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Where All the CCCs Have Gone

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High yield returns have turned positive on the year, with CCCs continuing to lead the way at 2.7%. Most investors have focused on the drag from higher rates as a reason for the underperformance of higher-quality high yield. With respect to CCCs, we believe their outperformance can be attributed partially to the dearth of higher-yielding securities. The CCC market, as a proportion of the US High Yield Index, has shrunk to 14%, from 25% at the bottom of the last credit cycle in 2008 (Figure 1). The size of the CCC market (by amount outstanding) is slightly larger than in 2008 (roughly $180bn as of the end of May, versus $165bn in 2018), but the overall US High Yield Index has nearly doubled over the same period (from $650bn to $1.3trn).

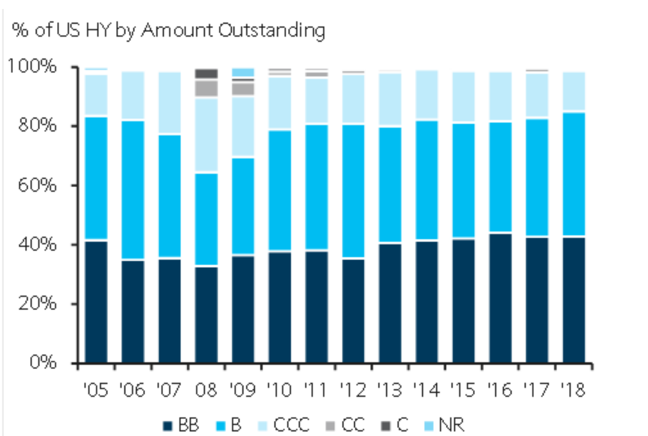
As is typical during the later phases of an economic cycle, companies' fundamentals have improved, allowing them to refinance at better levels. However, as Figure 2 highlights, CCC issuance as a percent of total high yield issuance has been much lower since 2014 than it was late in the previous cycle, when it reached 22% of issuance in 2007 and 24% in 2008.

The story when gauged by the number of CCC issuers is much the same as for amount outstanding. The total number of CCC issuers has been outpaced by the broadening of the issuer base across the rest of the high yield market over the past decade, with CCCs growing by only 11% while the US High Yield Index posted a 30% increase in the number of unique issuers over the same period. Despite a paucity of new CCC names, concentration within the ratings bucket has surprisingly decreased. In 2009, the 10 largest CCC issuers by par represented 36% of the entire CCC cohort and 7% of high yield. Conversely, today, the ten largest issuers represent just 25% of CCCs and 3% of the US High Yield Index.

So while CCCs have not disappeared, their presence in the high yield market has declined over the past decade. That said, the CCC bucket still carries outsized weight for select sectors. As seen in Figure 3, the energy and consumer non-cyclical sectors account for 41% of CCC bonds today, an outsized amount given that the two sectors represent only 28% of the high yield universe. Conversely, the communications sector is 20% of the US High Yield Index but makes up only 9% of CCCs outstanding.

FIGURE 1

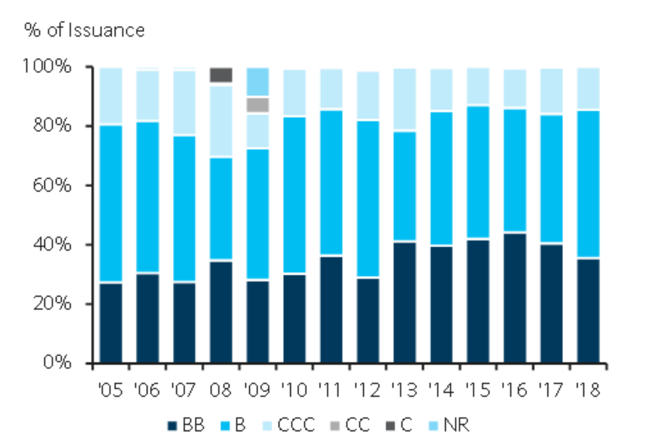
CCC Representation in US High Yield Has Continued to Fall…



Note: All data as of year-end except for 2018, which is as of May 31, 2018.
Source: Bloomberg Barclays Live

FIGURE 2

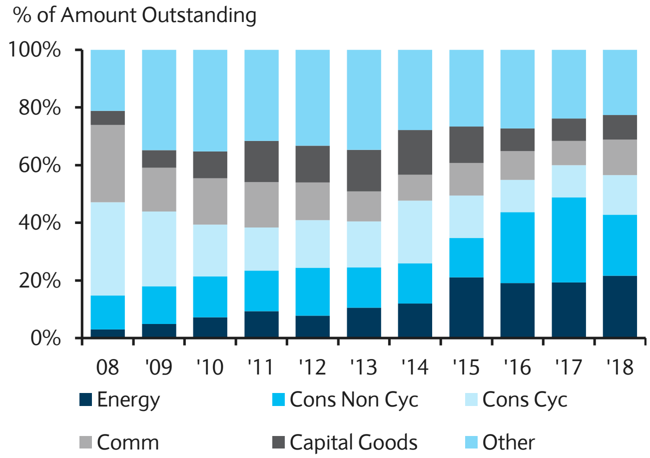
…With Issuance by Rating Roughly Unchanged since 2014



Note: All data as of year-end except for 2018, which is as of May 31, 2018.
Source: Bloomberg Barclays Live

FIGURE 3

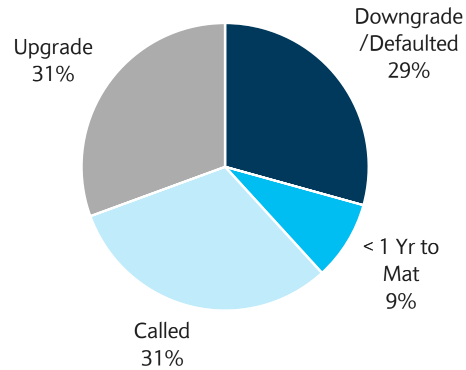
Energy and Consumer Non-Cyclical Represent More Than 40% of CCC Bonds



Note: All data as of year-end except for 2018, which is as of May 31, 2018.
Source: Bloomberg Barclays Live

FIGURE 4

Reasons for CCC Bonds Leaving Index since 2009



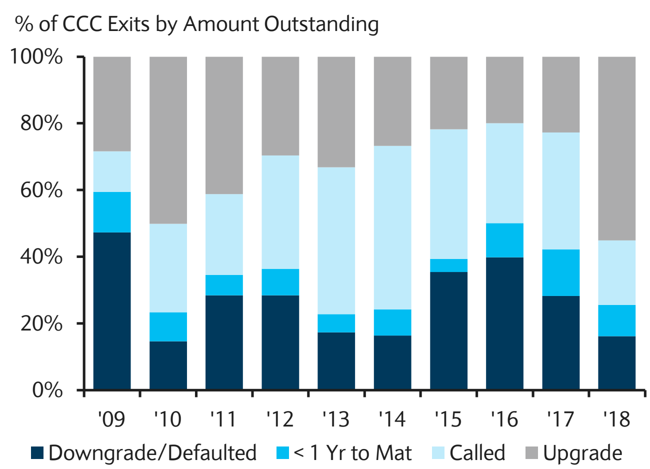
Source: Bloomberg Barclays Live

To determine how the category has evolved, we look at four potential reasons that bonds leave the CCC index: they default or are downgraded to CC or below, are called, are upgraded to the B cohort, or are removed because they have less than one year to maturity. Figure 4 shows that the three main outcomes (default/downgrade, upgrade, and refinancing) have been fairly even during this cycle. An additional 9% by amount outstanding left because of the index's one-year maturity restriction, but the end results for those were presumably split between defaults and refinancings.

Although upgrades (31% of amount outstanding) and downgrades/defaults (29%) have been broadly balanced over the cycle, 2018 has experienced an outsized number of upgrades, providing perhaps our biggest clue about the outperformance of CCCs (Figure 6). The increased has been driven in part by Valeant's move out of the CCC bucket in March. Excluding Valeant, though, upgrades have still outpaced downgrades/defaults (37% of amount outstanding relative to 24%). In light of this and in conjunction with our fundamental analysts, we recently highlighted CCCs in the energy sector that could be poised for an

FIGURE 5

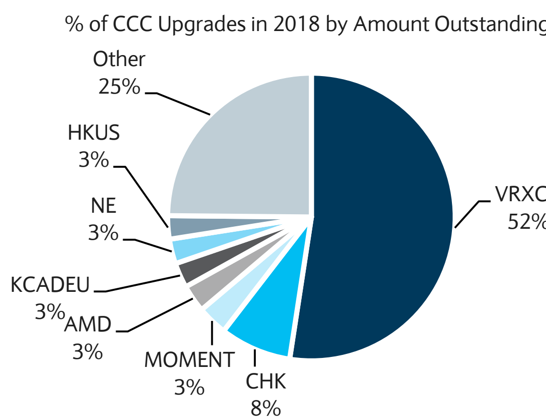
Upgrade Rate of Bonds Leaving CCC Index Has Increased in 2018…



Source: Bloomberg Barclays Live

FIGURE 6

…Driven by Valeant's Upgrade to B in March



Source: Bloomberg Barclays Live

upgrade (see *Drilling into CCC Energy*). CCC energy has outperformed year-to-date, and we expect the trend to continue and support this portion of the market.

Currently, there are roughly 300 bonds in the CCC index. Of those, 15, representing 6% of the CCC index, are rated CCC+ and either have a positive outlook or are on watch for upgrade at one of the rating agencies. Conversely, only three bonds, representing 1% of the index, are rated CCC- and either have a negative outlook or are on watch for downgrade. This skew echoes the year-to-date trend of an increased frequency of upgrades. Out of the roughly $540bn in B bonds outstanding, 8% (~$42bn) are rated B- and either have a negative outlook or are on watch for downgrade at one of the rating agencies. We note, however, that this number is based on ratings as of the end of May and that $1.2bn of JCP bonds were downgraded to CCC by Moody's this week.

In the context of the diminishing CCC sector, Figure 7 on the following page highlights the ten largest issuers in the CCC index, including comments from Barclays' fundamental analysts.

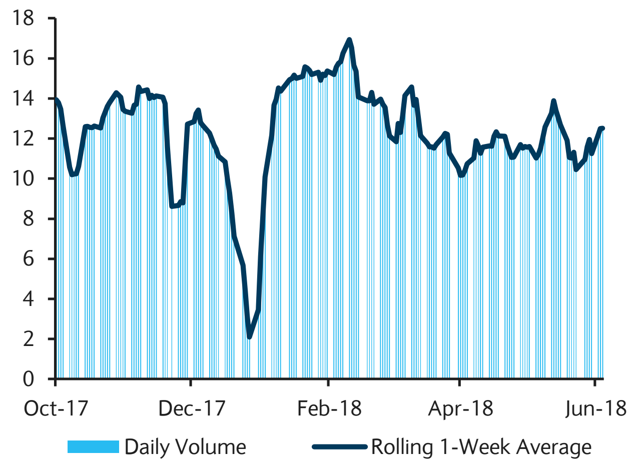
FIGURE 7

Ten Largest CCC Issuers

Ticker	CCC Amount Outstanding ($ mn)	Analyst	Barclays Rating	Comments
INTEL	6,850	Vince Foley	MW Jackson bonds (CCC)	We expect financial pressures to continue in 2018, with revenue and EBITDA remaining at multi-year lows. C-band monetization is a potential positive catalyst for Intelsat, but several uncertainties remain.
WFT	6,162	Paul Chambers	MW	We anticipate a recovery in international upstream spending in 2H18 and 2019 as oil prices are expected to average about $62.20/bbl for 2019, and WFT should be a prime beneficiary of this. Key concerns remain the company's lack of free cash flow and very high current leverage.
THC	5,927	Rishi Parekh	OW 24s (1st Lien), 5.125s of 25 (2nd Lien), and 31s MW remainder of structure	We remain positive on the credit, noting its business and asset diversity, and believe the company will achieve its leverage target.
CHK	4,867	Paul Chambers	OW 29-23s and 25s MW 22s (2nd Lien)	We remain Overweight across the CHK unsecured bonds and are Market Weight the 2L 2022s, as the company has tendered for the bonds multiple times and they therefore trade at a YTW of ~4%. The recent recovery in natural gas prices toward $3/mmbtu is supportive.
ENDP	4,681	Rishi Parekh	OW	Even though the unknowns related to opioids remain an overhang, we believe timing will eventually benefit bondholders.
PETM	3,900	Hale Holden	Private-side financials	The company's decision this week to dividend a portion of Chewy equity and reports that it has hired advisors could create a game theory scenario.
CYH	3,125	Rishi Parekh	UW	Despite the recent weak quarter and considering the lack of visibility, the company's unchanged guidance seems aggressive to us. The primary focus will shift to the announced exchange, which will likely drive trading levels.
RIG	3,017	Paul Chambers	OW 31s, 38s, and 41s MW 23s and 26s UW 20s, 21s, 22s, 24s, and 27s	Consistent with our belief that the ultra deepwater markets should begin seeing a recovery in 2H19, we view offshore credit and many of the longer-dated bonds as attractive.
NE	2,951	Paul Chambers	OW	Noble has outperformed in 2018 as a result of improved clarity on litigation, a refocus around the world on longer-term offshore programs, and higher oil prices that have spurred optimism for a drilling recovery in 2019 and beyond.
CEQUEL	2,920	Vince Foley	MW 21s OW 25s	Despite modest margin pressure in recent quarters, we expect continued strong fundamentals within the Cequel/Suddenlink structure and its margins of 45% to remain among the highest in the industry. Management is also clearly focused on deleveraging Altice USA closer to its peer group, as its new leverage target is 4.5-5.0x, down from 5.0-5.0x.

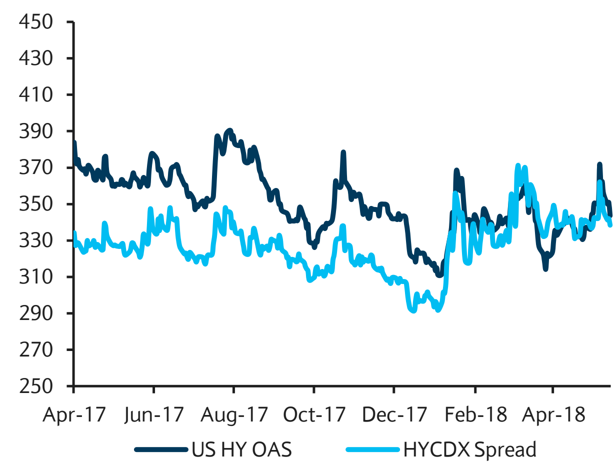
Source: Bloomberg Barclays Live, Barclays Research

High Yield Average Institutional Trade Volume ($bn)



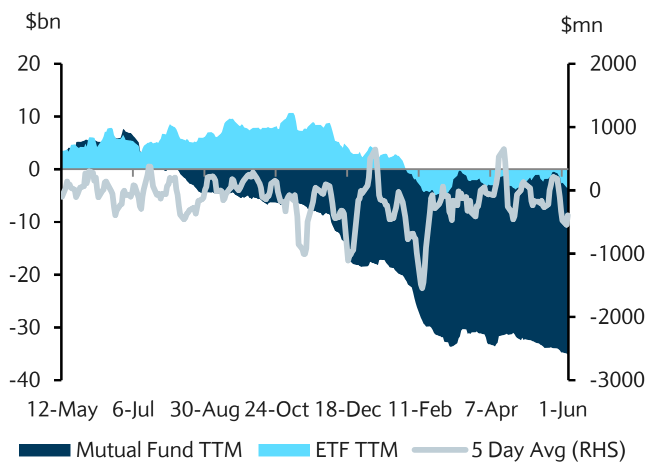
Note: Includes both registered and 144A volumes. Source: FINRA TRACE

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



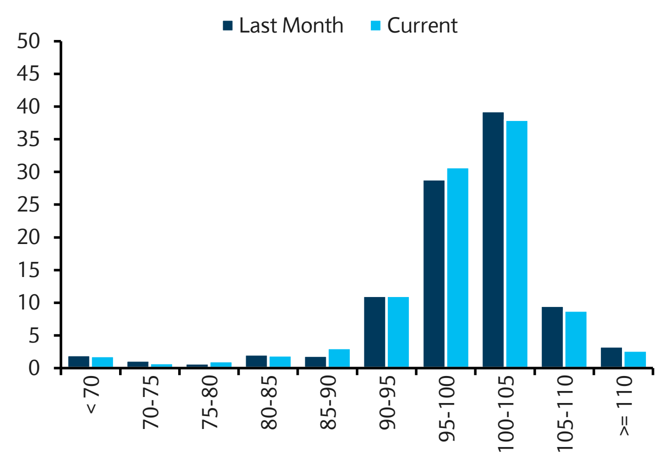
Source: Barclays Research

Flows to High Yield Mutual Funds and ETFs



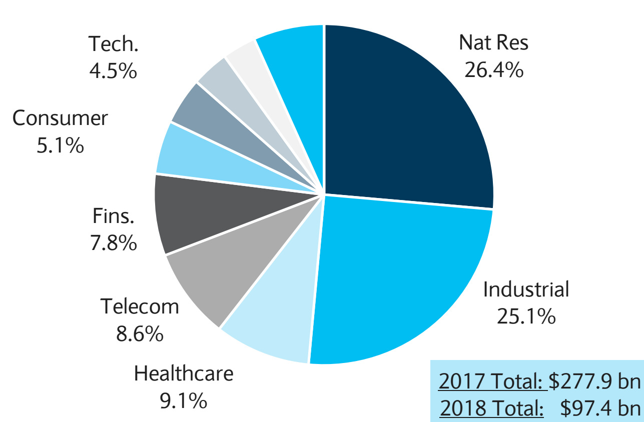
Note: Daily reporters only. Source: EPFR

High Yield Index Price Distribution by Par (%)



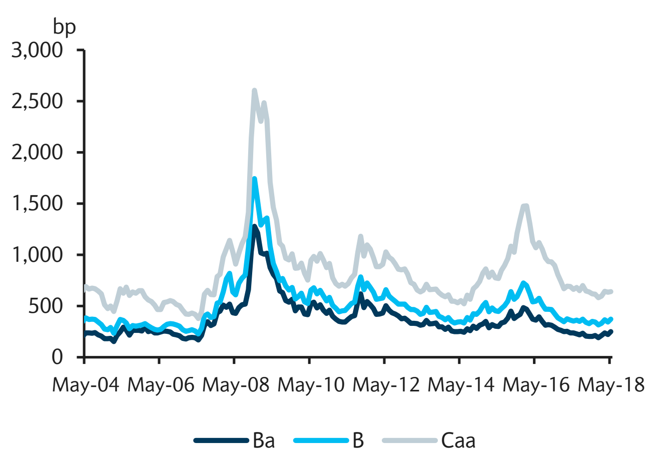
Source: Barclays Research

High Yield Supply by Sector



Source: Barclays Research

High Yield Spreads by Credit Quality



Source: Bloomberg Barclays Indices

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CHESAPEAKE ENERGY CORP, A/CD/CE/D/J/K/L/M

CHS/COMMUNITY HEALTH SYSTEMS INC, CD/J/K/M
Representative Bond: CYH 5 1/8 08/01/21 (USD 94.25, 06-Jun-2018)
Representative Bond: CYH 7 1/8 07/15/20 (USD 84.50, 06-Jun-2018)

ENDO FINANCE LLC, CD/J

INTELSAT JACKSON HOLDINGS SA, CD/D/J/K/L/M/N

JC PENNEY CORP INC, A/CD/D/J/K/L/M
Representative Bond: JCP 5.65 06/01/20 (USD 98.00, 06-Jun-2018)

NOBLE HOLDING INTERNATIONAL LTD, A/CD/D/J/K/L/M
Representative Bond: NE 7.7 04/01/25 (USD 91.50, 06-Jun-2018)

PETSMART INC, CD/D/J/K/L/M/N

TENET HEALTHCARE CORP, CD/CE/D/E/J/K/L/M

TRANSOCEAN INC, A/CD/D/E/J/K/L/M/N
Representative Bond: RIG 9 07/15/23 (USD 107.38, 06-Jun-2018)

VALEANT PHARMACEUTICALS INTERNATIONAL INC, A/CD/CE/D/E/J/K/L/M

WEATHERFORD INTERNATIONAL LLC, A/CD/D/J/K/L/M/N

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Underweight (UW):
The analyst expects the three-month excess return of the country's index eligible bonds to be less than the three-month excess return of the Bloomberg Barclays EM USD Sovereign Index.
Rating Suspended (RS):
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