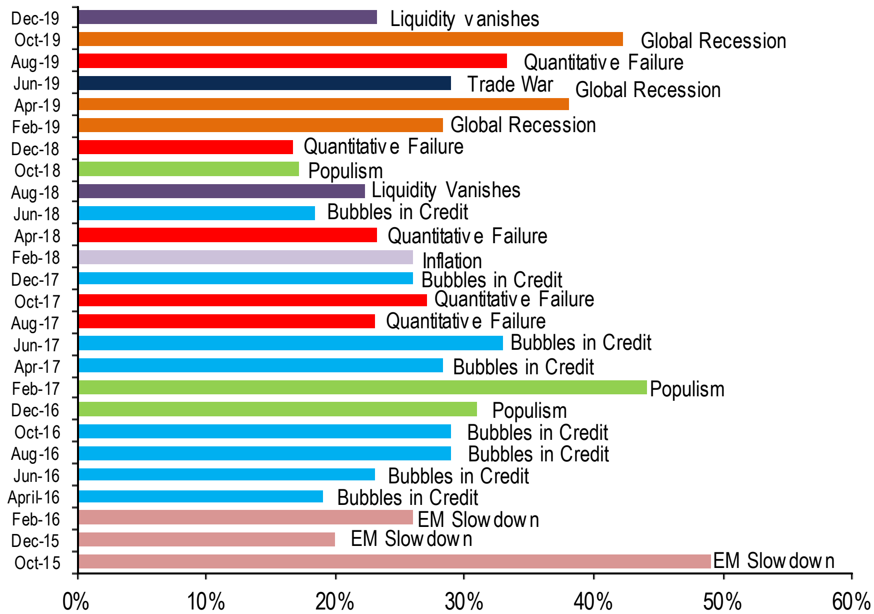
Strategy charts

When FOMO meets "oh no"

Chart 1 shows the history of credit investors' biggest concern. This month, fears of *Market Liquidity* rise to the top (23%), only the second time ever that liquidity has been the big worry. Investors say markets are starting to get stretched, with too much hubris entering 2020 – suggesting that spreads could wobble at some point next year. Moreover, a much bigger "buy side" vs. "sell side" today means that corrections could be more disorderly than in the past.

Global recession fears slide back to third place, with *bubbles in credit* now the second biggest worry. Note only 2% of investors worry about inflation surprising positively.

Chart 1: History of Credit Investors' biggest perceived risks (IG investors). % saying top worry.

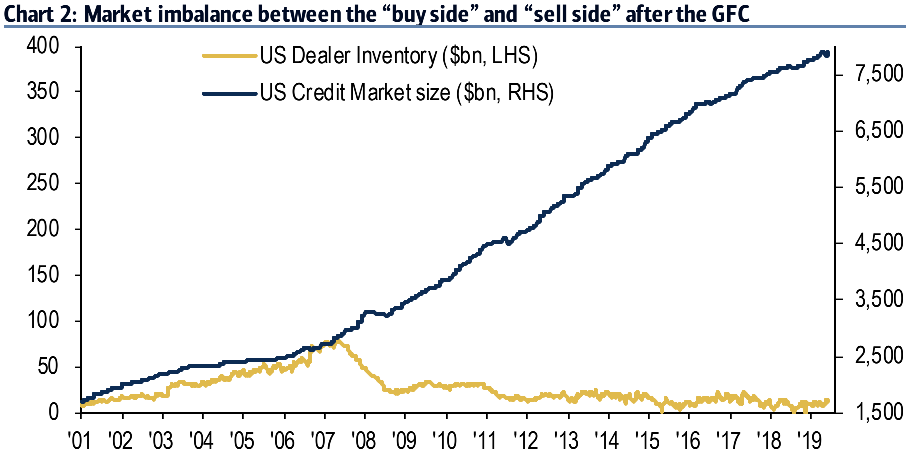


Source: BofA Global Research. IG investors only. % of investors.

"Buy side" vs. "Sell side"

Market liquidity is now the #1 worry for credit investors. Chart 2 shows that the imbalance between the "buy side" and the "sell side" still [remains extreme](#) today, and has surged in the post-GFC era.

Chart 2: Market imbalance between the "buy side" and "sell side" after the GFC

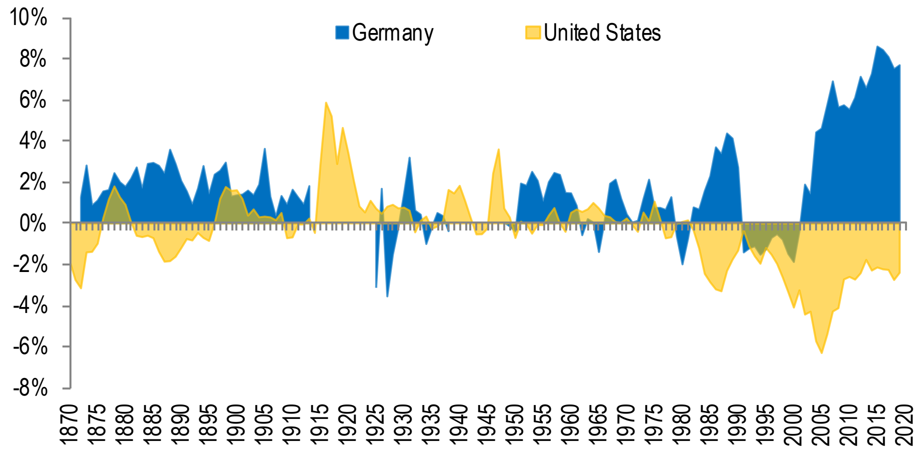


Source: BofA Global Research, Bloomberg. The US market size is the sum of the $ IG (C0A0) and $ HY (H0A0) cash indices face values.

Fiscal "frenzy", or "fantasy"?

While fiscal spending feels a way off in Europe, there is no doubt that the noise around it will only grow from here. Chart 3 shows that Germany's current account surplus is of historic proportions today, and one of the world's largest. Levels of government investment in Germany remain low by world standards.

Chart 3: Germany's current account surplus – of historic proportions today. (Current account balance as % GDP)

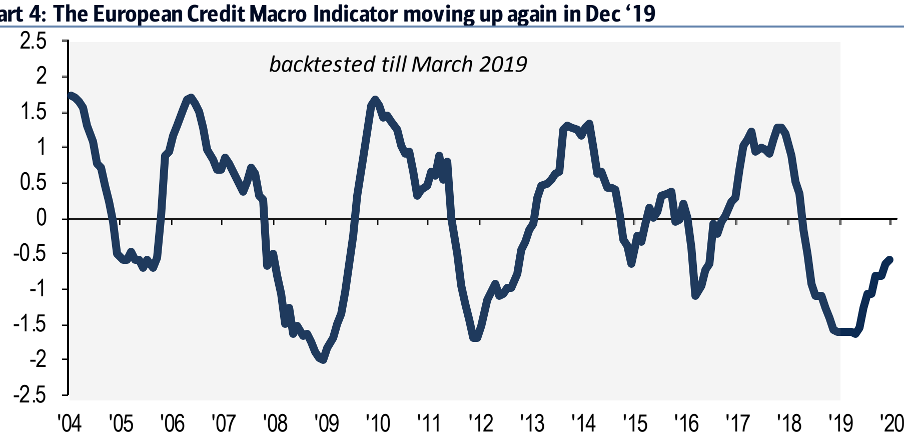


Source: BofA Global Research, Òscar Jordà, Moritz Schularick, and Alan M. Taylor. 2017. "Macrofinancial History and the New Business Cycle Facts." in *NBER Macroeconomics Annual 2016*, volume 31, edited by Martin Eichenbaum and Jonathan A. Parker. Chicago: University of Chicago Press.

FOMO data in Europe

Fodder for the bulls: BofA's European Credit Macro Indicator has moved another leg higher in December (based on end-November data), and is now clearly improving.

Chart 4: The European Credit Macro Indicator moving up again in Dec '19



Source: BofA Global Research, Bloomberg, ICE Data Indices, LLC; Note that a negative (positive) reading reflects deteriorating (improving) trends. This performance is back-tested and does not represent the actual performance of any account or fund. Back-tested performance depicts the theoretical (not actual) performance of a particular strategy over the time period indicated. No representation is being made that any actual portfolio is likely to have achieved returns similar to those shown herein. The shaded area represents backtested results from January 2004 – March 2019. The un-shaded area represents actual performance since March 2019. Backtesting is hypothetical in nature and reflects application of the screen prior to its introduction; it is not intended to be indicative of future performance. The indicator identified as European Credit Macro Indicator above is intended to be an indicative metric only and may not be used for reference purposes or as a measure of performance for any financial instrument or contract, or otherwise relied upon by third parties for any other purpose, without the prior written consent of BofA Global Research. This indicator was not created to act as a benchmark.

We find that the vast majority of the sub-components of our indicator have improved over the last month, with only five deteriorating:

- Of those that have improved, the ones that stand out have been the improvement in the German manufacturing PMI output and the German manufacturing PMI employment trends, along with the improvement of the Eurozone manufacturing PMI new export orders.

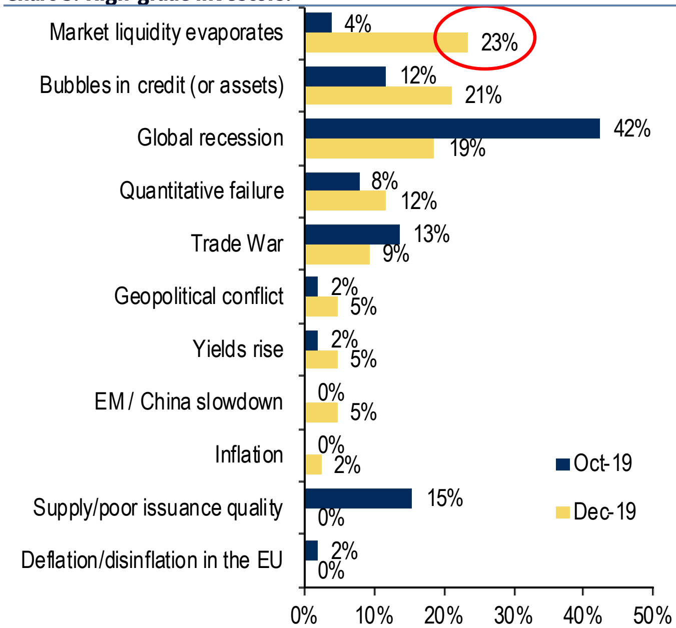
- On the flipside, the ones that have seen their trends deteriorate have been the UK OECD LIs and Earnings revision ratios in Germany.

Credit Survey Special Questions

This month, our special questions (for both high-grade and high-yield investors) focus on the *Wall of Worry*, the underappreciated risks, EU Fiscal policy and spreads for 2020.

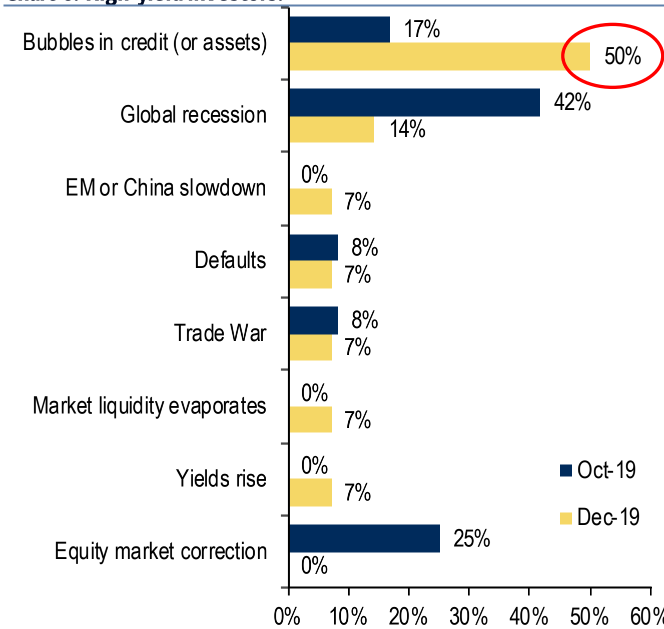
What are you most concerned about in credit for the next 12 months?

Chart 5: High-grade investors:



Source: BofA Global Research. Percentage of investors.

Chart 6: High-yield investors:

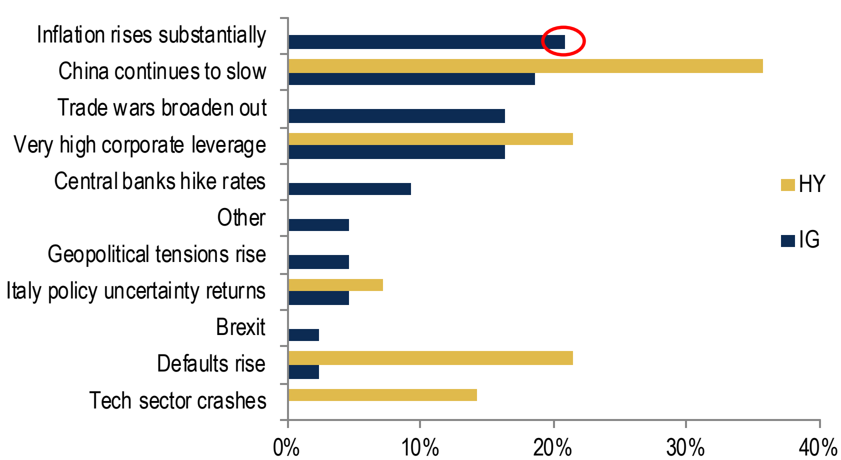


Source: BofA Global Research. Percentage of investors.

- At the top of the *Wall of Worry* for high grade investors is: *Market liquidity evaporates* followed by *Bubbles in credit (or assets)*. HY investors are predominantly concerned about tight spread, followed by fear of a global recession.
- *Global Recession* and *EM/China slowdown* are the third biggest risks seen by IG investors and HY investors, respectively.

What do you see as the most underappreciated risk for 2020?

Chart 7: My expectations for the most underappreciated risks for 2020:



Source: BofA Global Research. Percentage of investors.

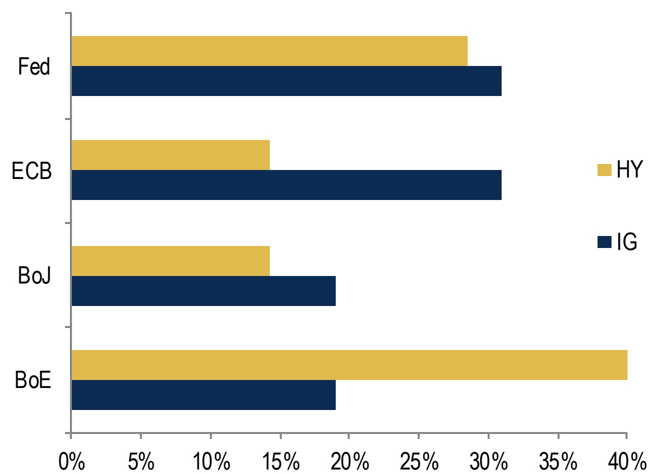
- Just over 20% say the most underappreciated risk in 2020 is the "whiff" of inflation…which would be enough to drive central bank hawkishness irrespective of any subsequent market volatility.

- Almost a fifth of IG investors view a further slowdown in China growth as the most underappreciated risk for 2020, following the weakest GDP growth recorded this year since at least 1991.

- A bigger proportion of HY investors say that a further slowdown in China growth is the most underappreciated risk.

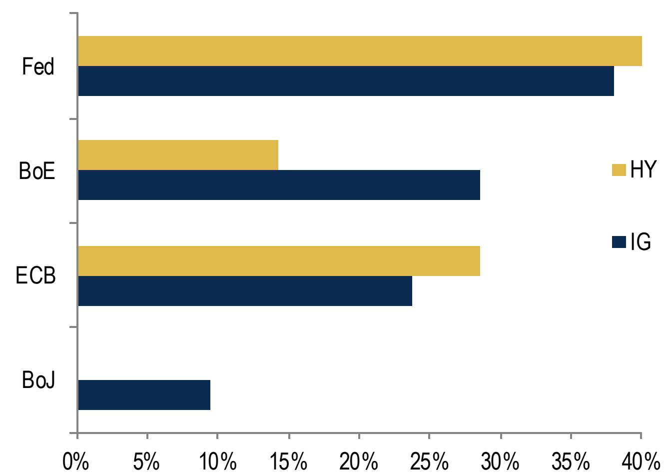
Which central bank is most likely to surprise *hawkishly/dovishly* in 2020?

Chart 8: Which central bank is most likely to surprise *hawkishly* in 2020?



Source: BofA Global Research. Percentage of investors.

Chart 9: Which central bank is most likely to surprise *dovishly* in 2020?



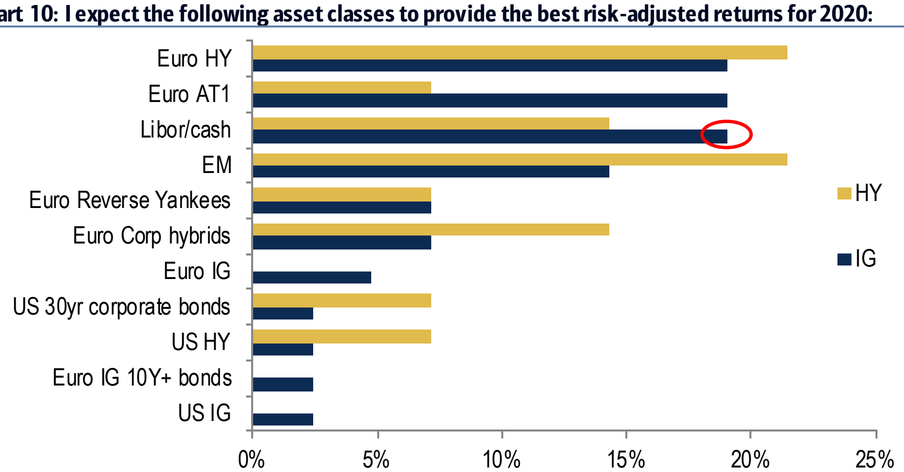
Source: BofA Global Research. Percentage of investors.

- A similar proportion of IG investors (31%) think either the Federal Reserve or the European Central Bank is likely to surprise *hawkishly* next year.

- Conversely, 43% of HY investors view the Bank of England (BoE) as the most likely central bank to adopt a *hawkish* stance next year.

Which part of the credit market do you expect to have the best risk-adjusted return in 2020?

Chart 10: I expect the following asset classes to provide the best risk-adjusted returns for 2020:

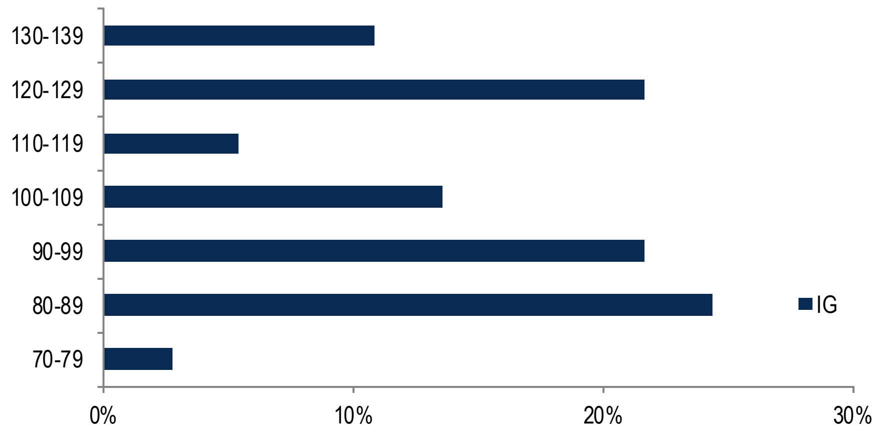


Source: BofA Global Research. Percentage of investors.

- Both IG and HY investors expect Euro HY to provide the best risk-adjusted returns in 2020 (19% and 21.5% of investors, respectively).
- IG investors view AT1 and libor/cash as the two other asset classes to provide best risk-adjusted returns whilst HY investors feel more confident about emerging markets in 2020.

Where do you see IG spreads by the end of 2020? (IG OAS currently 101bp)?

Chart 11: I expect IG spreads to end 2020 at: (IG investors only)

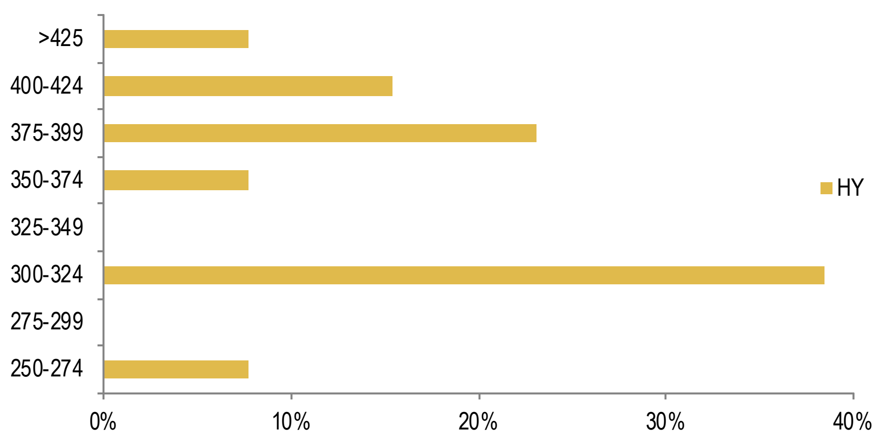


Source: BofA Global Research. Percentage of investors. Option Adjusted Spreads (OAS).

- 25% of IG investors expect IG spreads to end in the 80-89bp segment, with the second biggest proportion (22%) thinking spreads will end 2020 between 120 and 129bp.

Where do you see HY spreads by the end of 2020? (HY OAS currently 341bp)?

Chart 12: I expect HY spreads to end 2020 at: (HY investors only)

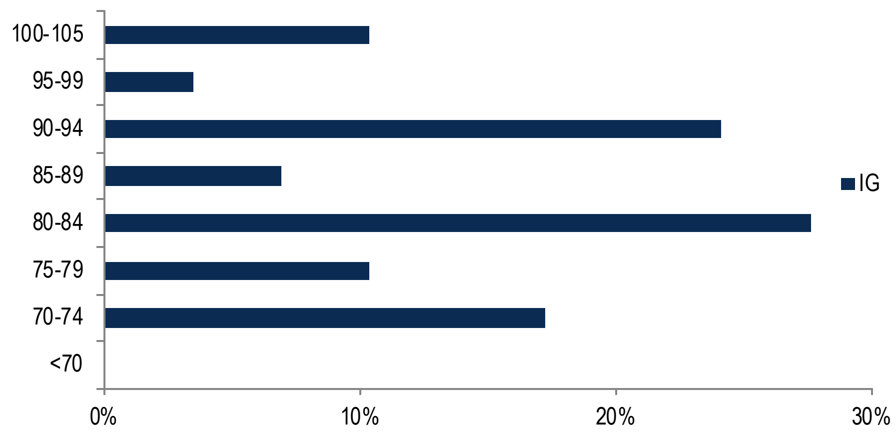


Source: BofA Global Research. Percentage of investors.

- Almost 40% of investors see Euro HY spreads ending next year between 300-324bp.

Where will IG spreads trough in this bull market?

Chart 13: I expect IG spreads to trough at: (IG investors only)

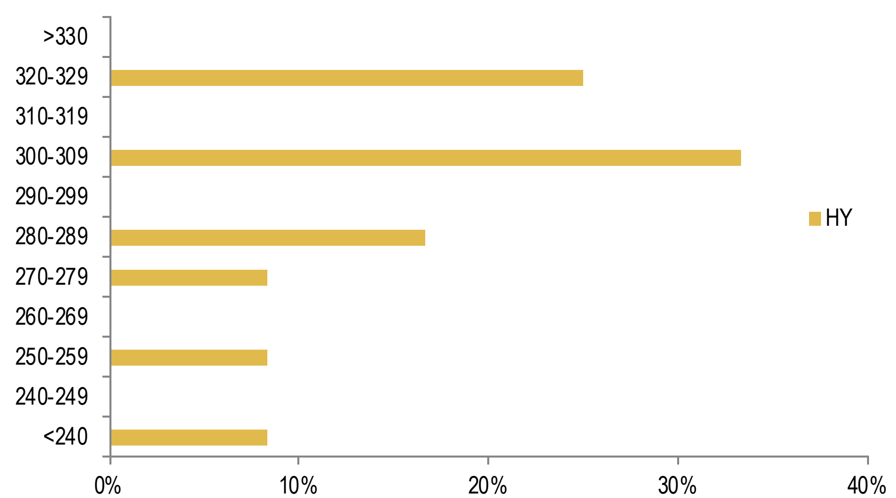


Source: BofA Global Research. Percentage of investors.

- Almost 30% of investors see the tights next year at 80-84bp.

Where will HY spreads trough in this bull market?

Chart 14: I expect HY spreads to trough at : (HY investors only)

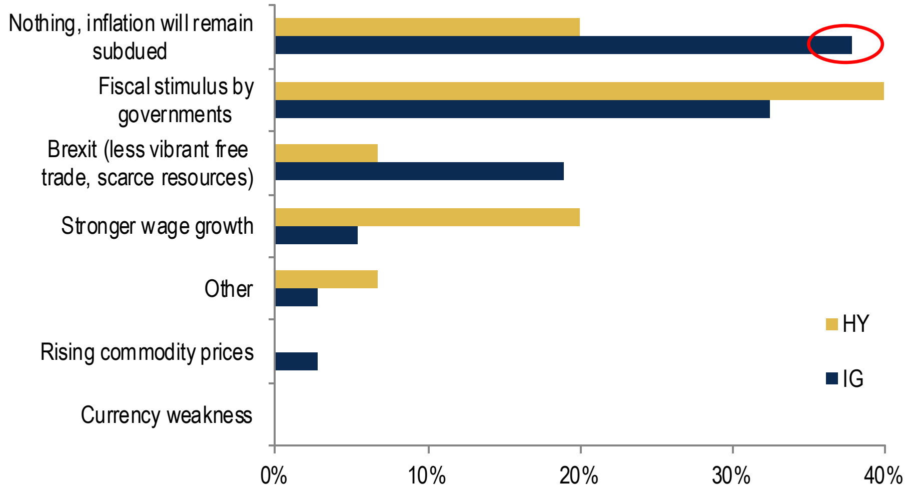


Source: BofA Global Research. Percentage of investors.

- A third of investors see HY spreads reaching a tight of around 300 bp in this cycle.

What do you see as the most likely catalyst for inflation to return in Europe?

Chart 15: Catalysts to revive inflation in Europe are:



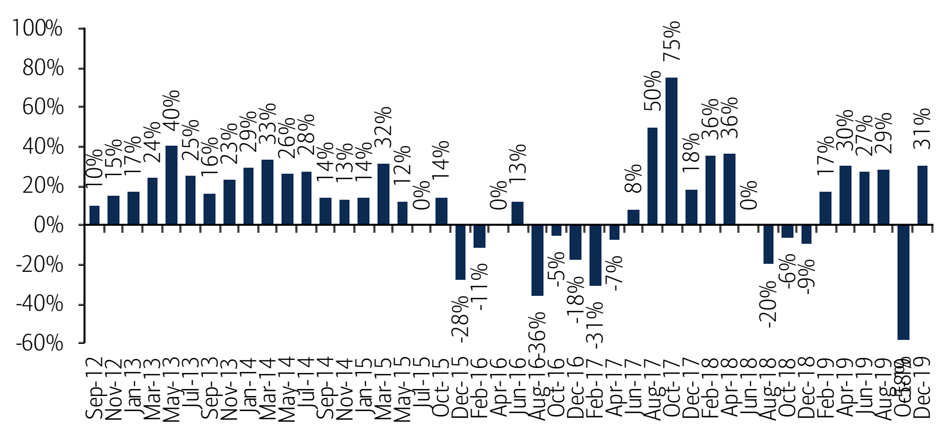
Source: BofA Global Research. Percentage of investors.

- Almost 40% of IG investors believe Europe is poised to face a sustained period of subdued inflation with no policy tool likely to help. For those who believe inflation may return in Europe, fiscal stimulus is viewed as the best catalyst for an inflation revival.
- HY investors appear more optimistic, as almost a majority think fiscal stimulus by governments is likely to revive inflation in Europe. Only a fifth of HY investors do not expect inflation to return.

High-yield credit survey

Our dedicated high-yield survey shows that investors have shifted yet again their positioning over the past two months and are now overweight. Cash positions have dropped to 4.0% (down from 4.7% in October), in line with the average observed throughout 2019 (4.1%).

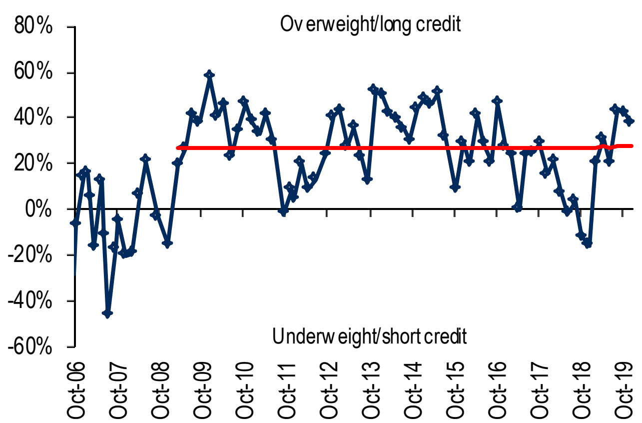
Chart 16: Overall credit investor positioning in European high-yield (net overweight)



Source: BofA Global Research. Net percentage of investors.

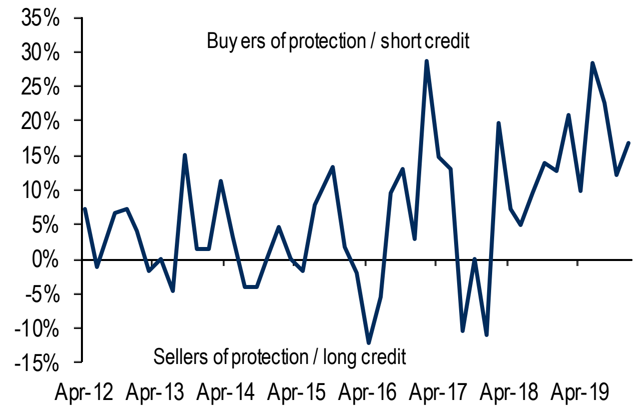
High-grade survey results

Chart 17: Overall credit market positioning (red line is the post crisis average)



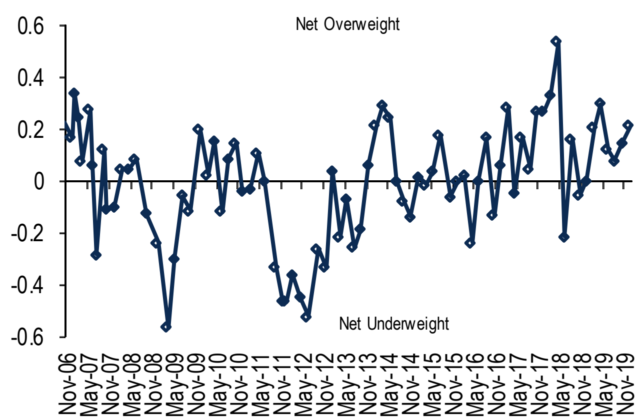
Source: BofA Global Research. Net percentage of investors.

Chart 18: Positions in CDS indices



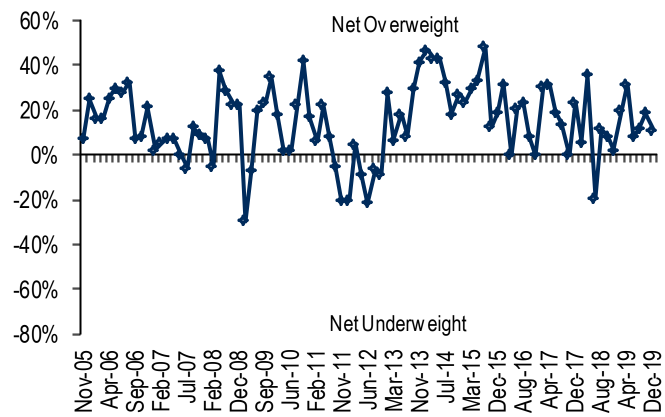
Source: BofA Merrill Lynch Global Research. Net percentage of investors.

Chart 19: Net positioning in T1 banks



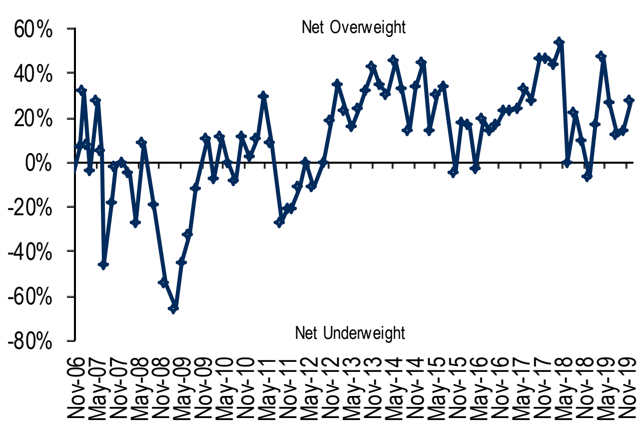
Source: BofA Global Research. Net percentage of investors.

Chart 20: Net positioning in LT2 banks



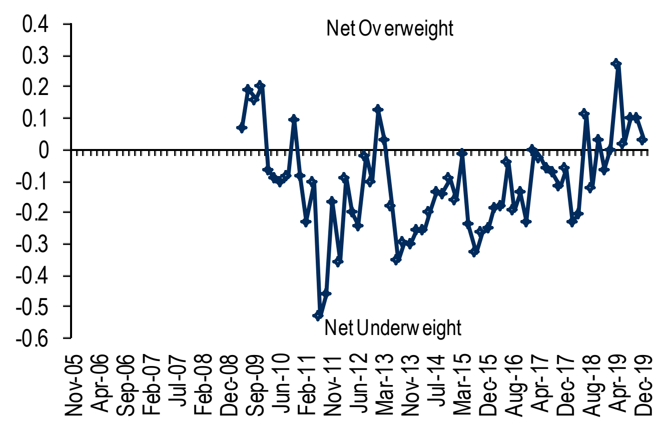
Source: BofA Global Research. Net percentage of investors.

Chart 21: Net positioning in sub Insurance



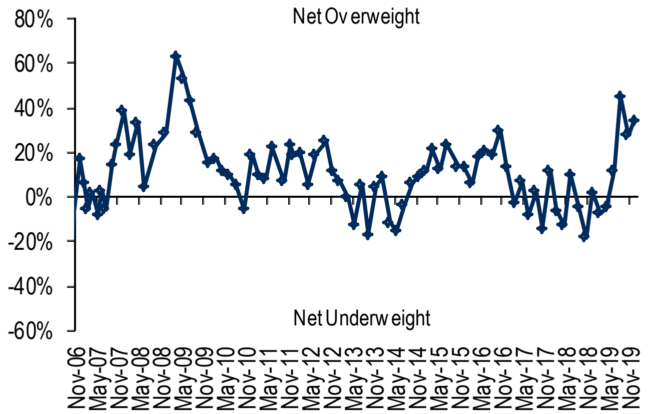
Source: BofA Global Research. Net percentage of investors.

Chart 22: Net positioning in senior banks



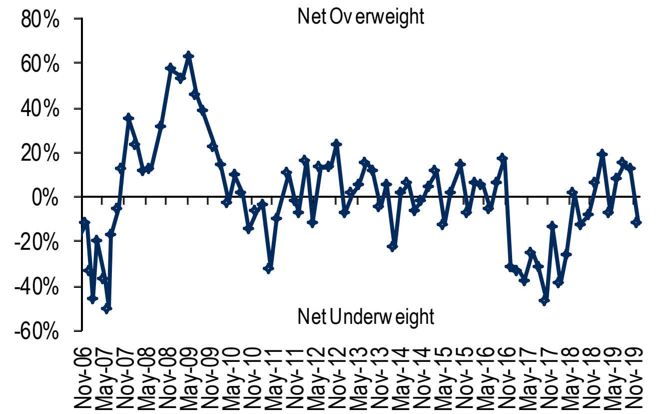
Source: BofA Global Research. Net percentage of investors.

Chart 23: Net positioning in telecoms



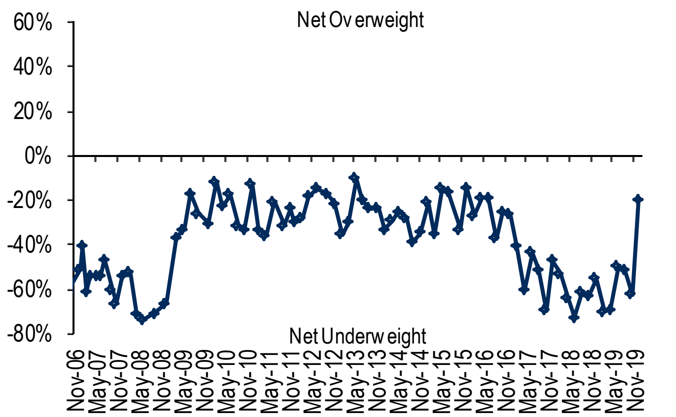
Source: BofA Global Research Net percentage of investors.

Chart 24: Net positioning in utilities



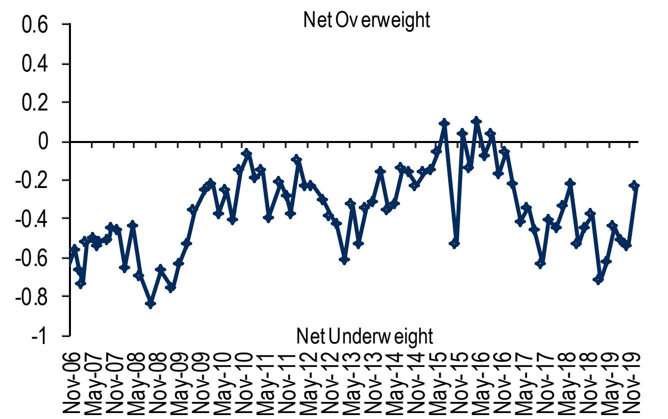
Source: BofA Global Research Net percentage of investors.

Chart 25: Net positioning in retail



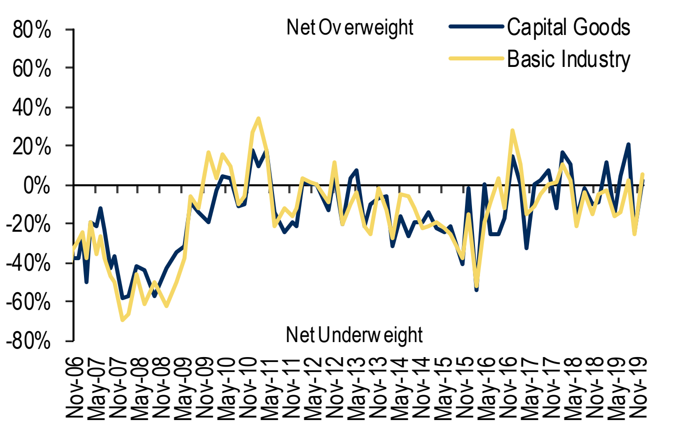
Source: BofA Global Research. Net percentage of investors.

Chart 26: Net positioning in European autos



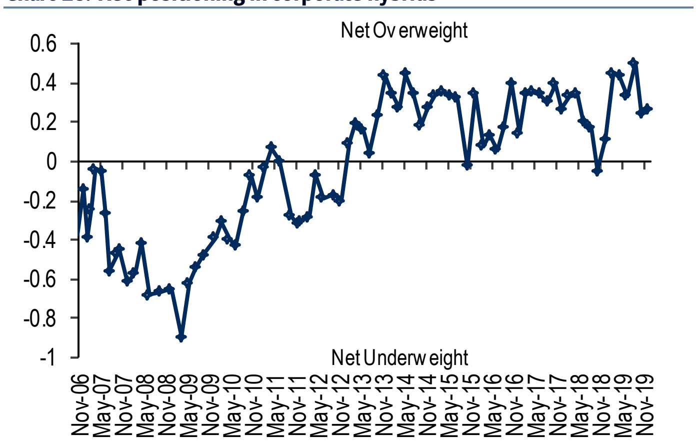
Source: BofA Global Research. Net percentage of investors.

Chart 27: Net positioning in capital goods and basic industry



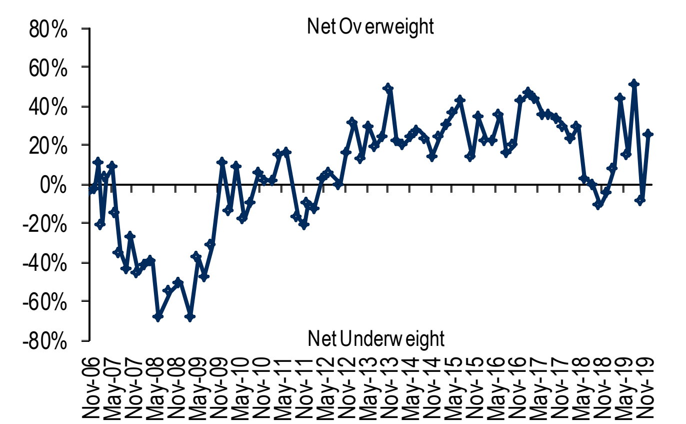
Source: BofA Global Research. Net percentage of investors.

Chart 28: Net positioning in corporate hybrids



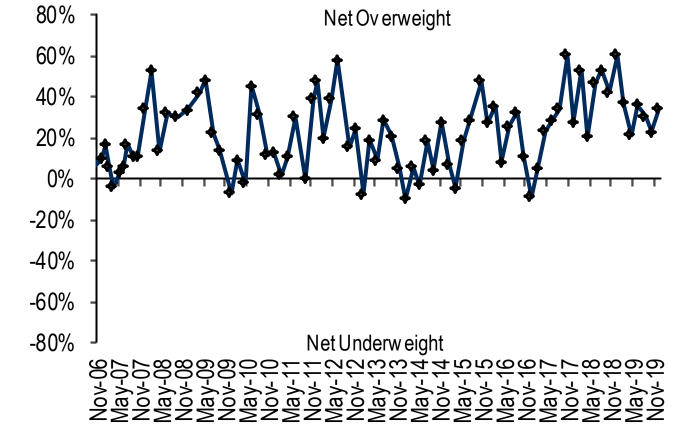
Source: BofA Global Research. Net percentage of investors.

Chart 29: Net positioning in 'Crossovers/HY'



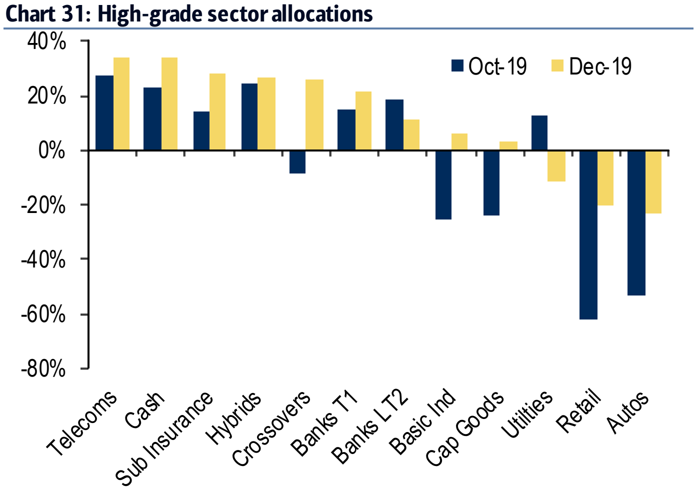
Source: BofA Global Research. Net percentage of investors.

Chart 30: Net positioning in cash



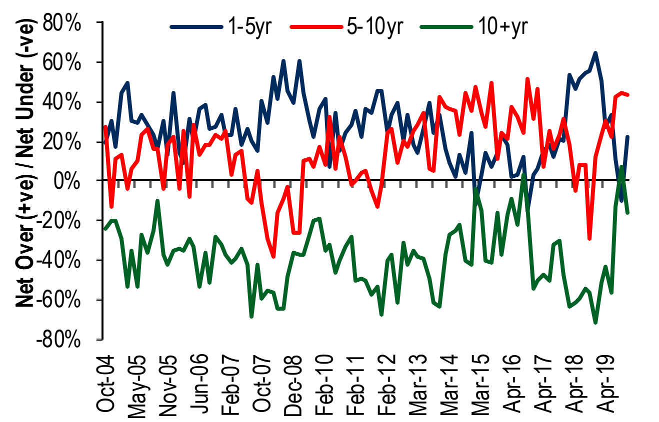
Source: BofA Global Research. Net percentage of investors.

Chart 31: High-grade sector allocations



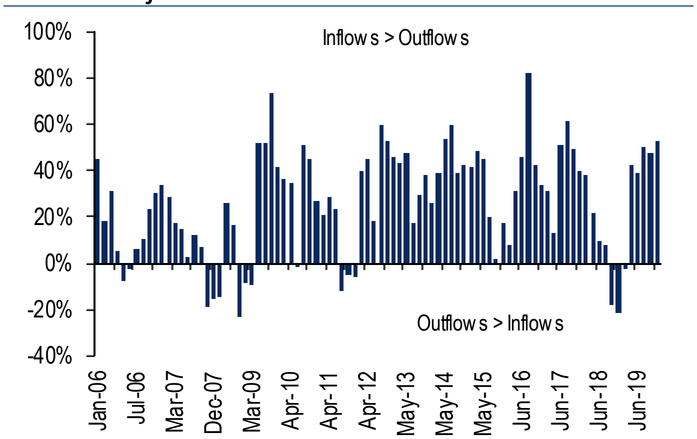
Source: BofA Global Research. Net percentage of investors.

Chart 32: What is your credit maturity positioning?



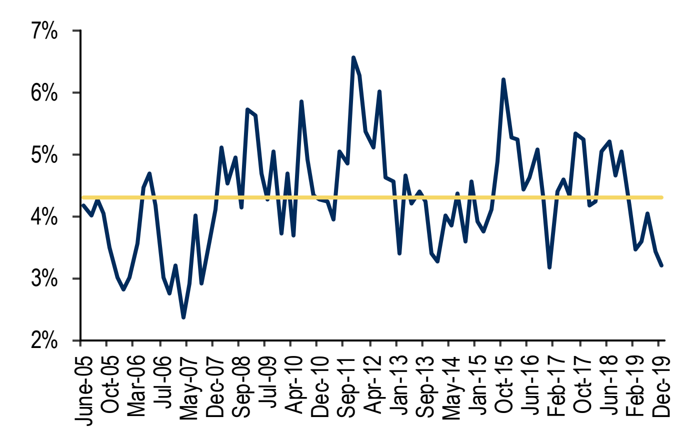
Source: BofA Global Research. Net percentage of investors.

Chart 33: Over the last 3m have you seen net inflows into or net outflows from your credit funds?



Source: BofA Global Research. Percentage of investors.

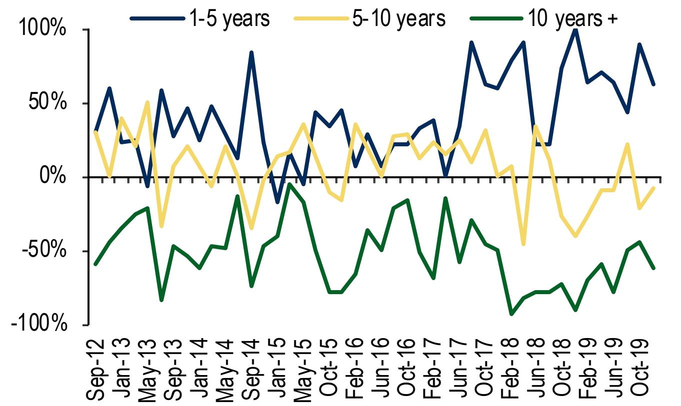
Chart 34: What is the current cash weighting within your credit portfolio? (average over time highlighted in yellow)



Source: BofA Global Research. Average cash weight.

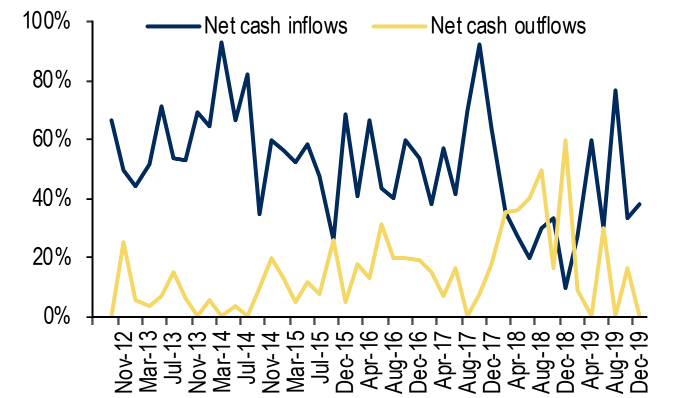
High-yield survey results

Chart 35: What is your credit maturity positioning?



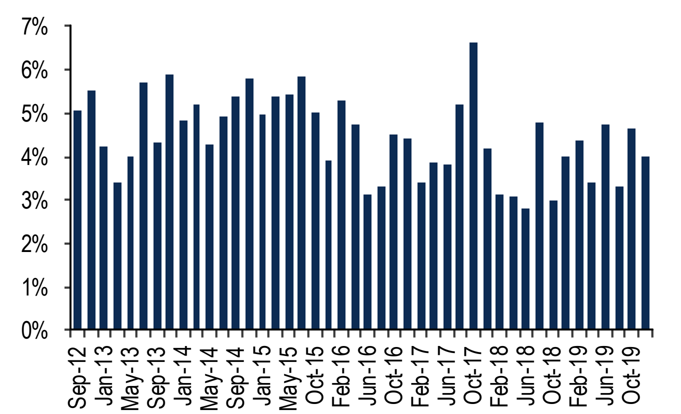
Source: BofA Global Research. Net percentage of investors.

Chart 36: Over the last three months, have you seen net Inflows/outflows to the credit funds that you manage?



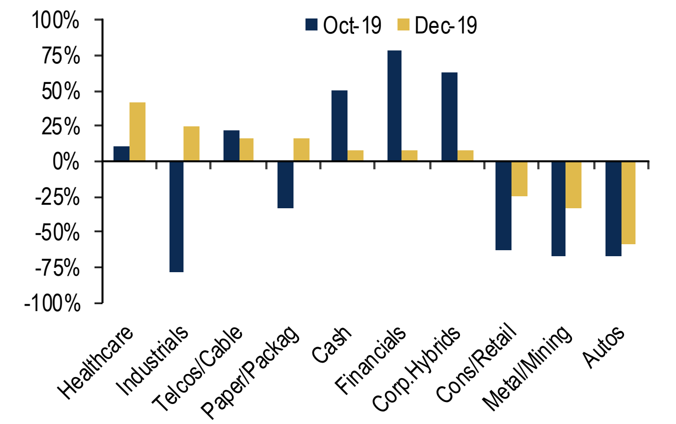
Source: BofA Global Research. Percentage of investors.

Chart 37: What is the current cash weighting in your portfolio?



Source: BofA Global Research. Percentage of investors.

Chart 38: Net positioning across sectors



Source: BofA Global Research. Net percentage of investors.

Survey methodology

Every two months we poll our Bank, Insurance Company, Pension Fund, Asset Manager and Hedge Fund clients in both high grade and high yield credit. The results of the survey are published straight after. The survey is Internet based.

This month 57 investors participated in the Survey.

To participate in our next survey, please contact your BofA sales representative.

Appendix

The table below shows the moves in the sub-components of our European Credit Macro Indicator.

Table 1: Most of the sub-components of our Indicator have edged higher in December

Rank	Indicator sub-components	Dec'19	Nov'19	MoM chg
1	DE Manuf. PMI Output SA	-0.410	-1.074	0.664
2	DE Manuf. PMI Employment SA	-0.924	-1.468	0.545
3	EZ Manuf. PMI New Export Orders SA	-0.143	-0.579	0.437
4	DE Manuf. PMI Suppliers' Delivery Times	-0.539	-0.823	0.284
5	EZ Manuf. PMI Suppliers' Delivery Times	-0.695	-0.900	0.205
6	Germany OECD LI	-1.285	-1.465	0.180
7	ECB Survey Chg in Demand for Loans	-0.869	-1.017	0.148
8	Italy OECD LI	-1.279	-1.389	0.111
9	Spain OECD LI	-1.912	-1.949	0.037
10	USA OECD LI	-1.279	-1.305	0.026
11	China OECD LI	2.012	2.056	-0.044
12	France OECD LI	-0.085	0.209	-0.294
13	BofA Earning Revision Ratio Germany	0.719	1.455	-0.736
14	UK OECD LI	-1.495	-0.691	-0.804
	European Credit Macro Indicator	**-0.585**	**-0.639**	**0.054**

Source: BofA Global Research, ICE Data Indices, LLC, Bloomberg
Presenting the z-score levels of the 14 sub-components of our indicator

Disclosures

Important Disclosures

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