# The HY Wire

# A Minsky moment

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High Yield Strategy
Global


**Michael Contopoulos**
HY Credit Strategist
MLPF&S
+1 646 855 6372
michael.contopoulos@baml.com

**Michael John**
HY Credit Strategist
MLPF&S
+1 646 855 6743
michael.john@baml.com

**Neha Khoda**
Credit Strategist
MLPF&S
+1 646 855 9656
neha.khoda@baml.com

**Rachna Ramachandran**
Quant Rel Value Strategist
MLPF&S
+1 646 855 7927
rachna.ramachandran@baml.com


## Stability is destabilizing

Economist Hyman Minsky is famous for saying stability is destabilizing; a phrase we relate to given our disposition that QE dampened volatility and helped to create today's market gyrations. And despite the recent bout of strength, we don't think the worst is over for high yield. In fact, we expect spreads to widen well north of 1000bp sometime in 2017, consistent with past credit cycles. And given higher liquidity premiums and reduced dealer balances sheets, we wouldn't at all be surprised to see wider spreads than the 1991 and 2002 peaks. But despite a rough start to 2016, at some point high yield should become a buy, and below we discuss past cycles, when spreads reached their peaks, and what we expect in this cycle. Additionally, we discuss what we think could be catalysts to capitulation and our concerns of why high yield stress could matter for the broader economy and markets, relating today's environment to Irving Fisher's 1933 theory of debt deflation.

## Flows:

US high yield continued its outflow streak with $1.07bn (-0.6%) in net outflows last week, the 5th week of negative flows in the past 6 sessions. In terms of $AUM, the flows were evenly distributed between ETFs (-$620mn, -1.9%) and non-ETFs (-0.3%). Non-US high yield saw similar outflows last week, losing -$1.46bn or 0.6% AUM. This week's biggest loser in terms of %AUM was loans, which tallied -$567mn (-0.7%) in net outflows.

## Issuance:

Although the DM HY primary market began February on a positive note with $4.3bn priced in the first week, that glimmer of hope quickly faded as only $250mn was priced in a single offering for the week ended February 12th. Month-to-date, we have seen $4.54bn priced out of developed markets ($3.78bn from the US) to bring the year-to-date total to $10.21bn ($8.98bn from the US). Global loan issuance has gotten off to a better start this year than the HY primary market, though it still remains 33% behind last year's pace.

## Performance:

Within HY, BBs (-1.67%) outperformed, followed by single-Bs (-1.81%) and triple-Cs (-3.69%). All 18 of our US HY sector classifications finished last week in the red, though Energy (-7.92%) was by far and away the worst performer due to the S&P's announcement that they lowered their hydrocarbon price assumptions, and subsequently took ratings actions on 45 speculative grade Energy companies. Financials (-2.51%) were the 2nd worst performing sector, which fell in sympathy with European financials and heightened skepticism over the state of the US economy.

### Recent BofA Merrill Lynch Global Research Reports

| Title: Subtitle | Primary Author | Date Published |
|---|---|---|
| The HY Note: Chair Yellen, can you get the market off the hook? For old times' sake 11 February 2016 | Michael Contopoulos | 11 Feb 2016 |
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**Refer to important disclosures on page 16 to 17.**


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# The View From Above

## Closer, but still a ways to go

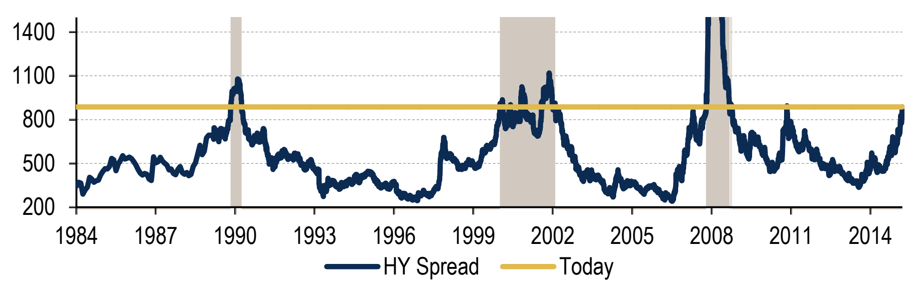
It is well known by now that we have been vocal believers that the end of the credit cycle started in the fall of 2014 when investor risk sentiment changed from one where they didn't want to sell bonds for the fear of not being able to buy them back, to one where they wanted to sell anything that wasn't a core long-term holding for the fear of not being able to sell them later. In hindsight, this also represented the time when the Fed effectively took a big step in tightening financial conditions, as the end of QE loomed and divergent central bank policy created significant dollar strength.

And after turning bearish, fundamentals have deteriorated, geopolitical risk has increased, liquidity remains challenging, energy continues to falter and the market has lost over 10% and continues to falter. Despite the price action in high yield reflecting our bearish call though, we don't view our forecast as hitting the mark until we see an unwind of the credit excesses developed during the post GFC QE fueled corporate debt bubble - likely meaning a pickup in defaults and a contraction of credit.

However, there will be a time where the darkest days are still ahead, both for the economy and default rates, yet we envision saying, "Buy". And in some single names, that time presents itself daily. At the market level, though, we are only partly through what we believe will be a difficult environment not only for high yield, but quite possibly broader markets and economies. As such, we expect spreads to widen well north of 1000bp sometime in 2017, consistent with past credit cycles. And given higher liquidity premiums and reduced dealer balance sheets, we wouldn't at all be surprised to see wider spreads than the 1991 and 2002 peaks.

To this end, the market already appears to be in a higher spread environment than past cycles. For example, the low in spread this cycle was 336bp versus 289bp in 1985, 251bp in 1997 and 241bp in 2007 or 45bp, 85bp and 95bp higher than the tights of the last 3 cycles. If we downplay the 2009 peak spreads as an anomaly, and focus instead on those reached during the 1990 and 2000 default cycles, it seems reasonable to expect peak spreads to be 50-100bp higher than what was experienced in 1991 and 2002. This would imply that spreads could increase to between 1130bp and 1230bp at the height of this cycle. Assuming Materials and Energy paper remain unchanged, this implies non-commodity paper at a spread of 1050bp to 1150bp (versus 720bp today). If we are correct that the turn is upon us, better entry points to buy the market could present themselves in the 2nd half of 2016 and into 2017.

**Chart 1: In past cycles, spreads remained above today's for up to 2 years before stabilizing lower**




Source: BofA Merrill Lynch Global Research
Note: Gray shading represents recessions

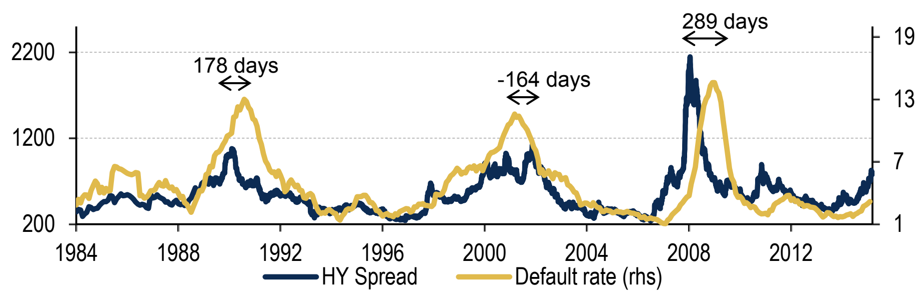
## The shape of the cycle matters

Despite our bearish views, however, we don't question the viability of the product but rather the optimal entry. Why buy now if there could still be another 10-20 points of loss? At what point should an investor be willing to absorb near-term mark to market pain, while not feeling like the longer term investment was a poor decision? Based on the potential that a high yield investor could still see a positive annual return for the next 5 years even under the most dire default scenarios, some may say that point is today. However, that's not unlike all default cycles, each of which priced in higher losses than what the market is reflecting today.

With a view that the market will eventually price in a much worse default environment than it is currently, we are left trying to determine when peak spreads will occur and for how long they will last. Unfortunately, when peak spreads are reached is not consistent across time periods, making it difficult to time the optimal entry. For example, in 1989 spreads peaked 178 days **before** the default rate peaked, in 2002 it was 165 days **after**, and in 2008 it was 290 days **before** (Chart 2). Convoluting the picture today is that the Energy default rate has the potential to skew that of the overall market. For example, if high yield E&P companies realize a 50% default rate this year and the rest of Energy experiences a 25% default rate, the Energy component of the market default rate could be nearly 6ppt. If the rest of the market experiences just a 4ppt rate, the market could realize double digit default rates in 2016, despite a relatively benign non-commodity contribution.

In our opinion, however, we think the biggest issue in the market is the buildup of corporate leverage without a place for it to go. And what will likely cause peak spreads is not an increase in defaults, but a capitulation moment that creates a rush for the exits. In this way, we think the 1989 and 2008 cycles are more representative of what we could see this go around, as max spreads occur before the highest defaults - whether that is in 2016 or 2017 will depend on the timing of the catalyst (noted below).

**Chart 2: Historically, there has been little consistency as to when markets price in the worst of a cycle**

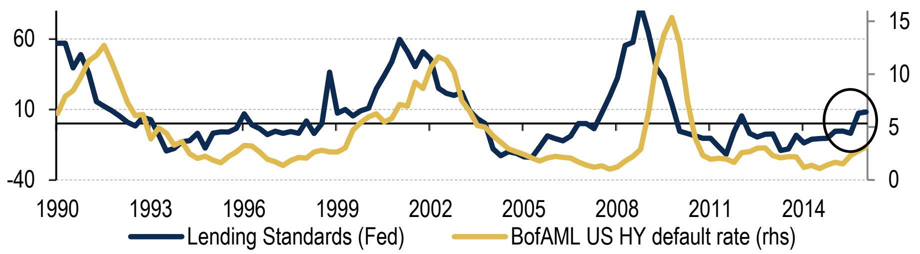



Source: BofA Merrill Lynch Global Research, Moody's

## Stability is destabilizing

While we believe the market will realize peak spreads sometime within the next 12 to 24 months, we continue to be very concerned about lending conditions and the effect of a low risk tolerance at banks - coupled with high market vol and global growth uncertainty - leading to a potential credit crunch. With European banks under siege and US banks' share prices faltering, we continue to expect low high yield issuance and a tightening of lending standards. As we wrote in a recent HY Note, companies don't default because of impending maturities, but instead because at some point in the credit cycle their access to funding dries up (Chart 3). And as regional banks yanked the leash tighter in what now amounts to two quarters of tightening lending standards in a row, we could envision a world where enterprises find it harder to acquire financing and widespread defaults may occur, even outside of commodities.

**Chart 3: The net percent of banks tightened lending standards for the 2nd consecutive period**



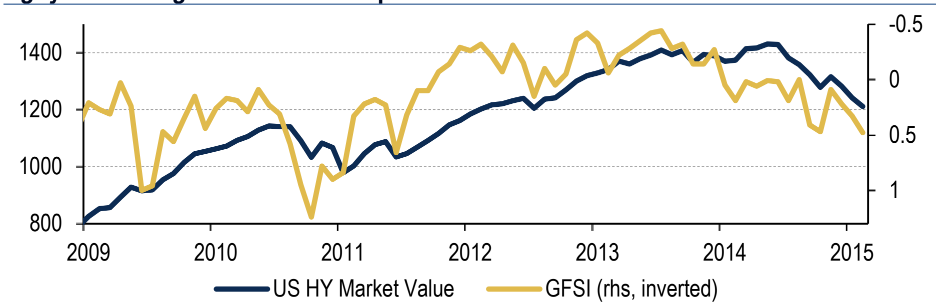

Source: BofA Merrill Lynch Global Research, Federal Reserve

Although the C&I lending survey shows lending loosened for consumers and was more industry specific - that is what happened in the past. Just like within markets, the weakest links go first: commodities, high yield, etc. before the exogenous shocks take the broader and stronger segments down. The fact is one has never seen a period of 2 quarters where there was an increase in the percentage of banks reporting a tightening of lending standards where it's turned back to loosening. Further, never have we seen that and have it not ultimately lead to a default wave.

We've often used the 1999-2002 period to show similarities to today, but two big differences from the late 1990s were that rates were significantly higher and GDP growth was much stronger than now. With more of a cushion to absorb a blow from external forces, the economy and markets were better able to handle shocks like Russia and LTCM. Additionally, it seems as though the issues of the late 90s, which were spread across years, are all combined today:  Emerging market weakness, a collapse in oil prices, a high yield bubble collapse, weak inflation, and an equity market that was largely defined by strength, in just a few.

These factors together bring us to the conclusion that what we are seeing in markets today is much more than just a high yield story. As Hyman Minsky wrote years ago, stability is destabilizing, and after a prolonged period of a central bank put, we are now witnessing the consequence of years of artificially depressed volatility and risk taking.

**Chart 4: As global volatility deteriorated (reflected in the Global Financial Stress Index below), the high yield market grew both in size and price**

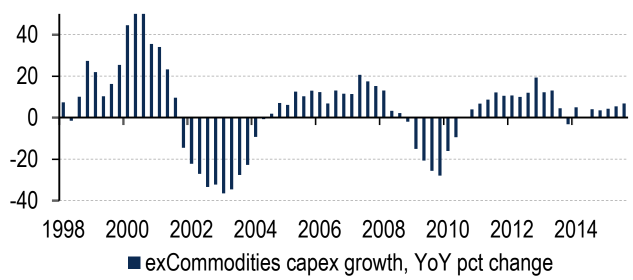



Source: BofA Merrill Lynch Global Research

Although we have argued for some time that what matters to market performance is underlying fundamental growth, we have further argued that should high yield be the canary in the coal mine for earnings and the macro economy, the ensuing crisis is likely to be one defined by the excessive credit creation in the corporate market. Should a market meltdown be accompanied with a lack of inflationary pressure, the credit creation of the last 5 years will likely be met with a period of significant credit destruction.

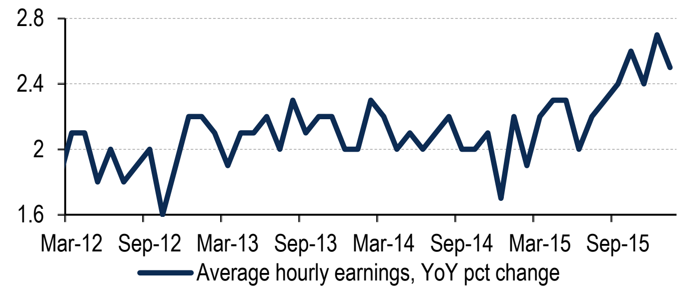
And in a world where corporate balance sheets are arguably the most unhealthy they have ever been (all-time high leverage in HG and HY) where companies have relied on cheap debt to fund a growth through acquisition strategy, what happens if funding is either unavailable or too expensive to make a growth through acquisition strategy make sense? Same goes for buybacks and special dividends? Then one would have to cut capex. But with little capex to cut (Chart 5), personnel could be cut next (particularly if those people are beginning to cost more, Chart 6). And when coupled with a consumer that is already saving 5.5% of disposable income, should we see layoffs amidst an already low GDP, poor CEO confidence, and banks that are risk averse and perhaps hurting with commodity exposure, things could potentially get messy in such a scenario.

**Chart 5: Even ex-commodities, capex growth has been anemic**




Source: BofA Merrill Lynch Global Research

**Chart 6: Wage growth is finally starting to pick up**

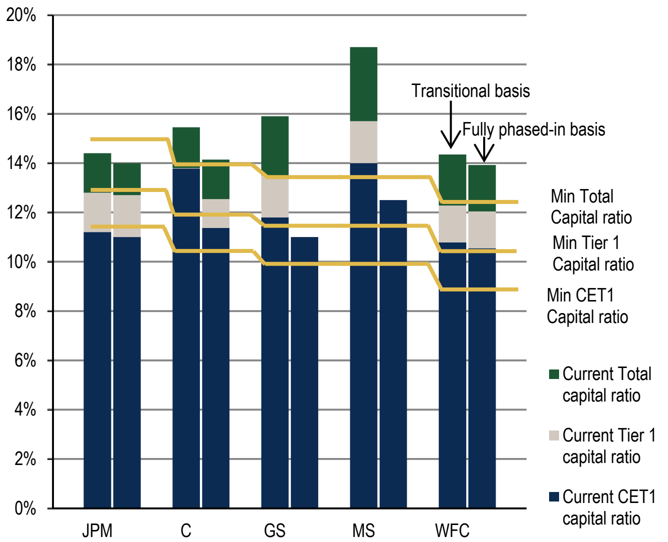



Source: Bloomberg

## Debt deflation

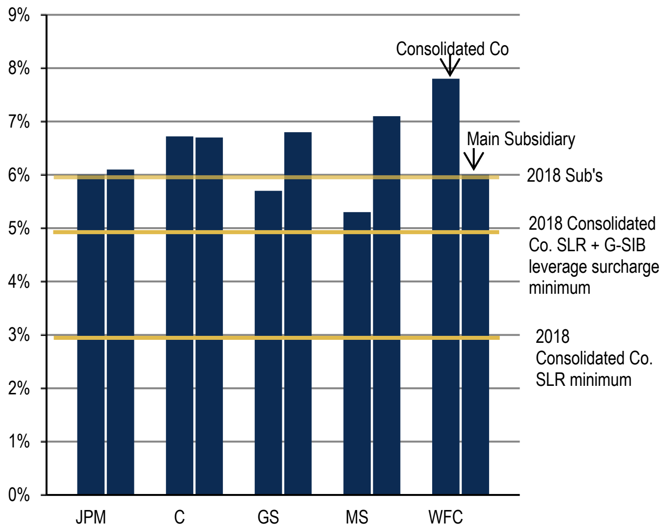
Although credit markets are perhaps only interesting to the broad investor base once every 5-7 years, it should not be lost on people that the Fed's number one priority in the wake of the GFC was to get credit flowing again. The free flow of credit runs economies and can subsequently destroy them; particularly when credit deterioration causes banks to collapse. Luckily, our high grade bank analyst, Hima Inguva, does not think there is any imminent danger to the banking system within the US. Chart 7 and Chart 8 show how well banks are currently capitalized relative to pre-crisis levels. Regardless, all banks were well capitalized as of Q2 2015 and after 10ks are out, we think that will probably show even more so today.

**Chart 7: G-SIBs are well-capitalized today**




Source: BofA Merrill Lynch Global Research
Minimum capital ratios for 2019

**Chart 8: G-SIBs are well-capitalized today**




Source: BofA Merrill Lynch Global Research

However, although the Fed succeeded in opening capital markets and recapitalizing the banks, we believe the ensuing corporate debt binge in the face of weak CEO confidence and poor earnings growth was probably far in excess of what was intended or desired. What we have been left with, then, is an inflated credit market that has to contract at some point in time; not only in price, but also in size. To this end, depression era economist Irving Fisher's theory as to the length and severity of the Great Depression has several relevant aspects to today's corporate market. This, coupled with Hyman Minsky's view on risk taking and American capitalism and the idea of a deflationary debt spiral which can only be cured through credit destruction or a reflation of asset prices, becomes incredibly relevant in today's world. Perhaps the cure for such ills could be future QE or further easing of monetary policy should macro fundamentals deteriorate further or if the Fed sees the need to stem a financial meltdown (as noted by our economists).

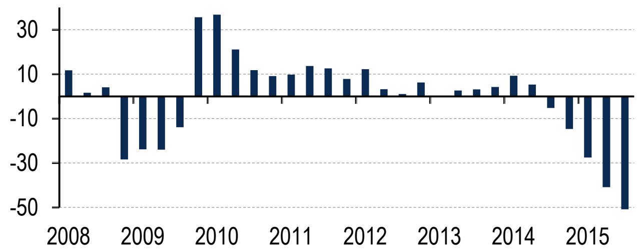
One of Fisher's key tenets is that economic changes include steady trends and unsteady occasional disturbances, which act as starters for cyclical oscillations of innumerable kinds. Over the last 8 years, the market realized steady growth both in size and value. Tightening spreads and rising equity markets were matched with falling unemployment, rising home prices, and an improvement in consumer and bank balance sheets. And as technology improved, US shale companies moved the country on a path towards energy independence. Perhaps less obvious, monetary policy created disturbances that caused a shift in investor risk sentiment. With a cyclical search for yield, issuers of all types of debt could finance growth through acquisition strategies.

Additionally, Fisher wrote that among the many occasional disturbances are new opportunities to invest, especially because of new inventions, and that these, with other causes, sometimes conspire to lead to a great volume of over-indebtedness. The excitement and promise of an energy revolution seemed to have created heightened investment in high yield debt and the associated infrastructure to support and maintain the industry.

But perhaps the biggest innovation of the post-GFC years, and potentially the most detrimental and levering, was the massive increase in the Fed's balance sheet on the back of quantitative easing. As the Fed's financial engineering created a lack of yield globally, opportunities to invest in corporate debt abounded both within the US and globally. Although consumer and bank balance sheets have been repaired, the post-GFC easy monetary world created an unsustainable thirst for corporate debt that earnings growth never supported (Chart 9 and Chart 10).

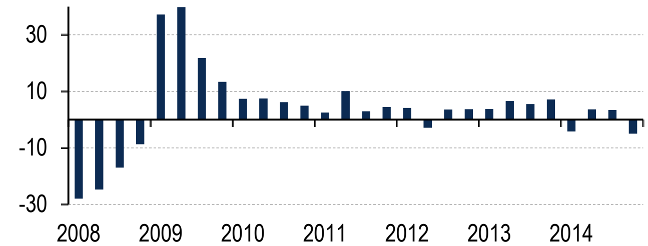
Herein lies our concern for markets and where the fear of a Fisherian debt deflation spiral can become worrisome. Although it is unlikely that the corporate market is enough to cause outright deflation, certainly a corporate credit bust can create disinflation or enhance deflation if it already exists. As liquidation leads to falling prices, dollar strength causes the very debt that needs to be paid down all the larger. Liquidation leads to defaults and layoffs, which, in a post-Volcker world, would likely cause banks to pull back on lending even further. The lack of lending coupled with job losses could create a weak consumer, which would further propagate a negative feedback loop to corporate earnings and further liquidation. Although we stress that this is not the scenario our economists envision for the US economy, we think attention needs to be paid to the potential impact credit markets can have on the macro economy, should the debt deflation cycle kick off. And perhaps one of the below catalysts to capitulation is what we should be looking out for as the trigger to such a sequence of events.

**Chart 9: US HY EBITDA growth has not supported corporate debt growth**




Source: BofA Merrill Lynch Global Research

**Chart 10: Even ex-Commodities, earnings growth has been anemic**




Source: BofA Merrill Lynch Global Research

## Potential catalysts to capitulation

With the stage set for debt deflation, we outline several events we believe could cause a rush for the exits, push spreads north of 1000bp and begin to create a compelling entry point for the overall market.

### Bankruptcies

Last summer, we wrote that now is the time in a credit cycle where scandals could begin to surface, and cracks in complex and large institutions begin to show. Although we have already seen news from several issuers cause sharp selloffs within the last 12 months (Valeant and VW over alleged fraud, Sprint due to a surprise downgrade, Glencore after announcements to shore up its balance sheet), we haven't yet seen a shock that has caused a name to suddenly jump to default. We worry that a large bankruptcy could be too much to bear and cause significant disruptions throughout the broader market. As we consider the possibility, we are reminded of past company examples and believe a market moving event would not only have to be a very big default, but also a surprise and probably an IG company as well.

### Policy missteps

Another catalyst to capitulation could be a policy misstep, possibly, though unlikely, by the US government, and perhaps more probably, by the Chinese government. Although we have spoken about the risks from China since late 2014, we didn't fully appreciate the challenges that China faced in structuring policy responses to a slowing economy in a relatively more market friendly way. Last August's devaluation and this year's stock market circuit breaker situation have left us seeing greater risks in China's ability to manage its slowdown without disruption.

### Significant Financial Disruptions

Lastly, we worry that over the next 12 months we could see some sort of financial problem; defined broadly as a sovereign default, large hedge fund collapse, regional banking problem, a large mutual fund gating, or large foreign bank failure, etc. With Brazil and Venezuela seeing greater risk, an EM default may be anticipated, but could also have consequences that are far reaching and not yet understood. It is easy to construct a scenario reminiscent of 2007 where a large hedge fund had the wrong currency or commodity trade on and realized mass redemptions. Further, with the commodity rout deepening, it becomes easy to envision smaller regional banks suffering severe losses and provisioning, causing perhaps a panicked reaction among the smaller banking institutions in the US. Alternatively, with recent news flow on various European banks and concerns of potential bail-in, should a large foreign bank suffer significant losses or troubles, we think there is the risk that fears (even if overblown) could create a panic among credit investors. Finally, the catalyst could come from the credit asset class itself. Should a large loan or high yield mutual fund realize significant redemptions, ultimately bringing about a gating event, we could envision retail pulling money from the asset class at an accelerated clip, potentially causing a severe repricing of and possibly freezing of capital markets.

### Weekly Recap

US HY widened 53bps on a WoW basis to deliver a -1.93% return, bringing the asset class' YTD performance down to -4.70%. This was the 3rd worst performance amongst asset classes, behind EM equities and EU HY. Yields widened beyond 10% for the first time since October 2009 while OAS is 23bps away from breaking the 900-handle. HY ex-Energy experienced similar carnage last week with a -1.17% return, while YTD performance currently stands at -2.85%. US HY continued its outflow streak with $1.07bn (-0.6%) in net outflows last week, the 5th week of negative flows in the past 6 sessions. The primary market was closed for all but one issuer to price a $260mn offering, bringing YTD issuance out of the United States to $8.98bn.

**Table 1: Spreads, yields, and returns**

| Index | OAS | 1W-Chg | 1M-Chg | YTW | WoW Return | YTD Return |
|---|---|---|---|---|---|---|
| US HY | 877 | 53 | 114 | 10.09 | -1.93% | -4.70% |
| ex-Energy | 757 | 42 | 92 | 8.90 | -1.17% | -2.85% |
| ex-Materials | 853 | 53 | 118 | 9.86 | -1.96% | -4.72% |
| ex-E&M | 720 | 41 | 95 | 8.53 | -1.15% | -2.71% |

Source: BofA Merrill Lynch Global Research

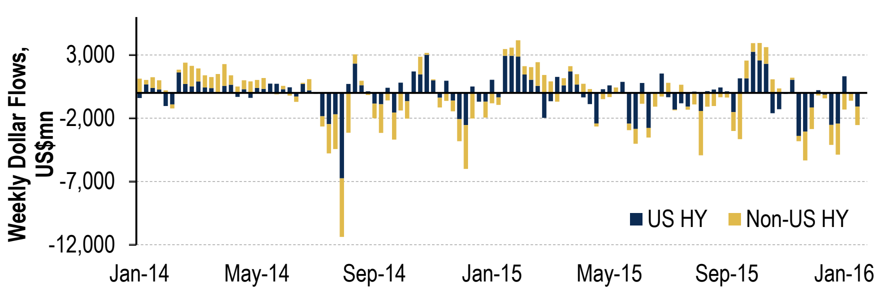
# Flows

This is an excerpt from our recently published report: The High Yield Flow Report: Outflows for HY continue 11 February 2016

US high yield continued its outflow streak with $1.07bn (-0.6%) in net outflows last week, the 5th week of negative flows in the past 6 sessions. In terms of $AUM, the flows were evenly distributed between ETFs (-$620mn, -1.9%) and non-ETFs (-0.3%), although the former lost more on a %AUM basis as it represents a smaller size of the overall market. Driving the outflows was the continued risk-off environment that has encapsulated all of 2016 and caused high yield to lose 4.07% on a total return basis thus far. YTD, US high yield has experienced -$4.93bn (-1.7%) in net outflows, nearly half of what the asset class experienced in 2015.

Non-US high yield saw similar outflows last week, losing -$1.46bn or 0.6% AUM. This week's biggest loser in terms of %AUM was loans, which tallied -$567mn (-0.7%) in net outflows for its 15th consecutive weekly outflow. EM debt (-$1.07bn, -0.4%) and equities (-$1.73bn, -0.0%) also recorded outflows last week. The up-in-quality trade continued to manifest itself through inflows into high grade (+$470mn, +0.0%), munis (+$857mn, +0.2%), and money markets (+$3.49bn, +0.1%) last week, as has been the case for all of 2016. Fixed income funds as a whole also saw a minor $919mn (+0.0%) net inflow, due to large inflows into government bond funds.

**Chart 11: Global HY flows distributed between US-domiciled and non US-domiciled funds**




Source: BofA Merrill Lynch Global Research, EPFR Global

# New Issue Roundup

## Bonds

Although the DM HY primary market began February on a positive note with $4.3bn priced in the first week, that glimmer of hope quickly faded as only $250mn was priced in a single offering for the week ended February 12th. Month-to-date we have seen $4.54bn priced out of developed markets ($3.78bn from the US) to bring the year-to-date total to $10.21bn ($8.98bn from the US). This is nearly 80% behind the pace set in 2015, though it is important to remember that 2015 issuance began the year on a rapid pace before fizzling out in May/June. This year, 43% of the issuance has been BB-rated, while 47% was B-rated and 10% rated triple C. A new regime of heightened volatility, combined with poor secondary performance and a general risk-off investor sentiment, has made it too costly for all but the highest quality companies to issue new paper. Case in point, nearly half of this year's US issuance can be attributed to just 2 issuers (Charter Communications and Centene Corporation for a combined $4.1bn).

**Table 2: DM issuance summary ($bn)**

| | DM | United States | Europe | BB | B | CCC/NR |
|---|---|---|---|---|---|---|
| WTD Feb 12 | 0.3 | 0.3 | 0.0 | 0.0 | 0.3 | 0.0 |
| Wk Feb 05 | 4.3 | 3.5 | 0.8 | 0.7 | 2.8 | 0.8 |
| Wk Jan 29 | 3.4 | 3.1 | 0.0 | 2.8 | 0.3 | 0.3 |
| Wk Jan 22 | 1.3 | 1.3 | 0.0 | 0.8 | 0.5 | 0.0 |
| | | | | | | |
| MTD Feb | 4.5 | 3.8 | 0.8 | 0.7 | 3.1 | 0.8 |
| January | 5.7 | 5.2 | 0.2 | 3.6 | 1.8 | 0.3 |
| December | 6.0 | 5.0 | 0.6 | 4.0 | 2.0 | 0.0 |
| November | 25.8 | 22.3 | 3.4 | 16.0 | 9.2 | 0.6 |
| | | | | | | |
| YTD 2016 | 10.2 | 9.0 | 0.9 | 4.3 | 4.8 | 1.1 |
| YTD 2015 | 49.3 | 28.8 | 19.4 | 15.6 | 27.6 | 6.0 |
| 2015 | 308.6 | 215.8 | 75.2 | 117.8 | 152.2 | 38.5 |
| 2014 | 376.0 | 238.8 | 119.5 | 129.9 | 186.8 | 59.2 |
| 2013 | 378.3 | 270.3 | 91.5 | 128.8 | 172.4 | 77.2 |

Source: BofA Merrill Lynch Global Research

**Table 3: Month-to-date HY bond issues**

| Pricing Dt | Name | Size ($) | Snr | Cpn | Maturity | Price | Yield | Moody's | S&P | Type | Sector | Region |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 2/8/2016 | MTW Cranes | 260 | Sr Sec Nts | 12.75 | 8/15/2021 | 95.32 | 14.00 | B1 | B+ | 144A w/RR | Machinery | United States |
| 2/5/2016 | Onorato Armatori | 335 | Sr Sec Nts | 7.75 | 2/15/2023 | 100.00 | 7.75 | Ba2 | BB- | 144A w/RR | Transportation | Europe |
| 2/5/2016 | Manitowoc Foodservice Companies Inc | 425 | Sr Nts | 9.50 | 2/15/2024 | 100.00 | 9.50 | Caa1 | B | 144A w/RR | Machinery-Diversified | United States |
| 2/4/2016 | Vizient Inc | 600 | Sr Nts | 10.38 | 3/1/2024 | 100.00 | 10.38 | Caa1 | CCC+ | 144A w/RR | Commercial Services | United States |
| 2/4/2016 | Charter Communications Inc | 1700 | Sr Nts | 5.88 | 4/1/2024 | 100.00 | 5.88 | B1 | BB- | 144A w/RR | Media | United States |
| 2/4/2016 | Acadia Healthcare Co Inc. | 390 | Sr Nts | 6.50 | 3/1/2024 | 100.00 | 6.50 | B3 | B | 144A w/RR | Healthcare-Services | United States |
| 2/3/2016 | Labeyrie Fine Foods SAS | 89 | Sr Sec Nts | 5.63 | 3/15/2021 | 99.75 | 5.63 | | B | 144A w/RR | Food | Europe |
| 2/2/2016 | Alliance Automotive Group | 76 | Sr Sec Nts | 6.25 | 12/1/2021 | 102.25 | 5.79 | B2 | B+ | 144A w/RR | Distribution/Wholesale | Europe |

Source: BofA Merrill Lynch Global Research

The single pricing last week came from Manitowoc Cranes in a $260mn offering of single-B senior secured notes. The 5.5 year bonds offer a coupon of 12 ¾, but were issued at a discounted price of 95.32 to yield 14%. This is significantly above the current single-B yield to maturity of 10.18%. In order for the deal to get completed, the maturity was decreased to 5.5 years from 8 years and stricter covenants were implemented than what was originally shopped, according to the High Yield Daily. The Wisconsin based crane manufacturer plans to use the proceeds to help repay all of its existing notes due in 2020 and 2022, as well as to repay and terminate its revolver and term loan and certain other debt of its subsidiaries. The prior business day, sister company Manitowoc Foodservice priced a $425mn issue of 9.5% 8-year senior notes that will be used to pay a $1.38bn cash dividend to Manitowoc ParentCo.

**Table 4: 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 |
| 10/16/2015 | 1,000 | 1,000 | | | | 1,000 | | | | | 1,000 | | | | 1,000 |
| 10/23/2015 | 1,926 | 776 | | 1,150 | | 1,650 | 276 | | | | 1,726 | 200 | 1,136 | 790 | |
| 10/30/2015 | 6,312 | 1,750 | 4,300 | 262 | | 6,050 | 262 | | | | 6,312 | | 2,162 | 3,400 | 750 |
| 11/6/2015 | 15,715 | 9,694 | 5,721 | 300 | | 13,650 | 2,065 | | | 4,037 | 11,278 | 400 | 10,965 | | 4,750 |
| 11/13/2015 | 4,303 | 1,830 | 2,150 | | 323 | 3,675 | 323 | 305 | | 405 | 3,898 | | 2,473 | 750 | 1,080 |
| 11/20/2015 | 5,486 | 4,506 | 980 | | | 5,486 | | | | 1,030 | 3,706 | 750 | 1,980 | | 3,506 |
| 11/27/2015 | 300 | | 300 | | | 300 | | | | | 300 | | 300 | | |
| 12/4/2015 | 5,196 | 3,515 | 1,681 | | | 3,600 | 1,165 | 431 | | 431 | 4,765 | | 5,196 | | |
| 12/11/2015 | 791 | 462 | 329 | | | 225 | 566 | | | 566 | 225 | | 791 | | |
| 1/8/2016 | 450 | | 450 | | | 450 | | | | | 450 | | 450 | | |
| 1/15/2016 | 512 | | 512 | | | 350 | 162 | | | | 512 | | 512 | | |

**Table 4: 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 |
| 1/22/2016 | 1,300 | 775 | 525 | | | 1,300 | | | | | 1,300 | | 525 | 775 | |
| 1/29/2016 | 3,400 | 2,800 | 300 | 300 | | 3,400 | | | | 300 | 3,100 | | 3,400 | | |
| 2/5/2016 | 4,283 | 735 | 2,792 | 756 | | 3,515 | 768 | | | 1,011 | 3,271 | | 4,283 | | |
| 2/12/2016 | 260 | | 260 | | | 260 | | | | 260 | | | 260 | | |

Source: BofA Merrill Lynch Global Research

## Loans

Global loan issuance has gotten off to a better start this year than the HY primary market, though still remains 33% behind last year's pace. Year-to-date, we have seen \$20.02bn in global loan issuance (all from the US), compared to \$29.26bn at this point in 2015 (\$23.82bn from the US). Last week, we saw 5 companies tap the primary market for a combined \$2.92bn, the 2nd lightest week this year behind the previous week's \$1.55bn. For similar reasons to the HY primary market, loan issuance is below historical levels. However, the leveraged loan market has not been as heavily impacted by heightened volatility and risk averse investor sentiment because of the asset class' higher quality nature.

**Table 5: Global loan issuance over time ($bn)**

| | Global | BB | B | CCC/NR | Cov lite | 2nd lien |
|---|---|---|---|---|---|---|
| WTD Feb 12 | 2.9 | 2.9 | 0.3 | 2.6 | 0.0 | 2.4 |
| Wk Feb 05 | 1.6 | 1.6 | 1.0 | 0.5 | 0.1 | 0.0 |
| Wk Jan 29 | 3.9 | 3.9 | 1.0 | 3.0 | 0.0 | 1.9 |
| Wk Jan 22 | 2.0 | 2.0 | 2.0 | 0.0 | 0.0 | 2.0 |
| | | | | | | |
| MTD Feb | 4.5 | 4.5 | 1.3 | 3.1 | 0.1 | 2.4 |
| January | 15.6 | 15.6 | 5.6 | 9.4 | 0.5 | 11.4 |
| December | 6.6 | 6.3 | 4.8 | 1.7 | 0.1 | 5.8 |
| November | 21.5 | 10.1 | 16.0 | 5.2 | 0.4 | 15.8 |
| | | | | | | |
| YTD 2016 | 20.0 | 20.0 | 6.9 | 12.5 | 0.6 | 13.8 |
| YTD 2015 | 29.3 | 23.8 | 10.3 | 16.2 | 2.8 | 21.5 |
| 2015 | 257.9 | 214.7 | 119.6 | 127.2 | 11.0 | 186.4 |
| 2014 | 379.4 | 320.7 | 109.5 | 218.3 | 51.6 | 267.1 |
| 2013 | 454.9 | 389.9 | 152.8 | 261.7 | 40.4 | 279.1 |

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

**Table 6: New issue breakdown by week, last 15 weeks**

| | | Ratings | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Total | BB | B | CCC | NR | TLb | 2nd Lien | Cov Lite |
| 10/23/2015 | 1,727 | 0 | 1,727 | | | 1,727 | | 1,420 |
| 10/30/2015 | 8,120 | 4,050 | 4,070 | | | 8,120 | | 8,120 |
| 11/6/2015 | 16,288 | 13,065 | 2,958 | 265 | | 16,023 | 265 | 12,698 |
| 11/13/2015 | 2,910 | 1,530 | 1,380 | | | 2,910 | | 1,374 |
| 11/20/2015 | 1,810 | 1,050 | 650 | 110 | | 1,700 | 110 | 1,410 |
| 11/27/2015 | 80 | 0 | 80 | | | 80 | | |
| 12/4/2015 | 6521 | 5046 | 1385 | 90 | | 6431 | 90 | 5761 |
| 12/11/2015 | 490 | 100 | 390 | | | 465 | 25 | 380 |
| 12/18/2015 | 0 | 0 | | | | 0 | | |
| 1/8/2016 | 5,800 | 1,035 | 4,265 | 500 | | 5,300 | 500 | 4,765 |
| 1/15/2016 | 3,810 | 1,600 | 2,210 | | | 3,810 | | 2,645 |
| 1/22/2016 | 2,035 | 2035 | | | | 2,035 | | 2,035 |
| 1/29/2016 | 3,905 | 955 | 2,950 | | | 3,905 | | 1,930 |
| 2/5/2016 | 1,554 | 989 | 480 | 85 | | 1,469 | 85 | |
| 2/12/2016 | 2,918 | 300 | 2,618 | | | 2,918 | | 2,415 |

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

Last week, we saw \$2.9bn in global loan issuance, all of it coming from the United States. As has been the case for nearly 9 months now, the issuance was concentrated in the double and single B buckets, with no triple-C loans priced last week. The largest offering was a \$1.9bn term loan from Solera Holdings Inc., the largest tranche pricing since MedAssets Inc \$2.53bn term loan on January 6th. The provider of risk and asset management software plans to use the proceeds to help fund the LBO buyout of Vista Equity Partners that was announced in September 2015. The acquisition is set to close later this quarter.

Also of note, Noranda Aluminum Inc issued \$35mn of DIP financing on February 8th after the company filed voluntary petitions for Chapter 11 restructuring. Although the company has only received \$35mn in commitments, Noranda has requested up to \$130mn in DIP financing. The aluminum producer has suffered from continued commodity price declines and has requested additional time and financial flexibility to evaluate options for its existing business operations.

**Table 7: Recent leveraged loan new issues**

| Launch Dt | Issuer | Deal Name | Size ($) | New Inst. Money ($) | Moody's | S&P | Asset Backed | Cov Lite | Proceeds | Sector | Country |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 2/10/2016 | Alpha Media | Alpha Media (3/16) | 265 | 265 | NR | NR | No | No | Acquisition | Radio | United States |
| 2/10/2016 | GCA Services Group Inc | GCA Services (TL 3/16) | 515 | 515 | B1 | B | No | Yes | LBO | Services & Leasing | United States |

**Table 7: Recent leveraged loan new issues**

| Launch Dt | Issuer | Deal Name | Size ($) | New Inst. Money ($) | Moody's | S&P | Asset Backed | Cov Lite | Proceeds | Sector | Country |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 2/9/2016 | Solera Holdings Inc | Solera (TL 3/16) | 1900 | 1900 | Ba3 | B | No | Yes | LBO | Computers & Electronics | United States |
| 2/8/2016 | MedRisk | MedRisk (3/16) | 228 | 203 | Ba3 | B | No | No | LBO | Healthcare | United States |
| 2/8/2016 | Noranda Aluminum Inc | Noranda Aluminum (DIP TL 3/16) | 35 | 35 | NR | NR | No | No | DIP | Metals & Mining | United States |
| 2/4/2016 | Kraton Performance Polymers Inc | Kraton Polymers (3/16) | 878 | 878 | NR | NR | No | No | Acquisition | Chemicals | United States |
| 2/4/2016 | Caliber Collision | Caliber Collision (Add-on TL 3/16) | 111 | 111 | NR | NR | No | No | Acquisition | Automotive | United States |
| 2/3/2016 | Lago Resort & Casino | Lago Resort (2nd Lien 3/16) | 85 | 85 | Caa2 | CCC+ | No | No | Project Financing | Gaming & Hotel | United States |
| 2/3/2016 | Lago Resort & Casino | Lago Resort (3/16) | 240 | 240 | B2 | B+ | No | No | Project Financing | Gaming & Hotel | United States |
| 2/3/2016 | Vivid Seats Ltd | Vivid Seats (3/16) | 240 | 240 | B2 | B | No | No | LBO | Film | United States |
| 2/3/2016 | Vivid Seats Ltd | Vivid Seats (3/16) | 240 | 240 | B2 | B | No | No | LBO | Film | United States |

Source: BofA Merrill Lynch Global Research

# Performance Summary

Performance continues to be driven by quality as 5yr treasuries and munis (+0.25%) tied for last week's best performing asset classes. Influenced by lower oil prices, poor earnings results from European financials, and uncertainty over central bank monetary policy, investors have become more risk averse and piled their money into lower yielding but safer asset classes. US HY tied for last week's 2nd worst performing asset class, behind only EM equities (-3.84%). EM equities also take the top spot for the worst performer YTD with a -10.44% return. The only asset classes to deliver positive returns last week were either governments or government-guaranteed as all corporates finished in the red (Table 8).

Within ratings buckets, quality continued to outperform across the corporate spectrum. AAAs (+0.56%) were the best performing ratings bucket, though IG as a whole still lost 0.23% thanks to a -0.48% return from BBBs. Within HY, BBs (-1.67%) outperformed, followed by single-Bs (-1.81%) and triple-Cs (-3.69%). Combined, US HY delivered a -1.98% WoW return, though the non-distressed portion fared slightly better with a -1.31% return (Chart 12).

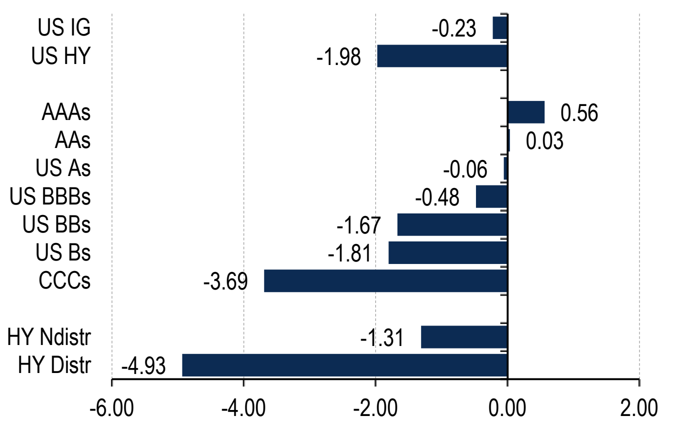
All 18 of our US HY sector classifications finished last week in the red, though Energy (-7.92%) was by far and away the worst performer due to S&P's announcement that they lowered their hydrocarbon price assumptions and subsequently took ratings actions on 45 speculative grade Energy companies. Financials (-2.51%) were the 2nd worst performing sector, which fell in sympathy with European financials and heightened skepticism over the state of the US economy (Chart 13).

**Table 8: Total returns across asset classes**

| Ticker | Name | WOW (%) | MTD (%) | YTD (%) |
|---|---|---|---|---|
| MXEF | EM Eqty | -3.84 | -4.19 | -10.44 |
| HE00 | EU HY | -1.98 | -2.53 | -3.64 |
| H0A0 | US HY | -1.98 | -3.08 | -4.61 |
| EMHB | EM HY | -1.34 | -1.03 | -2.11 |
| SPX | S&P 500 | -0.81 | -3.89 | -8.77 |
| CDXHY | CDX.HY | -0.78 | -2.39 | -3.39 |
| LCDI/ALL | Lev Loans | -0.65 | -0.69 | -1.36 |
| EMGB | EM Govts | -0.61 | -0.63 | -0.41 |
| CDXIG | CDX.IG | -0.30 | -0.87 | -1.38 |
| C0A0 | US IG | -0.23 | -0.09 | 0.34 |
| EMIB | EM IG | -0.19 | 0.05 | 0.44 |
| G0QI | TIPs | 0.10 | 0.13 | 1.65 |
| M0A0 | Mortgages | 0.10 | 0.22 | 1.47 |
| U0A0 | Municipals | 0.25 | 0.53 | 1.64 |
| GA05 | 5yr TRSY | 0.25 | 0.67 | 2.86 |

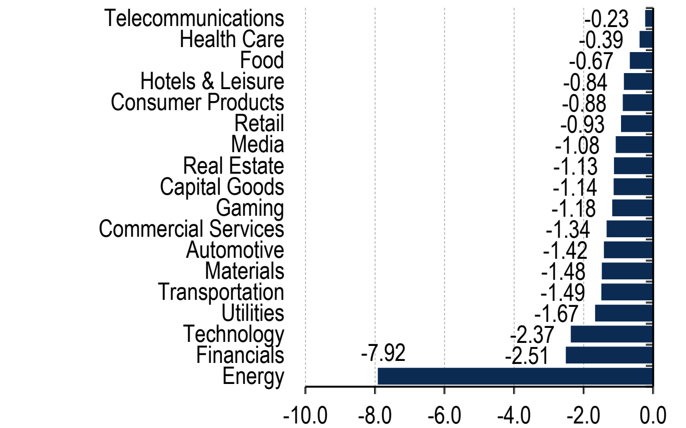
Source: BofA Merrill Lynch Global Research

**Chart 12: Segment and rating returns, week-on-week (WoW)**




Source: BofA Merrill Lynch Global Research

**Chart 13: Sector returns, week-on-week (WoW)**




Source: BofA Merrill Lynch Global Research

### Top performers

Sprint bonds dominated last week's best performing bonds, taking 7 of the top 10 spots after majority owner SoftBank announced that they will provide support in various ways and did not explicitly rule out helping the company purchase bonds at their currently discounted levels. The announcement caused Sprint bonds to generically jump 2-3 points across the credit curve. Also outperforming last week were the LINE 8 $^{5}/_{8}$'s (+17.7%), the TCMCN 9 ¾'s (+4.9%), and the MTW 5 $^{7}/_{8}$'s (+2.2%).

**Table 9: Bottom 10 performers, February $5^{th}$ – February $12^{th}$**

| Issue | Rating | Price | Yield | ZSpread | Px Change | Pct Change | Vol |
|---|---|---|---|---|---|---|---|
| LINE 8.63 '20 | CCC2 | 2.31 | 322.13 | 32135 | 0.3 | 17.7 | 51 |
| S 6.88 '28 | B2 | 66.49 | 12.09 | 1049 | 3.3 | 5.3 | 83 |
| TCMCN 9.75 '17 | B2 | 73.59 | 29.90 | 2916 | 3.4 | 4.9 | 8 |
| S 7.63 '25 | B2 | 65.39 | 14.68 | 1325 | 3.0 | 4.9 | 35 |
| S 7 '20 | B2 | 70.71 | 16.48 | 1543 | 3.3 | 4.8 | 73 |
| S 7.13 '24 | B2 | 64.37 | 14.67 | 1330 | 2.4 | 3.9 | 67 |
| S 6 '22 | B2 | 64.87 | 14.28 | 1302 | 2.2 | 3.5 | 58 |
| S 7.25 '21 | B2 | 68.52 | 15.99 | 1485 | 2.0 | 2.9 | 42 |
| S 7.88 '23 | B2 | 66.61 | 15.52 | 1422 | 1.5 | 2.2 | 111 |
| MTW 5.88 '22 | B1 | 110.41 | 1.27 | 279 | 2.4 | 2.2 | 54 |

Source: BofA Merrill Lynch Global Research

### Bottom performers

Once again, Exploration & Production bonds dominated last week's list of bottom performers, mostly due to S&P's announcement that they revised their hydrocarbon price assumptions and subsequently downgraded 45 high yield Energy companies Among the bottom 10 were the WLL 5's, which dropped 20.7pts (-35%) after Moody's downgraded the company 5 notches in a single day. Also performing poorly were the CHK 6 $^{5}/_{8}$'s (-41.3%) and 7 ¼'s (-39.9%), which fell over concerns that the company may file for bankruptcy in the near future, although the company denies the allegations. Also on the list of bottom performers were the SSE 6 ½'s (-60%), the CHAPAR 7 $^{5}/_{8}$'s (-57.5%), and the LINE 6 $^{3}/_{8}$'s (-42.9%).

**Table 10: Bottom 10 performers, February $5^{th}$ – February $12^{th}$**

| Issue | Rating | Price | Yield | ZSpread | Px Change | Pct Change | Vol |
|---|---|---|---|---|---|---|---|
| SSE 6.5 '22 | C | 1.85 | 366.00 | 35824 | -2.8 | -60.0 | 6 |
| CHAPAR 7.63 '22 | CCC2 | 5.25 | 146.61 | 14592 | -7.1 | -57.5 | 10 |
| LINE 6.38 '22 | CCC1 | 5.19 | 124.32 | 12375 | -3.9 | -42.9 | 16 |
| CHK 6.63 '20 | CCC1 | 14.74 | 0.00 | 7155 | -10.4 | -41.3 | 54 |
| CHK 7.25 '18 | CCC1 | 20.45 | 0.00 | 8500 | -13.6 | -39.9 | 22 |
| DNR 5.5 '22 | B2 | 19.53 | 44.54 | 4336 | -12.3 | -38.7 | 33 |
| CHK 6.5 '17 | CCC1 | 27.97 | 0.00 | 12310 | -17.1 | -37.9 | 35 |
| LGCY 6.63 '21 | CCC1 | 11.96 | 70.92 | 6984 | -6.9 | -36.7 | 61 |
| DNR 6.38 '21 | B2 | 22.73 | 46.06 | 4492 | -12.7 | -35.9 | 33 |
| WLL 5 '19 | BB3 | 38.43 | 42.85 | 4206 | -20.7 | -35.0 | 98 |

Source: BofA Merrill Lynch Global Research

# Rating Actions

Last week we saw 69 different ratings actions on HY issuers, mostly coming in the form of downgrades from energy and bank credits after Standard & Poor's announced it revised its hydrocarbon price assumptions. The ratings agency subsequently took ratings actions on 45 speculative-grade US oil and gas exploration and production companies, as well as 4 US regional banks with large energy exposures. The list of bank downgrades includes Texas Capital Bancshares Inc, who was lowered to high yield status as a result of its new BB+ rating. A total of 54 downgrades and 3 upgrades occurred on the week, including 1 rising star, 2 fallen angels, and 2 defaults.

The lone rising star came from S&P's upgrade of SourceGas LLC to BBB from BB+, which occurred after utility holding company Black Hills Corp announced it had completed its acquisition of the company. S&P revised SourceGas's stand-alone credit profile to BBB to reflect the removal of the holding company debt.

The two defaulting issuers include AM Castle & Co and Noranda Aluminum Holding Corp, who were downgraded to SD and D respectively by S&P. The former had its credit rating lowered as a result of the consummation of an exchange offer for its senior secured notes, while the latter was downgraded after the company filed voluntary petitions for Chapter 11 restructuring.

**Table 11: Ratings actions on HY issuers, February 5th – February 12th**

| Date | Action | Company Name | Rating Type | Agency | Curr Rtg | Last Rtg |
|---|---|---|---|---|---|---|
| 02/11/2016 | Upgrade | Atlantic Power Corp | LT Local Issuer Credit | S&P | B+ | B |
| **02/12/2016** | **Upgrade** | **SourceGas LLC** | **LT Local Issuer Credit** | **S&P** | **BBB** | **BB+** |
| 02/08/2016 | Upgrade | Sheridan Investment Partners I LLC | LT Local Issuer Credit | S&P | CCC- | SD |
| 02/10/2016 | Initiated | Civitas Solutions Inc | LT Local Issuer Credit | S&P | B+ | NR |
| 02/09/2016 | Initiated | Surgery Partners Inc | LT Local Issuer Credit | S&P | B | |
| 02/08/2016 | Initiated | MedRisk LLC | LT Local Issuer Credit | S&P | B | |
| 02/09/2016 | Initiated | Solera LLC | Senior Unsecured Debt | Moody's | Caa1 | |
| 02/11/2016 | Dropped | Magnum Hunter Resources Corp | LT Local Issuer Credit | S&P | NR | D |
| 02/11/2016 | Dropped | Pep Boys-Manny Moe & Jack/The | LT Local Issuer Credit | S&P | NR | B *- |
| 02/10/2016 | Dropped | Southern Railway Co | LT Local Issuer Credit | S&P | NR | BBB+ |
| 02/09/2016 | Dropped | Surgery Center Holdings Inc | LT Local Issuer Credit | S&P | NR | B |
| 02/08/2016 | Dropped | HMK Mattress Holdings LLC | LT Local Issuer Credit | S&P | NR | B |
| 02/10/2016 | Dropped | Broadcom Corp | Senior Unsecured Debt | Moody's | WR | Ba2 |
| 02/10/2016 | Downgrade | American Energy - Woodford LLC | LT Local Issuer Credit | S&P | CCC | CCC+ |
| 02/10/2016 | Downgrade | Midstates Petroleum Co Inc | LT Local Issuer Credit | S&P | CCC- | CCC+ |
| 02/09/2016 | Downgrade | Alta Mesa Holdings LP | LT Local Issuer Credit | S&P | CCC+ | B- |
| 02/09/2016 | Downgrade | Approach Resources Inc | LT Local Issuer Credit | S&P | CCC+ | B |
| 02/09/2016 | Downgrade | Bill Barrett Corp | LT Local Issuer Credit | S&P | B- | B |
| 02/09/2016 | Downgrade | Bonanza Creek Energy Inc | LT Local Issuer Credit | S&P | B- | B |
| 02/09/2016 | Downgrade | Breitburn Energy Partners LP | LT Local Issuer Credit | S&P | B- | B |
| 02/09/2016 | Downgrade | Chesapeake Energy Corp | LT Local Issuer Credit | S&P | CCC | CCC+ |
| 02/09/2016 | Downgrade | Clayton Williams Energy Inc | LT Local Issuer Credit | S&P | CCC+ | B- |
| 02/09/2016 | Downgrade | Denbury Resources Inc | LT Local Issuer Credit | S&P | B | BB- |
| 02/09/2016 | Downgrade | Endeavor Energy Resources LP | LT Local Issuer Credit | S&P | B- | B |
| 02/09/2016 | Downgrade | EP Energy LLC | LT Local Issuer Credit | S&P | B | BB- |
| 02/09/2016 | Downgrade | EV Energy Partners LP | LT Local Issuer Credit | S&P | CCC+ | B |
| 02/09/2016 | Downgrade | Fieldwood Energy LLC | LT Local Issuer Credit | S&P | CCC | B |
| 02/09/2016 | Downgrade | Gastar Exploration USA Inc | LT Local Issuer Credit | S&P | CCC+ | B- |
| 02/09/2016 | Downgrade | Genworth Financial Inc | LT Local Issuer Credit | S&P | B *- | BB- |
| 02/09/2016 | Downgrade | Interface Security Systems Holdings Inc | LT Local Issuer Credit | S&P | CCC+ | B- |
| 02/09/2016 | Downgrade | Legacy Reserves LP | LT Local Issuer Credit | S&P | B- | B |
| 02/09/2016 | Downgrade | MD America Energy LLC | LT Local Issuer Credit | S&P | CCC | B- |
| 02/09/2016 | Downgrade | Memorial Production Partners LP | LT Local Issuer Credit | S&P | B- | B |
| 02/09/2016 | Downgrade | Northern Oil and Gas Inc | LT Local Issuer Credit | S&P | B- | B |
| 02/09/2016 | Downgrade | Oasis Petroleum Inc | LT Local Issuer Credit | S&P | B+ | BB- |
| 02/09/2016 | Downgrade | Outerwall Inc | LT Local Issuer Credit | S&P | BB- | BB+ |
| 02/09/2016 | Downgrade | Prospect Holding Co LLC | LT Local Issuer Credit | S&P | CC *- | CCC+ |
| 02/09/2016 | Downgrade | Resolute Energy Corp | LT Local Issuer Credit | S&P | CCC | B- |
| 02/09/2016 | Downgrade | Sidewinder Drilling Inc | LT Local Issuer Credit | S&P | CC | CCC+ |
| 02/09/2016 | Downgrade | SM Energy Co | LT Local Issuer Credit | S&P | BB- | BB |
| 02/09/2016 | Downgrade | Solera Holdings Inc | LT Local Issuer Credit | S&P | B | BB- *- |
| 02/09/2016 | Downgrade | Sotheby's | LT Local Issuer Credit | S&P | BB- | BB |
| 02/09/2016 | Downgrade | Stone Energy Corp | LT Local Issuer Credit | S&P | CCC+ | B |
| 02/09/2016 | Downgrade | Targa Pipeline Partners LP | LT Local Issuer Credit | S&P | BB- | BB+ |
| 02/09/2016 | Downgrade | Templar Energy LLC | LT Local Issuer Credit | S&P | CCC- | B- |
| **02/09/2016** | **Downgrade** | **Texas Capital Bancshares Inc** | **LT Local Issuer Credit** | **S&P** | **BB+** | **BBB-** |
| 02/09/2016 | Downgrade | Triangle USA Petroleum Corp | LT Local Issuer Credit | S&P | CCC | B- |
| 02/09/2016 | Downgrade | Unit Corp | LT Local Issuer Credit | S&P | B+ | BB- |
| 02/09/2016 | Downgrade | W&T Offshore Inc | LT Local Issuer Credit | S&P | B- | B |
| 02/09/2016 | Downgrade | Whiting Petroleum Corp | LT Local Issuer Credit | S&P | B+ | BB |
| 02/08/2016 | Downgrade | Calumet Specialty Products Partners LP | LT Local Issuer Credit | S&P | B | B+ |
| 02/08/2016 | Downgrade | Gaming and Leisure Properties Inc | LT Local Issuer Credit | S&P | BB | BB+ *- |
| 02/08/2016 | Downgrade | Green Plains Inc | LT Local Issuer Credit | S&P | B | B+ |
| 02/08/2016 | Downgrade | Salem Media Group Inc | LT Local Issuer Credit | S&P | B- | B |
| 02/05/2016 | Downgrade | NESCO LLC | LT Local Issuer Credit | S&P | CCC | B- |
| 02/05/2016 | Downgrade | Vision Solutions Inc | LT Local Issuer Credit | S&P | B- *- | B+ |

**Table 11: Ratings actions on HY issuers, February 5th – February 12th**

| Date | Action | Company Name | Rating Type | Agency | Curr Rtg | Last Rtg |
|---|---|---|---|---|---|---|
| 02/11/2016 | Downgrade | Energen Corp | Senior Unsecured Debt | Moody's | B3 | Ba2 *- |
| 02/11/2016 | Downgrade | Newfield Exploration Co | Senior Unsecured Debt | Moody's | Ba3 | Ba1 *- |
| 02/11/2016 | Downgrade | QEP Resources Inc | Senior Unsecured Debt | Moody's | B1 | Ba1 *- |
| 02/11/2016 | Downgrade | Range Resources Corp | Senior Unsecured Debt | Moody's | Ba3 | Ba1 *- |
| 02/11/2016 | Downgrade | SM Energy Co | Senior Unsecured Debt | Moody's | B3 | Ba2 *- |
| 02/11/2016 | Downgrade | Whiting Petroleum Corp | Senior Unsecured Debt | Moody's | Caa2 | Ba3 *- |
| 02/11/2016 | Downgrade | WPX Energy Inc | Senior Unsecured Debt | Moody's | B2 | Ba1 *- |
| 02/08/2016 | Downgrade | Homer City Generation LP | Senior Secured Debt | Moody's | Caa2 | B3 |
| **02/05/2016** | **Downgrade** | **Broadcom Corp** | **Senior Unsecured Debt** | **Moody's** | **Ba2** | **A2 *-** |
| 02/05/2016 | Downgrade | CEC Entertainment Inc | Senior Unsecured Debt | Moody's | Caa2 | Caa1 |
| 02/05/2016 | Downgrade | Genworth Holdings Inc | Senior Unsecured Debt | Moody's | Ba3 | Ba1 |
| **02/09/2016** | **Default (selective)** | **A. M. Castle & Co** | **LT Local Issuer Credit** | **S&P** | **SD** | **CC** |
| **02/08/2016** | **Default** | **Noranda Aluminum Holding Corp** | **LT Local Issuer Credit** | **S&P** | **D** | **CCC+** |

Source: BofA Merrill Lynch Global Research, Bloomberg

# Relative Value

## Cash v. CDS

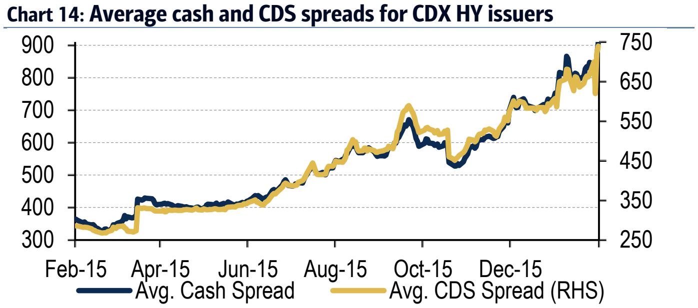
While HG cash outperformed CDX IG, our HY cash index underperformed its synthetic counterpart (Table 12). Whereas CDX IG widened 15bps, HG cash widened by only 13bps. In the high yield market, CDX HY widened by 60bp compared to 84bp of widening for our HY cash index. On an issuer matched basis however, the average HY basis increased a negligible 1bp (Chart 15) to -169bps.

**Table 12: CDX vs. ML Cash Indices**

| Index | Spread | 1W-Chng | 1M-Chng | 3M-Chng |
|---|---|---|---|---|
| CDX IG | 124 | 15 | 26 | 39 |
| HG Cash | 221 | 13 | 43 | 60 |
| CDX HY | 589 | 60 | 72 | 120 |
| HY Cash | 887 | 84 | 156 | 285 |

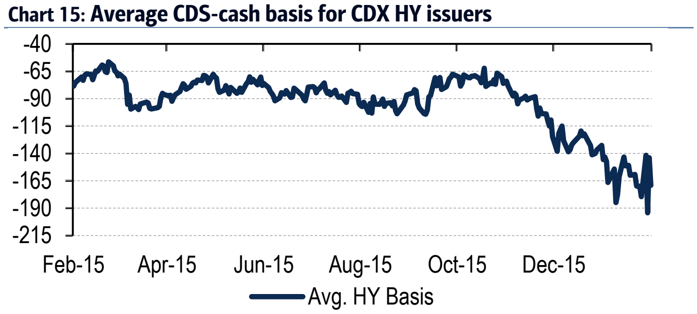
Source: BofAML Global Research, 5y spreads for CDX, OAS for cash

**Chart 14: 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 15: 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 widened over the week (Table 13). In CDX HY and iTraxx XO, indexes underperformed what is implied by single name movements as skews increased 23bps and 20bps, respectively. The HY/IG spread ratio is now at 4.74, 6bps lower since last week. The XO-HY spread increased 24bps as a selloff in European financials spilled over to the broader European credit market.

**Table 13: CDS Indices – spread, intrinsic and skew**

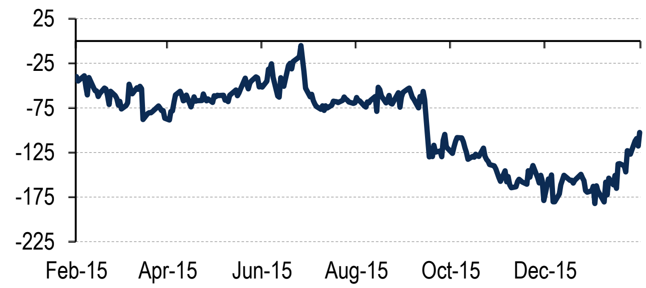
| Index | 5y Spread | 1W-Chng | 1M-Chng | 3M-Chng | 5y Intrinsic | 1W-Chng | 1M-Chng | 3M-Chng | Skew | 1W-Chng | 1M-Chng | 3M-Chng |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| CDX IG | 124 | 15 | 26 | 39 | 142 | 15 | 25 | 51 | -18 | 0 | 0 | -12 |
| CDX HY | 589 | 60 | 72 | 120 | 613 | 37 | 57 | 133 | -24 | 23 | 15 | -14 |
| iTraxx Main | 126 | 21 | 39 | 52 | 130 | 17 | 35 | 50 | -5 | 3 | 4 | 2 |
| iTraxx XO | 487 | 81 | 133 | 174 | 472 | 61 | 96 | 148 | 14 | 20 | 37 | 26 |

Source: BofA Merrill Lynch Global Research

**Chart 16: HY/IG**


Source: BofA Merrill Lynch Global Research

**Chart 17: XO-HY**

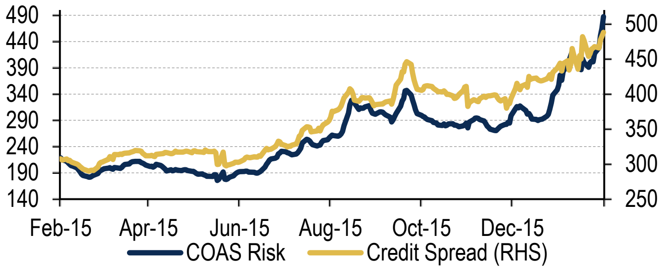



Source: BofA Merrill Lynch Global Research

## Credit v. Equities

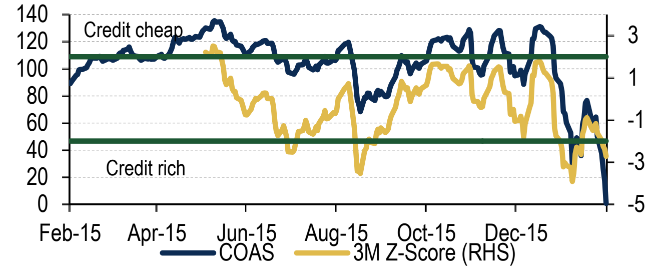
The average spread for our HY universe widened by 22bp compared to a massive 86bp increase in the equity implied credit risk (Chart 18). The US HY COAS value accordingly tightened 64bps and its 3m z-score is now at -2.72 indicating that credit appears rich relative to equity implied risk (Chart 19).

**Chart 18: US HY COAS Risk vs. Spread**




Source: BofA Merrill Lynch Global Research

**Chart 19: US HY COAS & Z-Score**




Source: BofA Merrill Lynch Global Research

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