High Yield Strategy
2019 – The Year Ahead

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This year in the rearview mirror

2018 almost made it to be another good year in HY, but its narrative had to be hastily rewritten in the last few weeks. The broad DM USD HY index was annualizing close to 4% total and 5.5% excess YTD returns as recently as early October. All that is now gone, with both total and excess returns now negative YTD, at -0.6% and -0.4% respectively. Our spreads which were almost breaking into 2-handles in January, April, and October are now comfortably in the 4-handles, near their two-year wides. CCCs that led the way most of the year with close to 650bps of excess returns over BBs accumulated by late summer, have given up more than 500bps in the last few weeks. This market reversal now exceeds the taper tantrum selloff in terms of overall index widening.

Our thoughts going forward

We do not believe this volatility episode will go down in history as the turning point in this credit cycle. At least, we do not see enough evidence to come to that conclusion here and now, although unquestionably the market has made a big move in that direction just in the last few weeks.

Key elements of our rationale here include debt and capex growth dynamics that have been slowing down for several years, and do not resemble their normal trends in approaching cyclical turns. In addition, earnings growth trends should remain relatively strong, in our opinion, even once we net out the inevitable drop of tax-reform contributions early next year. Our default rate model similarly produces a modest increase in expected credit losses next year, not a sharp spike.

All these elements add up to an argument that this volatility episode is more likely to register only as such, a volatility episode, and not the early stage of something bigger. In this context, we think spreads do not have to average materially higher than their current levels over the course of coming months, although this episode may not be over just yet. As we discussed last week, we see 500bps as a possible next stop in this market move. Longer-term, be prepared for wider spread ranges – so more risk to be concerned about but also more opportunities to pursue.

Importantly though our cyclical views do not substantiate a further move wider, given the evidence known to us so far. Some of the key risks we are watching here include sharp deterioration of investor sentiment in IG where GE – a name which was rated single-A just a few weeks ago – is now trading in line with better quality *single-Bs*. We are also watching the ongoing repricing in technology, as this sector, along with healthcare, was the cornerstone of this credit cycle. Further material weakness from current levels could have far-reaching implications for this credit cycle, in our opinion. Again, for now these are risks that do not yet add up to the base case.

If the market is trading in low-400s here and we think it is potentially headed towards 500 but is not very likely to break through that level, we think investors should be adding risk on their way there, not reducing it. We are still cautious on CCCs, although we clearly like 'em better here, after a 500bps reversal. We also like energy better at $54 WTI than we liked it at $75. Overall, with rates risk now receding – as we long expected it to – we think credit could produce some decent returns from wider levels. This year's +/-40bps spread range around our target is likely to grow to +/-50..75bps, at least.

Key macro assumptions

Our base-case scenario assumes the following five key developments taking place at some point over the coming months/quarters:

US corporate earnings growth slows down. Reported yoy EPS growth of S&P1,500 index (captures the full spectrum of issuers, from large to mid to small caps) has peaked at 25% in Q2 and is currently tracking 23% for Q3. While the extent of the slowdown in growth is not significant, it was the first quarter out of eight when the yoy EPS growth has failed to exceed the growth rate of a preceding quarter. We think this datapoint helps explain a relatively strong market reaction in October, which was less about the strength of earnings at hand and more about resetting expectations for the future.

Earnings are poised to experience further deceleration in growth as we go into the next year, as favorable effects of tax reform are bound to turn from a tailwind into a headwind. Earnings were growing at 10-12% pace prior to tax reform, and we see few reasons to suggest this is not where growth is headed eventually, perhaps by Q3/Q4 2019. We still view this as a healthy growth environment, and would not use this as an argument for increased risk of a turn in credit cycle.

Global central bank balance sheet starts to deflate. The Federal Reserve was engaged in rolling off its balance sheet at about a $25bn/mo average clip in 2018. At the same time, its actions were offset with a continued expansion of QE programs by the ECB and BOJ, at $30bn/mo and $25bn/mo in US dollar equivalents respectively. This dynamic will change next year, when the Fed hopes to at least maintain but ideally increase its pace of roll-offs to $50bn/mo, while the ECB stops its purchases in January. Even if the BOJ continues at its current pace for a while, this means the aggregate balance sheet starts to deflate next year for the first time in this new monetary policy experiment that was underway since the GFC.

Volatility set all-time record lows in 2017 and has clearly shifted into a higher gear this year, with at least two meaningful global shocks rocking the markets in February and October, aside from more localized events hitting EM, IG, and EU sovereign markets at different points in time. And while the direct link between central bank liquidity and volatility is hard to prove with mathematical precision, the connection appears evident. So we assume this link produces more, perhaps even more pronounced, volatility shocks next year. We do not yet see reasons why such shocks would necessarily lead to a more material reassessment of prospects for the cycle at this stage, although we remain open-minded when it comes to this particular point.

For now, we are setting ourselves up to be able/willing to increase portfolio credit risk as/if such volatility shocks materialize.

Inflation peaks. Core PCE has oscillated around 1.5% for over five years, before it made a breakthrough to 2.0% in 2018. This year's environment provided a good backdrop for a temporary upswing in inflation, with factors ranging from tight labor markets to strong GDP growth to higher oil prices all contributing to the outcome.

Going forward, we expect the environment to normalize somewhat, with fading tax reform effects and accumulating costs of the trade war leading the way to slower economic growth. Oil has appreciated by 50% from Sept 2017 to Sept 2018, before retracing over 20% in the last few weeks. As such, it is likely to turn from a tailwind into a headwind for inflation. Even as our focus here is on core PCE, we note a non-trivial +0.25x beta between percentage changes in WTI and core PCE over the past thirty years. In the meantime, our economists forecast core PCE rising to 2.3% by Q3 2019 before softening to 2.2% by the end of 2019.

Yield curve flattens. The 10/2yr US Treasury yield curve has flattened by 120bps over the past three years, just as the Fed has hiked short-term rates by 200bps, implying a 6bps of flattening for every 10bps of hiking. We do not expect this reaction function to change going forward, and given the current yield curve level of around 30bps, would not be surprised to see it flat and perhaps even modestly inverted after the next 2 maybe 3 rate hikes. Such an event should create a natural barrier for the Federal Reserve to continue hiking interest rates, as the FOMC has in the past generally refrained from raising Fed Funds more than once or twice into a flat yield curve.

Once the yield curve is flat, we think consensus would be all but certain to start vocally entertaining odds of the next recession, and this is going to make it more difficult for the Fed to continue tightening policy in a constructive way. We do not view the link between yield curve and timing of recessions as direct/immediate/automatic; however we do recognize a lagged and variable connection between the two. During the pre-GFC cyclical turn, it took around 18 months between the initial curve flattening in Dec 2005 and sharp tightening in credit conditions in Jul-Aug 2007. In the late 1990-ies the curve initially flattened in mid-1998 and the credit contraction did not arrive until mid-2000.

Our rates strategists forecast the yield curve to go flat by the middle of 2019 (both 2s and 10s at 3.30%) and to invert by 10bps by the end of next year (2s at 3.35% and 10s at 3.25%).

Trade war fades. With Democrats retaking the majority of US Congress, we think they may now have enough clout to be able to distract the Trump administration with various inquires and investigations. As such, the administration may eventually lose its focus on trade, although we would not be surprised to see one more push to apply higher pressure on China during the lame duck session. We think the fact that S&P500 is about 100pts away from wiping out all post-tax reform upside coupled with the fact that other major trading partners, including Canada, Mexico, the EU and S Korea, were able to achieve new arrangements in exchange for token concessions should both translate into eventual resolution of trade issues with China.

Across all assumptions we listed above this is the one we feel least confident about. If we are wrong about it, we think further escalation of tensions with China is the best shortcut from where we are to the next recession.

Risks to macro outlook

Based on these macro assumptions, we think the environment will remain supportive of the continued gradual evolution of this credit cycle, not its imminent turn.

This is our base case. It could be challenged by the following key risk factors:

Populism takes hold. With time, populist electoral gains look less like an aberration: the latest print came after US midterms failed to deliver a resounding rebuke to Trumpism, instead producing a divided government. In Germany, a leftist party (Greens) is now directly challenging CDU in polls, an establishment party that dominated the government since WWII. A right-wing populist party AfD has also seen some successes in recent elections there, perhaps an even greater concern. Between the UK, Italy, Austria, Sweden, and Brazil – the list of election "surprises" gets longer.

Trade contracts. Open trade requires open minds and cooperation on the part of sovereign governments. Populist and nationalist politics are pushing countries in the opposite direction. As such, there is a risk of trade wars escalating in the immediate near-term even if reason and evidence suggest this would be a mistake.

Key sectors get hit. A contraction in international trade would hit sectors that rely more heavily on global supply chains and/or cross-border final consumers, such as autos, industrials, and technology. Through these lenses, the developing GE situation and meaningful declines in largest tech names, including Apple, Google, Amazon, Netflix – all down 20% or more from recent peaks – look less of a surprise.

The GE situation in particular looks problematic at current levels as some of its benchmark bonds are now trading in line with better quality single-Bs (GE 10yr bonds are in the 340-380bps range). In the past, large IG names who crossed BB levels were eventually downgraded into HY more often than not.

Earlier examples of large IG names ($5bn+) trading through BB levels prior to becoming fallen angels include: JC Penney (2000), Enron (2001), Worldcom (2002), Tyco (2002), El Paso (2002), Comcast (2002) , Sprint (2003), GM (2004), Ford (2005), Rescap (2007), CIT (2008), Navient (2009), Telecom Italia (2011), ArcelorMittal (2012), Teck Resources (2014), Freeport-McMoRan (2015), Continental Resources (2015), Anglo American (2015), and many others. In each of these cases, the eventual downgrade came anywhere between a month to a year following the initial point in time when a credit was still technically IG but traded through BBs. The median excess spread of the initial print wider over BBs was +60bps.

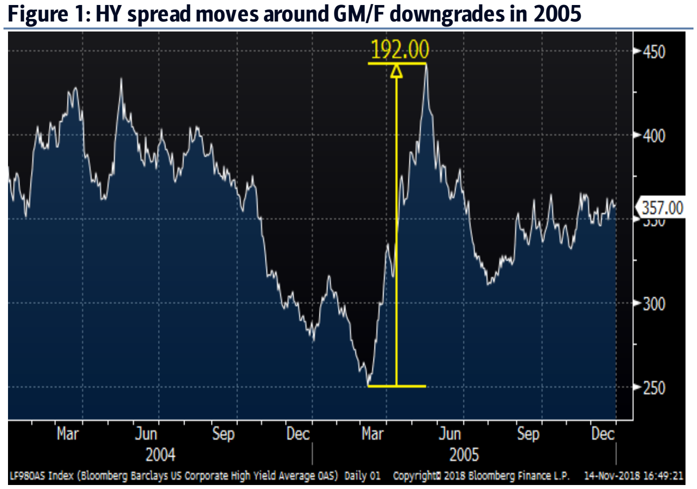
Examples to the contrary are limited, for the most part, to financial institutions that received various forms of government liquidity/capital support during and after the global financial crisis and European sovereign crisis. Non-financial IG names that have eluded that fate so far include Macy's (initially traded wide to BBs in 2017), Marathon Petroleum (2016), Williams Partners (2015), Barrick Gold (2013), and Daimler (2008).

This is not a forecast of what is going to happen to GE; we are only highlighting the historical track record of previous episodes when large IG names were trading wide to BBs. Given this track record, we think any steps taken by GE to remediate market concerns – asset sales and/or equity raises – need to happen soon and be sizeable to matter. Thus timing and decisiveness are critical here.

At $48bn in index-eligible bonds, GE could become the largest fallen angel in DM USD HY market history (Ford currently holds this title with a $40bn downgrade in 2005). The HY index widened almost 200bps on F/GM downgrades in 2005 (Figure 1), although the market was half its current size.

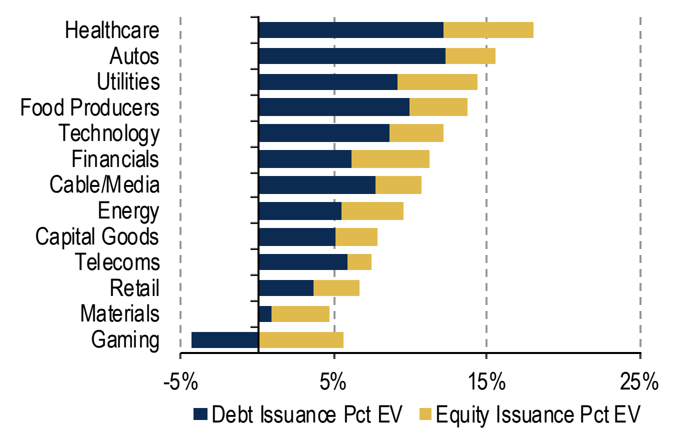
About $40bn of its index-eligible debt is issued by GE Capital, so the financial link is present here as well, with potential for regulators getting involved at some point.

Figure 1: HY spread moves around GM/F downgrades in 2005



Source: BofA Merrill Lynch Global Research, Bloomberg

Figure 2: New debt/equity capital raised by sector, last 5yrs



Source: BofA Merrill Lynch Global Research

Technology and healthcare

Two sectors were responsible for a significant share of capital raised, earnings generated, and employment created in this cycle: technology and healthcare. Figure 2 ranks sectors by the total amount of new debt/equity capital raised over the past five years, as a percent of their current enterprise values. Healthcare comes out at the top (also keeps that spot in absolute dollar terms, at $625bn). Technology is down the list primarily because of outsized EVs pushing the ratio lower; in dollar terms, tech is right behind healthcare, at $500bn in new debt and equity capital raised. The recent reversal in auto valuations looks less surprising through the lenses of this ranking, although this sector has a relatively small footprint in the US economy to be consequential to our broader cyclical discussion here.

In contrast, a protracted weakness in either one of the two key sectors – technology *or* healthcare – could be sufficient to turn the broader credit cycle, in our opinion. From this perspective, a near-bear market performance in some key technology names in recent months requires close monitoring going forward for any signs of further deterioration. It will be a mistake to dismiss further weakness in tech solely on the grounds of a limited overlap with HY issuer universe. This story could potentially have far greater consequences, way beyond the FAANGs themselves.

We are also watching EU financials, obviously not as much for their past contributions to growth but rather as a source of contagion risk related to Italy/EU.

To reiterate, we are still constructive on evolution of this cycle, however we think risks described above – the rise of populism, barriers to trade, impact on key sectors – are both real in terms of probabilities and meaningful in terms of potential impact. We continue to monitor their development for any signs of further deterioration that could trigger a change to our broader cyclical outlook.

Oil and energy HY

Oil has dropped by 30% from its recent peak in early October to settle at around $53-54/bbl in recent sessions. This move has initially put some pressure on energy HY names and eventually found its way to a broader market weakness narrative, as the commodity meltdown of 2015-2016 remains fresh in memory.

While it is natural to see some air come out of HY energy valuations given the extent and pace of the drop in underlying commodity, we do not think this move should be extrapolated towards the experience of 2-3 years ago. Back then, HY energy came under initial pressure at current levels of oil prices because most capital structures were built with $100/bbl assumptions. Following a full sector restructuring that reached its peak at sub-$30 oil prices and with defaults rates exceeding 25%, its composition has changed. Current survivors have re-built their cap structures while oil was in the $45-55 range.

So $54 oil today provides a very different backdrop to this sector, compared to where we were in late 2014. We think fundamental pressures could resurface at oil inside of $45 and it would take even further declines to $35-40 range to see meaningful credit losses picking up. This is not a scenario we put a high probability on. As such, we like Energy HY more at $54 WTI than we liked it at $75.

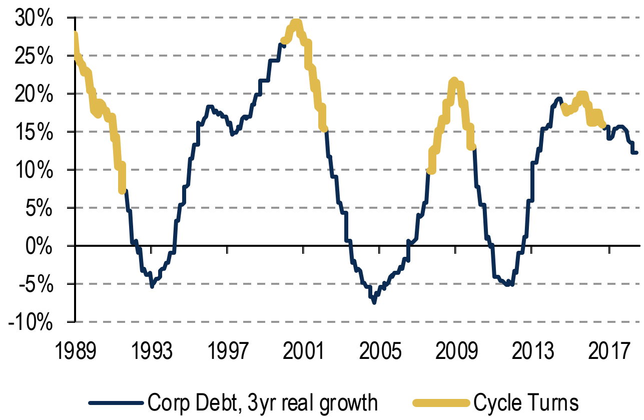
Fundamentals and defaults

As we continue to study the state of the current credit cycle, the accumulated evidence sides with the argument that it has more room to develop, as long as few more years. Previous cycles have lasted anywhere between 6-8 years, on average, and this observation would make it an unusual development to see the current cycle extend for much longer. However, we also note that more broadly, this economic cycle has been an unusual one in many respects, including how long it took the US GDP to return to trend growth rates, the unemployment to decline, and the inflation to recover. And if those major macroeconomic variables took an unusually long time to return to normal levels, then why should we expect the credit cycle to be an average one?

Away from this argument, we also continue to believe that the commodity episode in 2015-2016 represented a partial cycle in and of itself. Among the most conclusive pieces of evidence in support of this view, we present the charts in Figure 3 for debt growth and Figure 4 for capex. In both cases, we highlight cyclical turns, as defined by catalyst events as the starting points[1] and subsequent observed peaks in trailing 12mo HY issuer default rates as ending points.

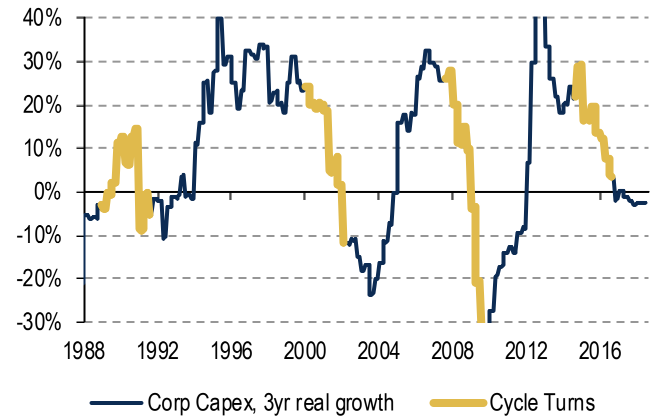
Both graphs suggest that previous cyclical turns have occurred at similar points on each respective line, had similar impact on each measure, and had left them at similar levels after defaults receded. Both graphs also suggest that a cyclical turn at current levels and given their recent trends would be inconsistent with historical experiences going into previous default cycles.

Figure 3: US non-financial corporate debt, 3yr real growth rate



Source: BofA Merrill Lynch Global Research

Figure 4: US non-financial corporate capex, 3yr real growth rate



Source: BofA Merrill Lynch Global Research

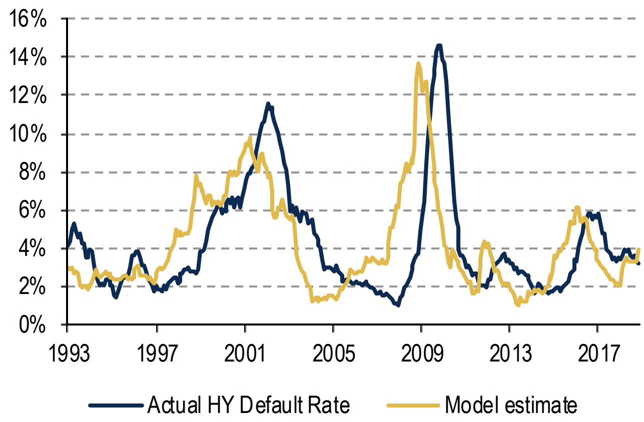
The exact timing of cyclical turns is an inherently uncertain exercise and we do not claim to possess superior skills to do so. Instead, our approach relies on using all available data and analytical tools to help us make a judgment on a relatively short next-12mo time horizon, and continue doing so as time progresses and new data becomes available. As such, we made a call that this cycle was unlikely to turn at this point last year. With all the evidence we accumulated since then, we believe this view still holds today.

Our latest update to the default rate model produced a 4.0% issuer-weighted forecast for the next 12mo – a material move higher from its previous range of 3.25-3.30% throughout most of this year (Figure 5). Continued volatility shocks have reached a point where their impact is now visible as a crack in the basement of this credit cycle. The 4.0% issuer default rate would translate to 2.5% dollar-weighted rate; these compare to actual last-12mo prints of 3.3% and 2.25% respectively, so noticeable increases in realized defaults as well.

In this context, we also continue to monitor the escalation in the longest component of our default model (9-12mo, the red line on Figure 6). This particular segment has an established track record of leading other components going into each previous episode of rising defaults in 2000-2001, 2007-2008, and 2013-2014. While still low in absolute terms, this measure has increased in each of the past nine months, and so it deserves close attention going forward.

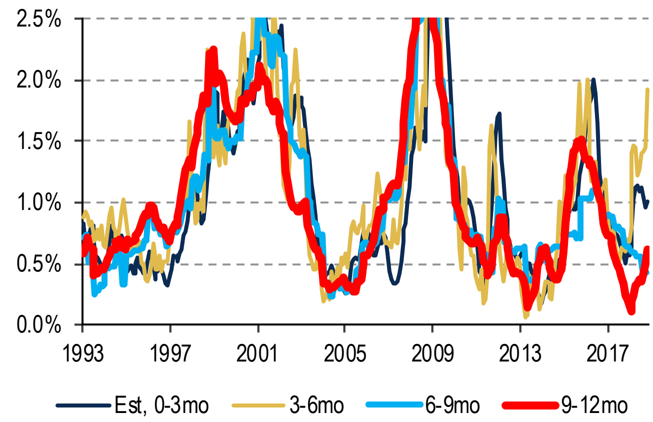
[1] We define the starting points of past credit cycles as following: Q4 1988: Drexel Lambert files for bankruptcy following a criminal conviction; Q1 2000: Tech bubble bursts; Q3 2007: Bear Stearns and BNP Paribas shut down mortgage funds; Q4 2014: OPEC's refuses to cut oil production in an effort to fight US shale competition.

Figure 5: Actual vs estimated 12mo HY issuer default rates



Source: BofA Merrill Lynch Global Research

Figure 6: Estimated default rates by time horizon



Source: BofA Merrill Lynch Global Research

Valuations and targets

Our models further translate these default expectations into a 390bps fair value spread level, in light of quantifiable liquidity conditions. Again, normally we would just use this as formal target, however we have decided to adjust this estimate higher. The model is yet to find out the latest developments in oil and GE and the shift in sentiment these events have created along the way.

In addition, volatility has set all-time lows in key asset classes in 2017 and then it shifted decisively higher in 2018 just as the Fed started rolling off its balance sheet, while the ECB and BOJ more than offset Fed's roll-downs with their purchases. As we described above, the aggregate central bank balance sheet is likely to start deflating next year for the first time since the GFC, and we think the implications of that volatility shocks could be more frequent and more significant.

This is not something we can easily model as the unwind of unprecedented policies is going to be, well, unprecedented. So we take an unusual step of adjusting our spread target wider over what our model indicates.

Taking all this into consideration, we set the new target for HY spread at 425bps, and importantly, we think the range around it is going to be wider going forward. This year we stayed +/-40bps around our spread target of 350bps most of the time. Next year, we think the range widens to +/-50..75bps, at least. Effectively, this means HY spreads could be peaking out around 500bps in this volatility episode, although we still expecting them to average 425bps in coming months.

Figure 7 below runs down our total/excess return scenarios based on credit loss and spread assumptions described above. Our base case relies on our rates team forecast of the 5yr Trsy to reach 3.25% yield by the end of next year. If HY OAS happens to be at 425bps at that point in time the index should produce +2.4% total and 1.0% excess return in that scenario. Note that realistically we are thinking about our spread target as the next meaningful level where it is likely to spend some time, not the Dec 31 level.

The low-rates column aligns more closely with our own thinking on rates where we would not be surprised to see the 5yr yield heading lower from here. This scenario ends up showing a 4.9% total return (excess is unchanged as it is a function of spread changes).

Another point to consider here is that realistically, if rates were indeed headed higher – as our rates team envisions – then we would envision HY spreads doing a little better than our base case.

Finally, as we described our thoughts on wider ranges, 2019 is not likely to be a year where you buy-and-hold-and-clip-the-coupon in HY. We think investors should remain nimble with their risk budgets: be prepared to add risk as spreads get wider and sentiment drops, but remain disciplined and lighten up into rallies. We probably will see prints of 500+ and under-400 in coming months.

Figure 7: Total/excess return scenarios

	Base-case	Lowe rates
HY OAS (actual)	433	433
HY OAS (target)	425	425
Change	-8	-8
5yr Trsy (acutal)	290	290
5yr Trsy (target)	325	265
Change	35	-25
Effective Duration	4.1	4.1
Capital gain from spread change	32	32
Capital gain from rates change	-142	101
Total capital gain	-109	134
Effective Yield	576	576
Default Rate	4.00	4.00
Assumed current price of future defaulters	90	90
Recovery rate	40	40
Credit Loss	222	222
Total Return	**2.4**	**4.9**
Excess Return	1.0	1.0

Source: BofA Merrill Lynch Global Research

Relative value

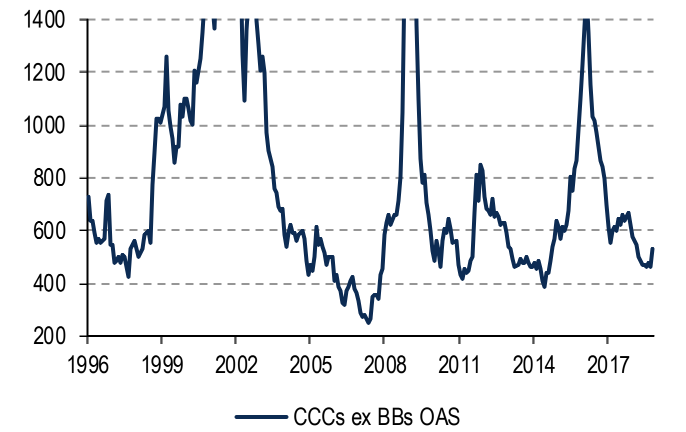
Quality positioning

Looking at valuations across US HY quality segments we note that recent underperformance in CCCs has pushed their valuations to less stretched levels. This segment was outperforming BBs by around 650bps in excess returns going into the Labor Day and since then the differential has compressed to 150bps. The spread between CCCs and BBs has also bottomed out at 14th percentile of its historical range in September, and has since moved out to the 30th percentile (Figure 8).

Our model for CCCs ex BBs return differential now points to a neutral expected performance between these two categories going into 2019 (Figure 9).

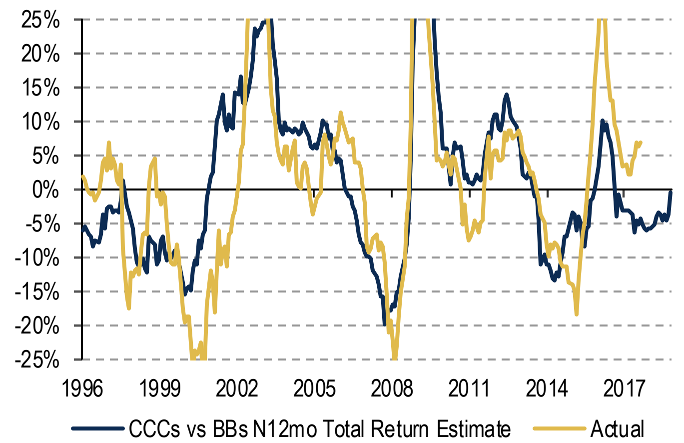
The conclusion from all these datapoints is simple: CCCs are now priced more attractively than they were just a couple of months ago. However, we still do not find them to be attractive enough to warrant returning them to a neutral weight. The 30th percentile on spread differential implies that they are still somewhat below historical median levels. The neutral expected performance differential implies that you are not being paid to take on materially higher credit risk.

Figure 8: CCCs ex BBs spread differential



Source: BofA Merrill Lynch Global Research

Figure 9: CCCs ex BBs total return differential + model estimate



Source: BofA Merrill Lynch Global Research

These two datapoints, coupled with what we believe to be a residual consensus overweight in CCCs to this day, tell us that it may be premature to return CCCs weight back to neutral. We recommend waiting for their valuations to normalize further, expected returns to offer some premium over higher quality, and the consensus positioning to clean out before adding risk in this segment. The 10% underweight in CCCs that we maintain here should be reallocated equally to BBs and single-Bs here.

In IG, Hans Mikkelsen thinks that higher Libor and tightening financial conditions are going to push US IG yields higher relative to non-USD assets, and expects 20-25bps wider spreads. He also points out that major global central bank monetary policy divergence could amplify this trend. Current valuations perhaps include a down payment on next year's spread widening.

Given our more benign view on rates we think IG could eventually benefit from lower rates pressures compared to the experience this year. But it needs to sort out the GE situation before the value proposition there becomes more defensible, in our opinion.

Loans

Loans have outperformed most other asset classes this year, helped primarily by the Libor component. Expectations of further increases in short-term rates should continue to stimulate loan demand for some time. We expect 2019 to be another year for competitive total returns in loans.

Neha estimates loan par default rates will climb 60bps to 2.5%, and recoveries will be lower than this year. She expects 2yr loan discount margins to average 440bps over the next 12 months, which is 40bps higher than the average this year. The range around the average will increase to 50-75bps from the current 20-30bps. Under these scenarios, loans could deliver returns of 4.2%-4.7% in 2019.

Overall, we think loans will continue to do well against HY in coming months for as long as consensus believes in the Fed remaining aggressive. The moment that belief gives way to realization that this is not going to be the case – as we expect it to – loans will probably feel the weight of poor credit quality/covenants that were previously masked by strong investor demand seeking shelter from the Fed.

Geographical positioning
In Europe, Barnaby Martin sounded appropriately cautious on credit markets going into the recent volatility episode, and he remains of the view that spreads will get wider as the whole macro and political backdrop is materially more complicated there. The EU HY market is priced somewhat better here today – at least it now offers 100bp premium over Italian 10yr. It previously traded right on top of Italy and it made little sense to us. So we like it a little more here, but we do think it will still struggle relative to US HY, in light of recent spread widening here.

EM HY was way ahead of US HY in this episode of repricing, and so it naturally fared better than US HY in recent weeks. Anne Milne expects fundamentals in those markets to improve going forward, which in combination with relatively wide spreads should produce continued outperformance. We share these views and continue to see somewhat better value in EM relative to US HY. Anne's biggest concerns are credit rating downgrades for Pemex and possibly Mexico (both still IG), so some similarities to US risks there as well.

Supply and demand

The slowdown in HY issuance is one of the surprises of this year. The perfect hindsight makes it look like an inevitability – with factors like rising rates, trade wars, and tax reform all contributing to this outcome. However this outcome was way out of consensus going into the year, and it caught us by surprise too.

So what can we learn from this experience going forward? Most importantly, we think the market remains generally open, i.e. most issuers who want to borrow can borrow on reasonable terms; there is just lack of appetite on both sides. This is not yet the case of demand drying up to an extent where financial conditions would become restrictive, although lack of appetite on the part of investors naturally leads to some degree of capital rationing, however modest at this stage.

What causes the lack of appetite on both sides? Investors appear to be most concerned about rising rates, and capital has flown towards floating rate instruments, including syndicated loans and private debt. Issuance has shifted away from bonds and towards loans, a process that was underway for a number of years, but the balance turned meaningfully negative only over the past twelve months. We accounted for at least $22bn in new money loan issuance in 2018 where borrowers are part of the HY index, a potential 10% to HY volume that never materialized.

Our model for HY issuance bottoms out at around $200bn annualized issuance pace over the next 12 months, although it shows a potential for a subsequent uptick later next year. Given that realized issuance has come in slightly below our model estimates over the past six months, we are making a qualitative adjustment and pencil down our formal forecast at $185bn to account for potential factors outside of our model scope.

Year 2018 is currently on pace towards $195bn full year issuance total (-28% vs FY 2017, if materialized), so our 2019 forecast could be another 5% off of this year's pace. At $185bn, the HY issuance would be the slowest since 2009, and 20% below its average over the past 10 years.

Switching gears to the demand side, YTD gross issuance of is running roughly $20bn ahead of redemptions, mostly as a function relatively strong calendar in Jan-Apr, so well behind us at this point. In 2019 we forecast calls, tenders and maturities to create $200bn in demand for the developed market USD HY product next year, exceeding our gross issuance forecast by 8.1%.

The last time redemptions exceeded issuance, briefly, was in early 2017. Prior to that, one will have to go back to 2012 and 2009 to find such instances. In other words, such a positive technical backdrop does not happen very often in our market, and we need to take this datapoint into account while sketching out our thoughts on valuations and performance next year. Technicals are likely to remain a supportive factor in the next few months; potentially even more so than what was the case since the early summer this year. Full details of our supply/demand forecast, including the discussion of model inputs and its track record, are available here.

Separately, we are forecasting a $410bn volume in broadly syndicated leveraged loan issuance next year, which would represent a similar 10% drop from this year's annualized pace of$450bn.

Disclosures

Important Disclosures

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