The HY Wire

Don't be hedgy

Bank of America Merrill Lynch

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High Yield Strategy
Global

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Expect near-term strength for high yield

Today's strong ADP employment report helps to support our view that the economy remains in a strong position ahead of payrolls on Friday. And, with a rebound in crude prices and steadily declining yields since March 1st, we think the worst of the "repeal and replace" debacle is behind the market for the moment. With tax reform back in the spotlight, we think markets will continue to rally until concrete proposals are put forth and debated within the House.

Where to B

Because high yield investors tend to concern themselves with total returns rather than excess returns, and given the large spread cushion and lower duration of the product, portfolio managers have historically chosen to not hedge rate risk when investing in high yield. Historically, this strategy has worked in their favor, as total returns have typically been higher on an unhedged basis. However, given today's environment of negative convexity and a Fed rate-hiking cycle, we consider if an investor could go up in quality into IG, hedge their rate risk, and outperform BBs. Although we remain concerned about rate risk at current levels, as well as BB valuations, we're not 100% convinced that this strategy would be optimal. However, for a high yield investor who must stay invested in their asset class, we do think a case can be made for lowering duration and moving to less rate-sensitive areas of the market.

Flows:

US HY flows rebounded to +$934mn (+0.4%) last week after three consecutive periods of outflows, the largest net inflow since December last year. However, these additions came entirely from HY ETFs (+$1.07bn, +2.5%) and were partially offset by a minor $137mn (-0.1%) outflow from open-ended funds.

Issuance:

DM high yield issuance remained active last week, with $7.1bn priced across developed markets, $6.2bn of which came from the United States. With respect to loans, $9.5bn was launched globally last week.

Performance:

Higher-beta US asset classes rebounded to positive returns last week after a two-week slump caused by political risks. US HY was the top-performing group and added 0.94%, bringing its YTD total up to 2.71%. Following closely behind were US equities (+0.80%), although both were unable to completely recoup their losses from the beginning of the month and finished March in the red.

Recent BofA Merrill Lynch Global Research Reports

Title: Subtitle	Primary Author	Date Published
High Yield Strategy: March: 1st half pain, 2nd half gains	Michael Contopoulos	04 April 2017
The HY Wire: FOMO NOMO	Michael Contopoulos	23 March 2017
The HY Wire: HY investors underweight: Contrarian long?	Michael Contopoulos	13 March 2017
High Yield Flow Report: US HY back in vogue	Michael John	30 March 2017

The View From Above

Expect near-term strength for high yield

Today's strong ADP employment report helps to support our view that the economy remains in a strong position ahead of payrolls on Friday. And, with a rebound in crude prices and steadily declining yields since March 1st, we think the worst of the "repeal and replace" debacle is behind the market for the moment. The fear of the broader implications for policy blunders seems to have receded, as the focus now is on what the market wanted to begin with: tax reform.

Although our view is that tax reform likely disappoints expectations, we think the markets will continue to rally until concrete proposals are put forth and debated within the House. Consider for a moment that tax reform, to be passed through reconciliation, needs to be, at worst, deficit-neutral. With an expected $1tn in offsets over 10 years now scuttled by the inability to alter the ACA, there is virtually no path to a 20% rate. Furthermore, we think the border adjustment tax (BAT), in its current form, is too penalizing to the consumer and large swaths of high employment sectors to be a base-case scenario. Without the BAT and its estimated $1tn in revenue over 10 years, again we believe there will be little chance to achieve a significant reduction in the tax rate.

This leaves the tax proposals to include the removal of net interest deductibility and possibly some form of VAT, as well as a much more muted reduction in the corporate tax rate; perhaps to between 25% and 30%. Considering that most US corporates' effective tax rates are in that range to begin with, we think the impact on corporate fundamentals is likely minimal, with the exception of highly levered, poor free cash flow companies that have little ability to pay down debt.

We don't view this as terrible news, however, as we don't think the economy is in a place where it needs to have a massive reduction in corporate taxes; particularly at the expense of healthcare coverage for 24 million people (according to the CBO) and importers and consumers. Similarly, a watered-down version of infrastructure spending – it's hard to see Republican deficit hawks and Democrats agreeing on a large infrastructure bill -- is also likely not the worst outcome, as on overheated economy could derail the growth the policy is meant to support. The markets, however, will likely have a different take to these "disappointments" -- at least initially – and this is why we remain cautious for late spring, when many of the proposals may come to light.

In the meantime, our economists have raised their 1Q GDP tracking to 1.2% and they continue to expect the Fed to hike two additional times this year -- in September and December. However, should the market expectations (currently 60% chance) be correct, and a June hike accompany the March hike, we think rate risk could be a concern for high-quality high yield this quarter. Note that our rate strategists believe the 5y could increase to 2.50% in Q2 and the 10y sell off by 63bp, to 3.0%.

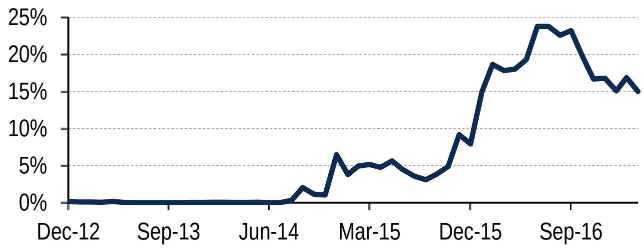
Given the possibility for such a move in treasury yields, and the current tight spreads between BBs and BBBs, we discuss below some thoughts on the efficacy of rate-hedging low-quality IG versus investing in unhedged BB paper.

Where to B

Over the last several months, we have discussed how the high degree of rate sensitivity in high yield is an unprecedented phenomenon. The combination of high coupons and rates that are increasing creates a dynamic that most leveraged finance professionals are unused to: negative convexity and the risk for rising rates to erode returns. Judging by history, a nonchalant attitude about higher rates makes a lot of sense; simply put, rate-hedging has led to no better returns for investors. However, one dynamic exists today that has not existed in the past: relatively tight spreads and negative convexity are fixtures at the beginning of a tightening cycle rather than the end.

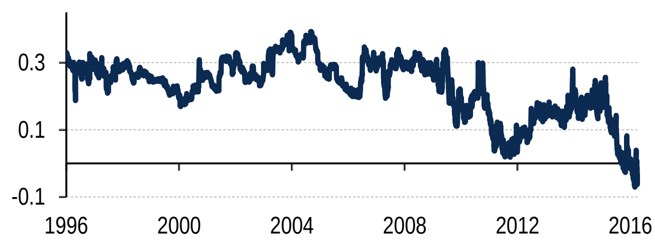
For years, the story of the equity market was that QE and the central bank put caused valuations to rise in anticipation and ahead of realized growth. In credit markets, the story has been a little bit different. Of course, easy central bank policy has had a dampening effect on corporate default rates, but more than rallying in the face of expected growth, credit markets have tightened, in large part, because yield has been sucked from global fixed income. Conversely, as we've mentioned in numerous publications since the fall, an increase in global and US yields is likely to create an environment where investors feel less compelled to reach down in credit quality, eliminating a crucial tailwind that existed in 2016. This dynamic becomes important when one considers the dramatic spread compression between ratings since last winter and the effect that higher rates may have on various parts of the credit-quality stack.

Chart 1: Percent of global fixed income market with negative yield



Source: BofA Merrill Lynch Global Research

Chart 2: BB convexity at all-time lows



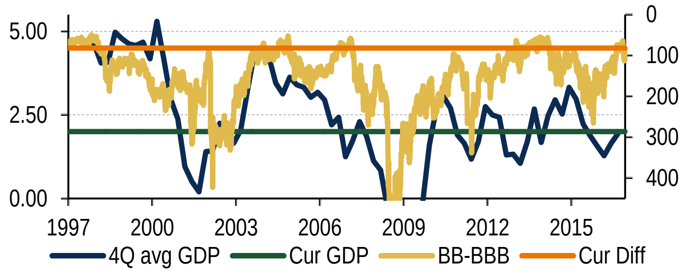
Source: BofA Merrill Lynch Global Research

Historical cycles unlike this one

In past credit cycles, spread compression has largely been defined by the business cycle. After coming out of a recession, low quality trades wide to high quality, rates are low, and, when the economy begins to accelerate, valuations of all rating classes draw closer together. The converse is also true: after a period of prosperity and shrinking spread differentials, low quality tends to be at its tightest heading into an economic downturn and Fed easing. Rarely have we seen a situation where spread ratios are tight headed into a hiking cycle, let alone a hiking cycle when GDP is averaging sub 2%.

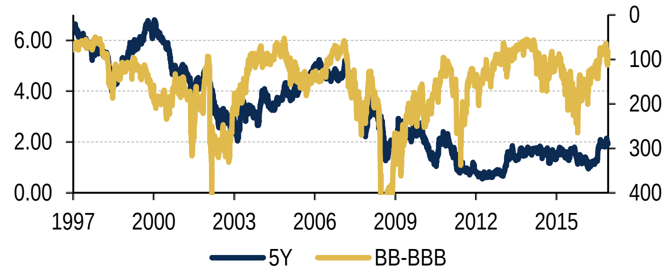
Chart 2 below highlights periods where economic growth is similar to today's level and contrasts that with the spread difference between BBs and BBBs. Notice that, during the run-up to the GFC, the only time this difference was as tight as today with such a low GDP was in 2007, prior to the recession. In the cycle before, the tights were realized pre: Russia, widening marginally for several years before 9/11.

Chart 3: GDP vs BB-BBB spread differential



Source: BofA Merrill Lynch Global Research

Chart 4: 5yr treasury vs BB-BBB spread differential



Source: BofA Merrill Lynch Global Research

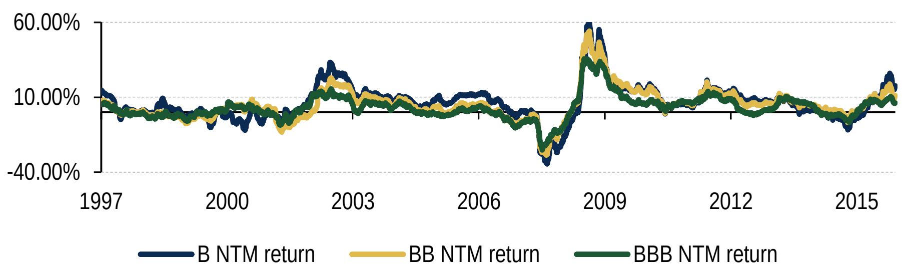
Of course, coinciding with the economic story is the effect that growth has on rates, and, consequently, the effect that rates have with credit spreads across ratings. With high spread differentials to start, and ample room to absorb increases in treasury yields, low quality, high yield has historically tightened into higher treasury yields. In fact, the historical spread beta for high yield is -1. Chart 3 above clearly shows that, pre-crisis, falling rates have coincided with decompression, while rising rates have coincided with compression. What it also shows is that the BB minus BBB spread difference rarely falls below 60bp -- not far from today's level -- and that, at those moments, rates are close to their highest for that respective cycle, if not significantly higher than at the beginning of the cycle.

And, as such, hedging historically levels the playing field

Because high yield investors tend to concern themselves with total returns rather than excess returns, and given the large spread cushion and low duration of the product, high yield portfolio managers have historically chosen to not hedge rate risk. Although we find it ironic that PMs are paid to take credit risk, yet are implicitly taking a view on rates by not hedging, historically, the strategy has paid off. When one considers that treasury returns have contributed 67% of the total return for high yield over the last 30 years -- average annual total return for high yield is 9.3% while the average annual excess return is just 3.4% -- it is easy to see why hedging has not only been avoided, but that the focus is on total, not excess, returns.

One way to consider the benefits of rate-hedging, at least in the pre-crisis world, where spreads were wide going into higher rates, is to calculate the next-12-month return for varying rating categories where all are hedged to be duration-neutral. What we find is that, during periods of expansion, where rates are generally rising and spreads are compressing, low quality outperforms high quality. This, of course, makes intuitive sense; all else equal, the compensation for taking credit risk is higher and, hence, so will the return if the economy is performing well and credit fundamentals appear intact.

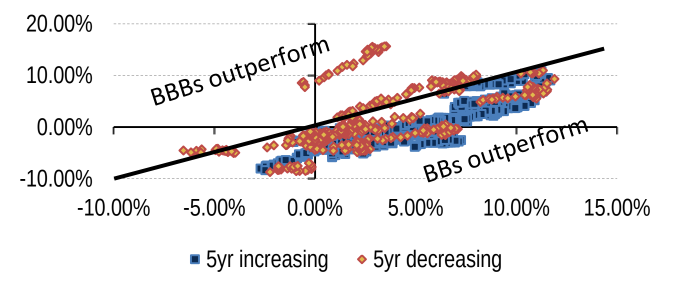
Chart 5: Duration neutral next twelve month returns, B vs BB vs BBB



Source: BofA Merrill Lynch Global Research

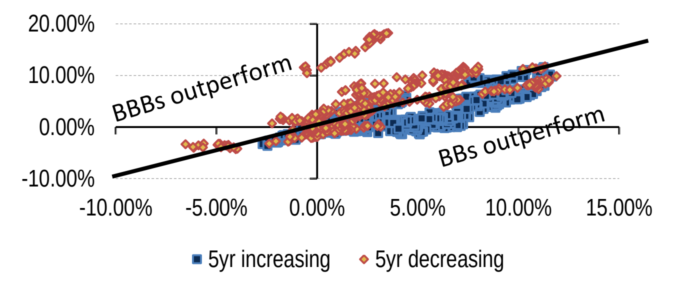
However, as we mentioned above, very rarely does a high yield investor even consider rate-hedging, let alone matching duration across ratings. This stands in stark contrast with the high grade investor, who routinely hedges rate exposure. Which investor has had it right in the past? It seems the high yield investor. Chart 4 below shows that, even when rates are increasing and duration has been hedged in BBBs (to the same level as BBs), they never outperform unhedged BBs. When the 5y is decreasing, i.e., during periods of economic malaise or uncertainty, the unnecessary hedge hurts performance. Contrast this performance with the comparative unhedged returns in Chart 5. Here, we see that, when the 5y moves lower, BBBs outperform, but when rates are increasing, the unhedged longer duration underperforms the lower-duration higher-spread product.

Chart 6: Hedged BBB vs. unhedged BB performance



Source: BofA Merrill Lynch Global Research

Chart 7: Unhedged BBB vs BB performance



Source: BofA Merrill Lynch Global Research

Is the current environment different?

Much of the above analysis is intuitive when you consider the final conclusion: Don't hedge duration into an economic downturn and lower rates, as high grade will outperform high yield in such circumstances and hedging is an unnecessary drag on returns. Conversely, hedging duration in a rising rate environment versus dropping down in quality doesn't seem to make sense, as the high spread cushion in low-quality credit provides ample room to compress when the economy is performing well and corporate fundamentals are strong.

However, historical precedent is only as good a predictor as the current context is the same. And, as we established above, today is generally quite different then past episodes. With $1.6tn in high grade paper trading with a yield of greater than 4% (30% of the market) and $580bn in high yield paper trading with a yield of less than 5% (45% of the market), we wonder could an investor go up in quality into IG, hedge their rate risk, and finally outperform BBs in a rising rate environment? The question is an interesting one for an allocator of capital deciding between giving money to a manager who hedges IG or a manager who doesn't hedge high yield. The answer? It depends on your rate assumptions.

Let's first start with the BBB and BB indices. BBBs currently trade with a 3.69% yield and 7.14-year duration, while BBs trade with a 4.54% yield and 4.67-year duration. Immediately, it is clear that no amount of math will be able to justify duration-matching BBB to BB if the concern is an increase in rates. However, if an investor were to eliminate duration completely, the new yield of the investment would be 191bp, or 263bp less than the unhedged BBs. Assuming no change in credit compensation, little differences in liquidity and default risk (the default rate for BBBs in the last 2 years has been 0%, while, for BBs, it has been 0.3% and 0.1%), rates would need to increase by more than 56bp for BBs to underperform fully hedged BBBs. With our rate strategist's call for the 5y to approach 2.50% in Q2, a 61bp increase, this is certainly a possibility. Furthermore, with negative convexity characterizing BBs and positive convexity characterizing BBBs, each marginal increase in rates will contribute to a further increase in rate sensitivity for the lower-quality index.

The story is less compelling if an investor simply searches out yield in investment grade. For example, the universe of IG bonds mentioned above has a duration of 12 years and an average yield of 4.5%, while the high yield universe has a duration of just 3 years and an average yield of 4%. In this case, higher yield doesn't necessarily mean a better return if rate-hedged because the much longer duration, and the treasury short to neutralize, eliminates too much carry.

Although concerned about rate risk at current levels, as well as valuations, we're not 100% convinced that it would make sense for an investor to shift risk into hedged BBBs versus unhedged BBs. However, for a high yield investor who must stay invested in their asset class, we do think a case can be made for lowering duration and moving to less rate-sensitive areas of the market. Negative convexity is a new concern for the market and, with credit fundamentals in solid shape and an economy that appears healthy, we think Bs and CCCs continue to outperform BBs at this point. We reiterate our view that policy disappointment likely leads to a bit of a selloff ahead of the August recess, that higher quality underperforms lower quality in the meantime, as investors either a) reach for yield or b) don't sell yield, and that the single-most important thing for markets is to be conscious of policy risk and the effects that proposals (or lack thereof) on tax reform and infrastructure spending will have on expectations.

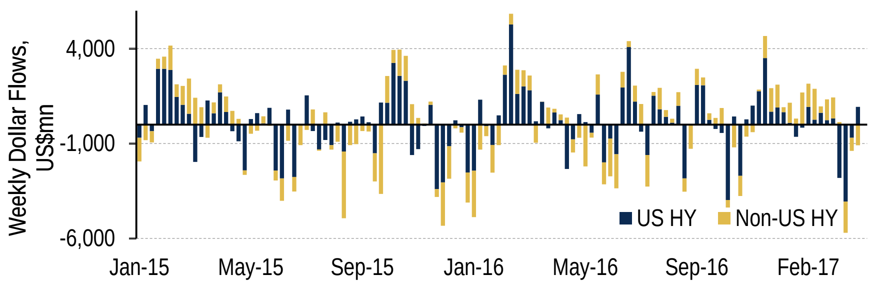
Flows

This is an excerpt from our recently published report: [High Yield Flow Report: US HY back in vogue 30 March 2017]

US HY flows rebounded to +$934mn (+0.4%) last week after three consecutive periods of outflows, the largest net inflow since December last year. However, these additions came entirely from HY ETFs (+$1.07bn, +2.5%) and were partially offset by a minor $137mn (-0.1%) outflow from open-ended funds. After a brief period of market weakness, mostly due to concerns around oil prices and the ability of Congress to pass tax reform later this year, leg 2 of the 'Trump Trade' may have begun this week and likely drove the inflows to high yield. Although we are skeptical, investors appear to be optimistic that the failure to pass the AHCA last week will force Republicans to unite around tax reform in order to regain approval before the 2018 mid-term elections. Hence, equities also experienced inflows this past week, with a $1.8bn (+0.03%) increase in AUM, partially reversing last week's $3.65bn net outflow.

Inflows into Loan funds slowed considerably with just $292mn (+0.3%) coming into the asset class, the smallest amount in nearly five months, as 3m LIBOR managed to decline by 1bp last week. Outflows from non-US HY continued for the third consecutive week, with $1.1bn (-0.4%) in net redemptions, bringing their MTD losses to -$3.3bn (-1.15%). High grade and EM inflows remained strong, with gains of $4.20bn (+0.3%) and $2.05bn (+0.6%), respectively. As a whole, fixed income funds experienced a $6.0bn (+0.3%) increase in AUM.

Chart 8: Global HY flows distributed between US-domiciled and non US-domiciled funds



Source: BofA Merrill Lynch Global Research, EPFR Global

New Issue Roundup

Bonds

DM high yield issuance remained active last week, with $7.1bn priced across developed markets, $6.2bn of which came from the United States. This was a modest increase from the previous week's $6.27bn, although it was below the $8.26bn figure seen during the week ended March 17th. Of last week's new supply, $2.4bn (34%) was BB-rated, whereas $4.14bn (58%) was B and the remaining $530mn (7%) was CCC or lower. Additionally, $3.1bn (44%) was 144a with registration rights, $3.25bn (46%) was 144a for life, and $725mn (10%) was SEC registered.

The month of March concluded with $47.4bn in DM HY issuance, the most active month for the high yield primary market since April 2014. Of this new supply, $41.8bn was USD-denominated. Additionally, Q1 saw $95.46bn of new paper, $80.7bn of which was USD-denominated. This was the busiest quarter since Q2 2015, when $106.8bn was priced. At the current pace, we will conclude 2017 with $322.7bn in DM USD issuance, representing

Table 1: DM issuance summary ($bn)

	DM	United States	Europe	BB	B	CCC/NR
WTD Mar 31	7.1	6.2	0.9	2.4	4.1	0.5
Wk Mar 24	6.3	3.9	2.4	1.5	2.4	2.3
Wk Mar 17	8.3	5.6	0.4	1.7	5.8	0.8
Wk Mar 10	18.5	16.1	0.7	12.6	5.5	0.4
MTD Mar	47.4	38.4	5.1	20.4	22.9	4.1
February	25.6	20.3	4.1	10.5	9.6	5.0
January	22.5	12.2	8.4	8.1	8.5	5.8
December	21.6	16.9	2.1	7.9	11.2	2.5
YTD 2017	95.5	70.9	17.7	39.0	40.9	14.9
YTD 2016	37.7	34.7	2.8	19.7	13.7	4.4
2016	265.7	194.7	57.4	107.9	128.8	29.0
2015	308.7	215.8	75.2	117.9	152.2	38.5
2014	376.0	238.8	119.5	129.9	186.8	59.2

Source: BofA Merrill Lynch Global Research

a 42% increase from last year's amount. This would also be significantly above our forecast of roughly $218bn in DM USD issuance for the year.

Table 2: DM HY new issues, March 27th – March 30th

Pricing Dt	Name	Size ($)	Snr	Cpn	Maturity	Price	Yield	Moody's	S&P	Type	Sector	Region
3/30/2017	CalAtlantic Group	125	Sr Nts	5.88	11/15/2024	104.50	5.13	Ba2	BB	SEC	Home Builders	United States
3/30/2017	Six Flags Entertainment Corp	800	Sr Nts	5.50	4/15/2027	100.00	5.50	B2	BB-	144A for Life	Entertainment	United States
3/30/2017	Six Flags Entertainment Corp	700	Sr Nts	4.88	7/31/2024	99.00	5.04	B2	BB-	144A for Life	Entertainment	United States
3/30/2017	Exterran Energy Solutions LP	375	Sr Nts	8.13	5/1/2025	100.00	8.13	B3	B+	144A w/RR	Oil&Gas Services	United States
3/30/2017	Chobani, LLC	530	Sr Nts	7.50	4/15/2025	100.00	7.50	Caa2	CCC+	144A for Life	Food	United States
3/30/2017	Cardtronics Inc	300	Sr Nts	5.50	5/1/2025	100.00	5.50	Ba3	BB+	144A for Life	Commercial Services	United States
3/30/2017	CalAtlantic Group	100	Sr Nts	5.25	6/1/2026	98.50	5.46	Ba2	BB	SEC	Home Builders	United States
3/30/2017	Charter Communications	1250	Sr Nts	5.13	5/1/2027	100.50	Float	B1	BB+	144A w/RR	Media	United States
3/29/2017	Loxam SAS	323	Sr Sec Nts	3.50	4/15/2022	100.00	Float	NR	BB-	144A for Life	Commercial Services	Europe
3/29/2017	Loxam SAS	269	Subordinated	6.00	4/15/2025	100.00	Float	NR	B-	144A for Life	Commercial Services	Europe
3/29/2017	Loxam SAS	323	Sr Sec Nts	4.25	4/15/2024	100.00	Float	NR	BB-	144A for Life	Commercial Services	Europe
3/29/2017	B&G Foods Inc	500	Sr Nts	5.25	4/1/2025	100.00	Float	B3	B+	SEC	Food	United States
3/29/2017	Ascent Resources Plc	1500	Sr Nts	10.00	4/1/2022	100.00	Float	B3	B-	144A w/RR	Oil&Gas	United States

Source: BofA Merrill Lynch Global Research, company filings

Last week, we saw 13 high yield tranches price for a combined $7.1bn in DM issuance. One of the largest deals came from Six Flags Entertainment Corp, in a two-tranche offering of $1.5bn combined debt. The deal consisted of a $700mn add-on to their outstanding 4 7/8% notes, which priced at 99 to yield 5.04%, as well as an $800mn tranche of 5 ½% notes that priced at par to yield 5.50%. The yield printed at the wide end of talk and initial guidance in the 5.375% area. The theme park operator plans to use the proceeds to fund the tender for its 5.25% notes due 2021 and for general corporate and working capital purposes, including share repurchases. Also coming to market was Charter Communications in a single-tranche $1.25bn offering of 5 1/8% notes that mature in May 2027. The split-rated, Ba1/BBB- deal priced at 100.5 to yield 5.06%, which was tight to final spread talk. Proceeds will be used for general corporate purposes.

Table 3: New issue breakdown by week, last 15 weeks

	Ratings					Currency (US$mn)				Seniority			Deal Type		
	Total	BB	B	CCC	NR	USD	EUR	GBP	CAD	Secured	Senior	Sub	144a w RR	144a w/o RR	Public
12/23/2016															
12/30/2016															
1/6/2017	800	600	200			800					800		200		600
1/13/2017	6,162	2,472	1,200	2,490		4,985	690	487		750	5,412		2,372	3,540	250
1/20/2017	10,975	3,933	5,376	1,666		8,450	801	1,724		2,504	8,471		2,120	8,855	
1/27/2017	4,290	1,115	1,485	1,690		3,975		315		2,090	2,200		940	3,050	300
2/3/2017	6,009	500	3,395	2,114		5,739	270			3,234	2,775		1,495	4,514	
2/10/2017	12,212	4,865	5,389	1,585		10,410	1,802			2,807	9,405		2,440	8,397	1,375
2/17/2017	1,755	1,000	500	255		1,755				255	1,500		1,500	255	
2/24/2017	5,847	4,118	500	1,000		2,815	2,803		229	2,207	3,340	300	3,239	1,508	1,100
3/3/2017	7,294	2,250	5,044			6,300	264	730		1,830	5,464		800	3,914	2,580
3/10/2017	18,495	12,559	5,535	400		17,550	685		259	5,450	12,795	250	5,275	6,895	6,325
3/17/2017	8,258	1,660	5,773	825		7,550	402	305		1,377	6,100	780	1,740	4,617	1,900
3/24/2017	6,274	1,549	2,386	2,340		4,175	2,099			3,617	2,537	120	2,055	4,220	
3/31/2017	7,095	2,421	4,144	530		6,180	915			646	6,180	269	3,125	3,245	725

Source: BofA Merrill Lynch Global Research

Loans

Global loan issuance also remained moderately active last week, with $9.5bn launched, up from the $5.9bn seen in the previous session. The vast majority of this new supply came from single-B issuers ($7.35bn, 77%), compared to $1.65bn (17%) from double-B companies and $508mn (5%) of NR supply. Additionally, just over $8bn was cov lite paper versus $1.5bn that offers traditional maintenance covenants. This brought the total issuance during March up to $56.1bn globally, a $21bn increase from the $35.2bn seen during February and the 4th most active month of all-time.

Year-to-date global loan issuance currently stands at $169.1bn, a pace more than 4 times faster than the $40.7bn seen at this point last year. This was the most active quarter ever for loan issuers, easily outpacing the $149bn seen during Q1 2013 that previously held that claim. At the current pace, we would finish the year with $676bn in global loan issuance and $552bn in US loan supply, both of which would be record amounts.

Table 4: Global loan issuance over time ($bn)

	Global	US	BB	B	CCC/NR	Cov lite
WTD Mar 31	9.5	7.2	1.7	7.3	0.5	8.1
Wk Mar 24	5.9	5.9	1.5	3.4	1.0	3.4
Wk Mar 17	14.4	11.0	5.4	8.5	0.5	9.0
Wk Mar 10	18.8	15.0	14.9	2.4	1.6	11.5
MTD Mar	56.1	45.6	25.8	26.0	4.3	38.3
February	35.2	32.5	16.6	16.5	2.1	27.9
January	77.8	60.0	39.4	33.4	5.0	52.3
December	19.3	15.9	8.1	10.6	0.7	14.7
YTD 2017	169.1	138.1	81.9	75.9	11.4	118.5
YTD 2016	40.7	40.7	18.9	18.6	3.2	26.3
2016	336.4	305.8	126.1	183.8	26.5	252.3
2015	256.9	212.2	112.5	126.6	17.7	185.6
2014	376.7	312.5	109.5	216.2	51.1	265.5

Source: BofA Merrill Lynch Global Research, S&P LCD

Table 5: New issue breakdown by month, last 3 months

		Ratings						
	Total	BB	B	CCC	NR	TLb	2nd Lien	Cov Lite
12/9/2016	14,001	5,715	7,961	325	0	13,666	335	11,861
12/16/2016	2,460	2,405	55			2,460		1,425
1/6/2017	9,925	3,900	5,035	430	560	9,375	550	9,750
1/13/2017	18,439	10,024	8,030	200	185	18,239	200	6,792
1/20/2017	21,315	9,985	9,485	1310	534	20,005	1310	15,547
1/27/2017	22,359	13,223	8,380	405	351	21,954	405	16,796
2/3/2017	8962	4139	3782.9	1040	0	8582	380	5570
2/10/2017	9,380	6,870	2,180	205	125	8,675	655	8,045
2/17/2017	3,510	1,703	1,712	50	45	3,135	375	2,505
2/24/2017	15,714	4,525	9,889	1,300	0	14,414	1,300	11,768
3/3/2017	10,818	4,006	5,765	310	737	10,508	310	9,656
3/10/2017	18,835	14873	2,402	715	844	18,120	715	11,547
3/17/2017	14,441	5,433	8,498	460	50	14,391	50	9,031
3/24/2017	5,929	1,535	3,392	1002	0	5,277	652	3,422
3/31/2017	9,506	1650	7,348		508	9,291	215	8,090

Source: BofA Merrill Lynch Global Research, S&P LCD

Last week's largest deal came from a $1.795bn covenant-lite B term loan from USI Holdings Inc. Price talk on the seven-year loan is currently L+325, with a 0% floor and OID of 99.5; at these levels, the loan would offer a 4.57% yield to maturity. Proceeds, along with a $705mn issue of senior notes, will be used to finance the buyout of USI by KKR and Caisse de Depot. Also coming to market last week was Platform Specialty Products Inc with a $1.23bn B-6 term loan. This deal recently priced at par and offers a coupon of L+300bps, with a 100bp floor. Proceeds will be used alongside a euro-denominated term loan C to refinance the borrower's outstanding bank debt.

Table 6: Leveraged loan new issues, March 27th – March 30th

Launch Dt	Issuer	Deal Name	Size	New Inst. Money	Moody's	S&P	Asset Backed	Cov Lite	Proceeds	Sector	Country
3/30/2017	Constellis Group	Constellis Holdings (2nd Lien 4/17)	215	215	NR	B-	No	Yes	Acquisition	Services & Leasing	United States
3/30/2017	Constellis Group	Constellis Holdings (TL 4/17)	725	725	NR	B+	No	Yes	Acquisition	Services & Leasing	United States
3/30/2017	Northstar Travel	Northstar Travel (Add-on 4/17)	58	58	NR	NR	No	No	Acquisition	Computers & Electronics	United States
3/29/2017	Playa Resorts Holding BV	Playa Resorts (TL 4/17)	530	530	B2	BB-	No	Yes	Refinancing	Gaming & Hotel	Netherlands
3/29/2017	USI Holdings Corp	USI (TL 4/17)	1795	1795	B2	B	No	Yes	LBO	Insurance	United States
3/28/2017	ProAmpac	ProAmpac (Add-on 4/17)	249	249	B2	B	No	Yes	Acquisition	Forest Product	United States
3/28/2017	Telenet Holding NV	Telenet (US 4/17)	1000	1000	Ba3	BB-	No	Yes	Refinancing	Telecom	Belgium
3/28/2017	NBG Home	NBG Home (4/17)	265	265	B1	B	No	Yes	LBO	Home Furnishings	United States
3/28/2017	NXT Capital LLC	NXT Capital (Add-on 4/17)	75	75	B1	BB-	No	No	Dividend	Services & Leasing	United States
3/28/2017	iPayment Inc	iPayment (4/17)	305	305	B2	NR	No	No	Refinancing	Services & Leasing	United States
3/28/2017	Cedar Fair LP	Cedar Fair (4/17)	910	650	Ba1	BBB-	No	No	Refinancing	Entertainment & Leisure	United States
3/28/2017	Albea Beauty	Albea Beauty (US TL 4/17)	408	408	B2	B	No	Yes	Dividend	Manufacturing & Machinery	France
3/27/2017	Dealogic	Dealogic (4/17)	328	328	B2	B+	No	No	Refinancing	Computers & Electronics	United Kingdom
3/27/2017	DPx Holdings	Patheon (US TL 4/17)	1136	1136	B1	B	No	Yes	Refinancing	Healthcare	United States
3/27/2017	Platform Specialty Products Corp	Platform Specialty (US 4/17)	1317	1317	B2	BB-	No	Yes	Refinancing	Chemicals	United States
3/27/2017	Utility One Source	Utility One (TL 4/17)	450	450	NR	NR	No	Yes	Refinancing	Manufacturing & Machinery	United States

Source: S&P LCD

Performance Summary

Higher-beta US asset classes rebounded to positive returns last week after a two-week slump caused by political risks. US HY was the top-performing group and added 0.94%, bringing its

Table 7: Total returns across asset classes

Ticker	Name	WOW (%)	MTD (%)	YTD (%)
MXEF	EM Eqty	-1.11	2.35	11.14

YTD total up to 2.71%. Following closely behind were US equities (+0.80%), although both were unable to completely recoup their previous losses and finished in the red for March. Higher-quality US asset classes fared slightly worse last week, with TIPs (-0.08%), US IG (+0.07%) and Lev loans (+0.08%) all finishing in the bottom third.

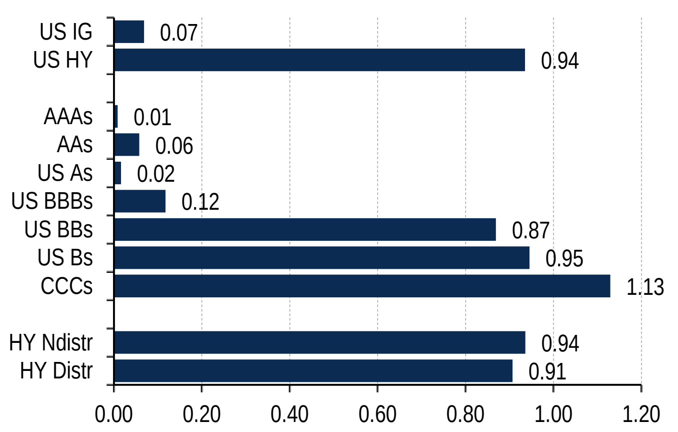
Within corporate rating buckets, performance last week was mostly dominated by higher-beta groups, as CCCs (+1.13%) finished at the top of the pack. Coming in 2nd and 3rd were Bs (+0.95%) and BBs (+0.87%), as all high yield rating buckets fared better than their IG counterparts. As a whole, distressed credits added 0.91%, compared to a 0.94% return for the nondistressed portion of HY.

All 18 of our credit strategy sector classifications finished in the green last week. Energy (+1.63%) posted the best return, after WTI prices found a floor and rebounded to settle above $50/bbl in the back half of the week. Utilities (+1.44%) also outperformed, due to their higher correlation with treasuries. At the opposite end of the spectrum, consumer-driven sectors including Consumer Products (+0.26%) and Food (+0.45%), underperformed last week.

G0QI	TIPs	-0.08	-0.10	1.31
EMGB	EM Govts	0.00	0.38	3.54
C0A0	US IG	0.07	-0.12	1.42
LCDI/ALL	Lev Loans	0.08	0.08	1.15
CDXIG	CDX.IG	0.08	0.24	0.72
GA05	5yr TRSY	0.08	-0.02	0.46
M0A0	Mortgages	0.11	0.02	0.46
HE00	EU HY	0.13	-0.03	1.67
U0A0	Municipals	0.17	0.23	1.39
EMHB	EM HY	0.21	0.08	3.79
EMIB	EM IG	0.23	0.24	2.25
CDXHY	CDX.HY	0.72	0.58	1.31
SPX	S&P 500	0.80	-0.04	5.53
H0A0	US HY	0.94	-0.21	2.71

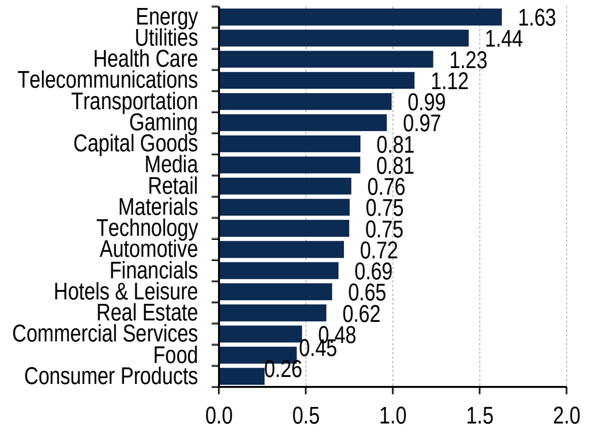
Source: BofA Merrill Lynch Global Research

Chart 9: Segment and rating returns, week-on-week (WoW)



Source: BofA Merrill Lynch Global Research

Chart 10: Sector returns, week-on-week (WoW)



Source: BofA Merrill Lynch Global Research

Top performers

Last week's top-performing bonds were the ESV 5.2s, which added 5.9% as their bonds jumped from 82.4pts to 87.2pts. The RIG 6.8s also outperformed last week, with a 5.1% gain, as the company navigates an asset sale of some of its rigs. Other top performers include the WFT 6 ½ (+4.3%), the IHRT 9s (+4.3%), and the CHK 5 ³/₈s (+4.3%).

Table 8: Top 10 performers, March 24th – March 31st

Issue	Rating	Price	Yield	ZSpread	Px Chg	Pct Chg	Volume
ESV 5.2 '25	BB3	87.23	7.35	508	4.9	5.9	26
RIG 6.8 '38	B2	82.76	8.59	606	4.0	5.1	34
WFT 6.5 '36	CCC1	94.90	6.98	444	3.9	4.3	14
IHRT 9 '19	CCC2	85.28	15.91	1414	3.5	4.3	35
CHK 5.38 '21	CCC2	93.23	0.00	531	3.8	4.3	6
ESV 4.5 '24	BB3	85.13	7.09	483	3.4	4.2	23
CVECN 6.75 '39	BB1	114.36	5.62	305	4.0	3.7	49
RFP 5.88 '23	B1	91.30	7.68	554	3.1	3.5	87
CLR 3.8 '24	BB2	93.48	4.89	266	3.1	3.5	19
FTR 9 '31	BB3	85.96	10.96	854	2.8	3.4	28

Source: BofA Merrill Lynch Global Research, Bloomberg, Finra TRACE

Bottom performers

Last week's bottom performers saw little changes in price, with most of the declines ranging from ¼ to ¾ of a point. Case in point, the IHRT 14s were last week's worst-performing credit, with a ½ point drop on thin trading volumes. Other bottom performers include the RAD 6 ¾s (-0.8%), the VSTO 5 $^{7}/_{8}$s (-0.8%), and the GNW 7.7s (-0.8%).

Table 9: Bottom 10 performers, March 24th – March 31st

Issue	Rating	Price	Yield	ZSpread	Px Chg	Pct Chg	Volume
IHRT 14 '21	CC	33.38	0.00	5813	-0.5	-1.5	8
RAD 6.75 '21	B3	100.90	6.30	454	-0.8	-0.8	37
VSTO 5.88 '23	BB2	97.92	6.27	410	-0.8	-0.8	20
GNW 7.7 '20	B1	98.82	8.12	629	-0.7	-0.8	10
WIN 7.75 '21	B1	99.12	7.99	600	-0.7	-0.7	29
CTL 7.65 '42	BB2	88.36	8.81	628	-0.5	-0.5	16
GENONE 9.13 '31	CCC3	91.61	10.26	785	-0.4	-0.5	8
LXU 8.5 '19	CCC2	97.48	9.73	804	-0.4	-0.4	14
LINTA 8.25 '30	BB3	107.74	0.00	488	-0.4	-0.4	5
NATCIN 5.75 '26	B2	101.32	5.53	322	-0.4	-0.4	6

Source: BofA Merrill Lynch Global Research, Bloomberg, Finra TRACE

Rating Actions

Last week, we saw 37 ratings actions on high yield issuers, including 13 downgrades, 10 upgrades, 10 initiations, and four drops. Notably, Dun & Bradstreet Corp was lowered to high yield status after S&P downgraded the company's issuer credit rating from BBB- to BB+. According to the rating agency, the action reflects their expectation that D&B's turnaround will take longer than they previously expected, and that competition will hurt profitability and keep leverage elevated until 2019. However, because the issuer still has a BBB rating from Fitch, they will remain in our BofA Merrill Lynch Investment Grade index for at least the next month.

On upgrades, EXCO Resources Inc. was raised to CCC- from SD last week by S&P after the company completed its debt exchange offer. Last week, EXCO exchanged most of its outstanding 12.5% second-lien secured term loans for $683mn new 1.75-lien secured PIK term loans. The rating agency believes the company's financial risk profile is highly leveraged and expects that its leverage will remain unsustainable over the next year, with debt to EBITDA exceeding 10x.

Table 10: Ratings actions on high yield issuers, last week

Date	Action	Company Name	Rating Type	Agency	Curr Rtg	Last Rtg
03/29/2017	Upgrade	Perry Ellis International Inc	LT Local Issuer Credit	S&P	B+	B
03/24/2017	Upgrade	Crestwood Holdings LLC	LT Local Issuer Credit	S&P	B-	CCC+
03/24/2017	Upgrade	Williams Cos Inc/The	LT Local Issuer Credit	S&P	BB+	BB
03/23/2017	Upgrade	EXCO Resources Inc	LT Local Issuer Credit	S&P	CCC-	SD
03/31/2017	Upgrade	Summit Materials LLC	Senior Unsecured Debt	Moody's	B3	Caa1
03/30/2017	Upgrade	Six Flags Entertainment Corp	Senior Unsecured Debt	Moody's	B2	B3
03/29/2017	Upgrade	HD Supply Inc	Senior Secured Debt	Moody's	Ba3	B1
03/29/2017	Upgrade	HD Supply Inc	Senior Unsecured Debt	Moody's	B2	B3
03/28/2017	Upgrade	Kratos Defense & Security Solutions Inc	Senior Secured Debt	Moody's	Caa1	Caa2
03/24/2017	Upgrade	Louisiana-Pacific Corp	Senior Unsecured Debt	Moody's	Ba2	Ba3
03/30/2017	Initiated	MaxLinear Inc	LT Local Issuer Credit	S&P	BB-	
03/30/2017	Initiated	ORBCOMM Inc	LT Local Issuer Credit	S&P	B	
03/29/2017	Initiated	Playa Hotels & Resorts NV	LT Local Issuer Credit	S&P	B	
03/28/2017	Initiated	AdvancePierre Foods Holdings Inc	LT Local Issuer Credit	S&P	B+	
03/27/2017	Initiated	Exterran Energy Solutions LP	LT Local Issuer Credit	S&P	BB-	
03/27/2017	Initiated	Utility One Source LP	LT Local Issuer Credit	S&P	B	
03/24/2017	Initiated	KNB Holdings Corp	LT Local Issuer Credit	S&P	B	
03/30/2017	Initiated	ORBCOMM Inc	Senior Secured Debt	Moody's	B2	
03/29/2017	Initiated	USI Inc/NY	Senior Unsecured Debt	Moody's	Caa2	
03/27/2017	Initiated	Chobani LLC	Senior Unsecured Debt	Moody's	Caa2	
03/24/2017	Dropped	Avaya Inc	LT Local Issuer Credit	S&P	NR	D
03/27/2017	Dropped	Speedy Cash Intermediate Holdings Corp	Senior Secured Debt	Moody's	WR	Caa3
03/24/2017	Dropped	Prospect Holding Co LLC	Senior Unsecured Debt	Moody's	WR	Caa3
03/23/2017	Dropped	Illinois Power Generating Co	Senior Unsecured Debt	Moody's	WR	Ca
03/30/2017	Downgrade	CCC Information Services Inc	LT Local Issuer Credit	S&P	B-	B
03/30/2017	Downgrade	Remington Outdoor Co Inc	LT Local Issuer Credit	S&P	CCC+	B-
03/29/2017	Downgrade	Quorum Health Corp	LT Local Issuer Credit	S&P	B- *-	B
03/29/2017	Downgrade	Westmoreland Coal Co	LT Local Issuer Credit	S&P	CCC+	B
03/27/2017	Downgrade	Dayton Power & Light Co/The	LT Local Issuer Credit	S&P	BB-	BB
03/27/2017	Downgrade	DPL Inc	LT Local Issuer Credit	S&P	BB-	BB
03/27/2017	Downgrade	Drumm Corp	LT Local Issuer Credit	S&P	B- *-	B
03/27/2017	Downgrade	Dun & Bradstreet Corp/The	LT Local Issuer Credit	S&P	BB+	BBB-

Table 10: Ratings actions on high yield issuers, last week

Date	Action	Company Name	Rating Type	Agency	Curr Rtg	Last Rtg
03/24/2017	Downgrade	BI-LO LLC	LT Local Issuer Credit	S&P	CCC+	B-
03/24/2017	Downgrade	David's Bridal Inc	LT Local Issuer Credit	S&P	CCC+	B-
03/24/2017	Downgrade	FR Dixie Acquisition Corp	LT Local Issuer Credit	S&P	CCC+	B-
03/24/2017	Downgrade	StoneMor Partners LP	LT Local Issuer Credit	S&P	CCC+	B-
03/30/2017	Downgrade	Quorum Health Corp	Senior Unsecured Debt	Moody's	Caa2 *-	Caa1

Source: BofA Merrill Lynch Global Research, Bloomberg, S&P, Moody's. Rising stars and fallen angels bolded.

Relative Value

Cash v. CDS

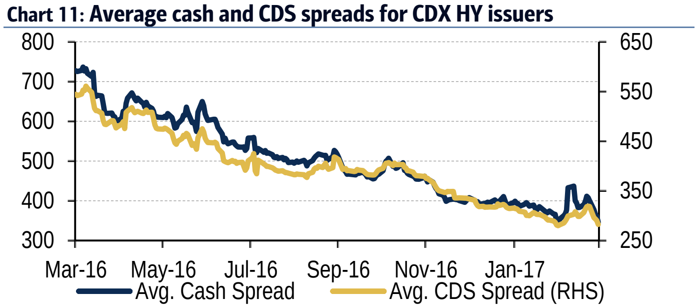
Cash indices performed in line with their respective CDX indices over the week (Table 11). CDX HY tightened by 22bp compared to 26bp of tightening for our HY cash index. On an issuer matched level, however, CDS spreads significantly underperformed cash, with a 25bp increase in the average basis (Chart 11). The average basis for CDX HY issuers we track now stands at -64bps.

Table 11: CDX vs. ML Cash Indices

Index	Spread	1W-Chng	1M-Chng	3M-Chng
CDX IG	67	-1	-3	-9
HG Cash	122	-1	1	-7
CDX HY	339	-22	-7	-45
HY Cash	385	-26	11	-36

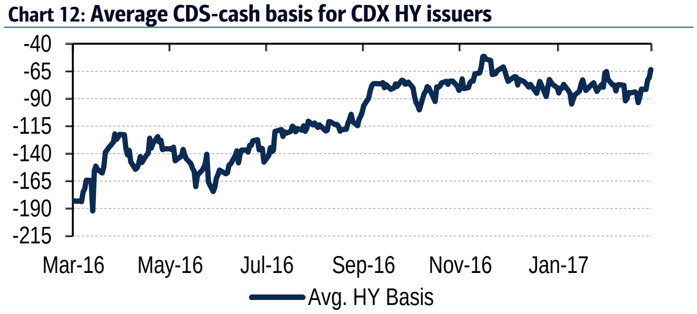
Source: BofAML Global Research, 5y spreads for CDX, OAS for cash

Chart 11: Average cash and CDS spreads for CDX HY issuers



Source: BofA Merrill Lynch Global Research, Average spreads for a selection of issuers in the On The Run CDX HY index. Currently includes 82 HY20 constituents.

Chart 12: Average CDS-cash basis for CDX HY issuers



Source: BofA Merrill Lynch Global Research, Average basis for a selection of issuers in the On The Run CDX HY index. Currently includes 82 HY20 constituents.

CDS Indices

CDS indices in the US and Europe tightened over the week. Single-names lagged index performance in high yield with a 17bp increase in the skew. The HY/IG spread ratio is now at 5.06, about 15bps lower since the roll into S28. The XO-HY spread rose by 9bps, to -48bps (see Table 12).

Table 12: CDS Indices – spread, intrinsic and skew

Index	5y Spread	1W-Chng	1M-Chng	3M-Chng	5y Intrinsic	1W-Chng	1M-Chng	3M-Chng	Skew	1W-Chng	1M-Chng	3M-Chng
CDX IG	67	-1	-3	-9	71	-1	-4	-12	-4	0	1	3
CDX HY	339	-22	-7	-45	365	-5	5	-39	-25	-17	-11	-6
iTraxx Main	74	-1	-6	-5	73	0	-5	-7	1	-1	0	2
iTraxx XO	292	-3	-24	-21	286	-2	-23	-33	5	-1	-1	12

Source: BofA Merrill Lynch Global Research

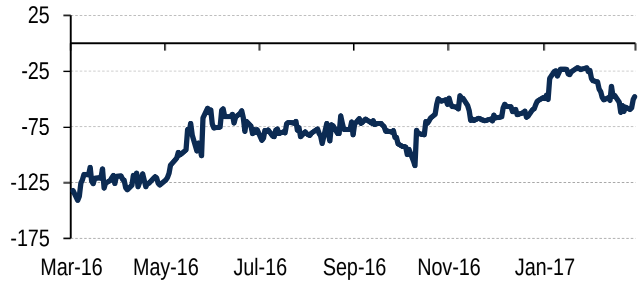
Table 12: CDS Indices – spread, intrinsic and skew

Index	5y Spread	1W-Chng	1M-Chng	3M-Chng	5y Intrinsic	1W-Chng	1M-Chng	3M-Chng	Skew	1W-Chng	1M-Chng	3M-Chng

Chart 13: HY/IG

Source: BofA Merrill Lynch Global Research

Chart 14: XO-HY

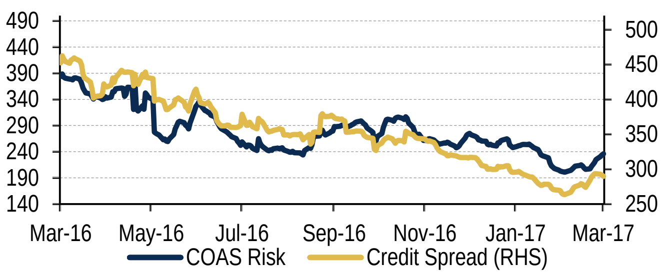


Source: BofA Merrill Lynch Global Research

Credit v. Equities

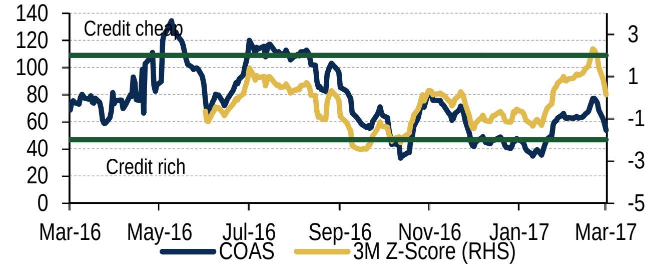
The average spread for our HY universe tightened by 2bp, compared to a 20bp increase in the equity implied credit risk (Chart 15). The US HY COAS value accordingly fell by 22bp and its 3m z-score is now at 0.13, indicating that credit looks fairly valued relative to equity implied risk (Chart 16).

Chart 15: US HY COAS Risk vs. Spread



Source: BofA Merrill Lynch Global Research

Chart 16: US HY COAS & Z-Score



Source: BofA Merrill Lynch Global Research

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