

## US Credit Alpha

# Rally Resumed

Recent context of supportive technicals and adequate economic and corporate fundamentals continues to be the dominant driver of spread performance

**Overview** ..... 2

After slowing in mid-July, the big 2016 rally in credit has resumed in the past two weeks. The recent context of supportive technicals and adequate economic and corporate fundamentals continues to be the dominant driver of spread performance.

**Focus****CDS Index Option Basics** ..... 4

CDS index options – which give the right to buy or sell index protection at a predetermined strike and time in the future – have grown significantly in recent years, evolving into a much more balanced market. Even so, one impediment to investing in CDS options is that they tend to be clouded in 'Greeks and geeks' terminology, which they need not be, as their applications tend to be relatively straightforward. We address this hurdle by providing a detailed and practical introduction to CDS option trading.

**Investment Grade and High Yield****Steady Ownership in Commodities** ..... 30

Year-to-date, the overall ownership breakdown of commodity credits has remained generally steady despite \$58bn of fallen angel volumes in the sector, and forced selling has been less severe than expected. Insurance companies continue to have a significant underweight on investment grade commodity securities; however, the share was this low before the downgrades occurred six months ago, and they appear to have retained a significant ownership share in the securities that did get downgraded. There has also been a notable increase in mutual fund ownership of securities rated BB or better.

**Structured Credit****CLO Equity Returns Get Squeezed** ..... 35

As Libor and swap rates have risen more than ABS spreads have tightened, yields across all structured credit products have increased. In this environment, we still think CLOs and private SLABS look most attractive, though CLO equity returns will be lower.

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- Academically this suggests that GE will likely continue to and maybe even increasingly trade at a discount to peers
- This also suggests that GE will likely have to find new ways to entice new shareholders
- Ultimately though, this suggests that GE will likely need to change, potentially more drastically than it or its board may be considering at present

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## Focus

### CDS Index Option Basics ..... 4

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## Investment Grade and High Yield

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## Structured Credit

### CLO Equity Returns Get Squeezed ..... 35

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## Part Heading

## Chapter Heading

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*Quote Pull: Most activity indicators are slowing in Q3 14, but still signal solid growth*

# Article Heading

*Section Summary: Academically this suggests that GE will likely continue to and maybe even increasingly trade at a discount to peers. This also suggests that GE will likely have to find new ways to entice new shareholders (higher dividends, for example).*

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Body Text. In some ways we are in a holding pattern, awaiting a positive catalyst or better 1Q14. We believe the stock is too cheap versus the peer group to justify a downgrade and the recent pullback is more severe than likely deserved (down ~9.8% YTD versus XLI down ~0.7%). Fundamentally, we still view GE's margins and earnings as depressed and if the company executes on costs (see Figure 1), returns could rise to far higher levels than we all forecast.

### Heading 2

Still-strong demand for safe assets call for maintaining a relatively balanced portfolio between equities and bonds, with only a modest overweight in equities in the past. Even SOTP supports a more bullish thesis at these levels (10x GECC 2015E EPS of 0.71 + 17x Industrials 2015E EPS of \$1.29 suggests a value of \$29/share versus the current \$25.53 level). Lastly, GE can't expect that it can continue to underperform and take as little action as the company has taken. business.

**In line semibold**, in our view, suggests that GE should not be in the banking business; the appliance business; the lighting business; datacenters, or any other non-core, non-infrastructure based business.

### Heading 2: Time Warner Cable to sell TWC 2020 notes and buy DTW 20s or Discovery 20s.

Body Text: On an OAS basis, DF 2023s are trading at 372bp, compared with the Barclays US HY Index at 434bp, Ba index at 301bp, and US Food & Beverage index at 316bp. We think there could be 30-50bp of absolute return upside, as well as excess spread

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In some ways we are in a holding pattern, awaiting a positive catalyst or better 1Q14. We believe the stock is too cheap versus the peer group to justify a downgrade and the recent pullback is more severe than likely deserved<sup>1</sup> (down ~9.8% YTD versus XLI down ~0.7%). Fundamentally, we still view GE's margins and earnings as depressed and if the company executes on costs (see Figure 1), returns could rise to far higher levels than we all forecast. The dividend is attractive (3.0% versus peer group average of 1.2%), the buyback should help, and the M&A strategy is now far lower risk and more rational than what we have seen. Although expected returns on equities remain far above those on bonds.

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The dividend is attractive (3.0% versus peer group average of 1.2%). Investors are still looking for a GE that can be a pure play global infrastructure company: power-generation, aerospace, rail, even mining are all businesses that require capital, technology, global reach, and exceptional project execution. Projects are becoming increasingly complex, increasingly sovereign, and are increasingly in difficult places to do business. This is exactly where GE excels. *Companies like CAT*, Siemens, and even Emerson.

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*-Someone Name, Financial Times, December 16, 2016*

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For GE and its board, we expect the company to address the mandates of the changing (likely permanently changing) needs of investors. It's up to the company to make bold decisions and to move faster. The theme of this year's annual report is “progress”. However, few investors would agree that progress is being made.

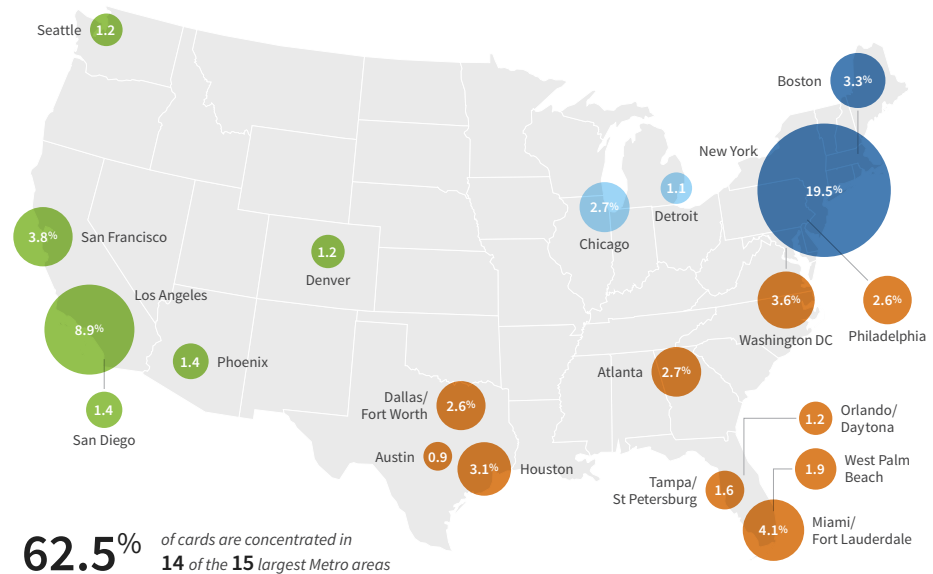
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**FIGURE 1. Credit card concentrations across the U.S.**



At 13x our 2014E EPS, we believe the IPO (priced at W7,700) was conducted at a steep discount to fair value. With global online travel peers trading in the range of 17-35x 2014E P/E, and considering INT's earnings growth outlook, we see upside from the current price level.

Source: Barclays Research

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### Time Warner Cable to sell TWC 2020 notes

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**FIGURE 1. Key Metrics Title Could Go Here Above the Chart**

General Electric (GE)	2013A	2014E	2015E	2016E
Revenue (\$ mn)	146,240	149,381	156,605	159,655
EBITDA (\$mn)	12,612	14,193	19,237	20,767
Pre-tax income (\$mn)	15,824	17,226	20,526	19,743
Net income (\$ mn)	114,055	15,291	17,226	16,209
EPS	1.64	1.65	1.90	1.85
P/E (adj) (x)	15.90	15.90	13.70	14.10
EV/EBITDA (x)	21.50	18.50	14.00	12.80

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Academically this suggests that GE will likely continue to and maybe even increasingly trade at a discount to peers.

- The overwhelming evidence suggests that GE should not be in banking, appliance, lighting, datacenters, or any other non-core.
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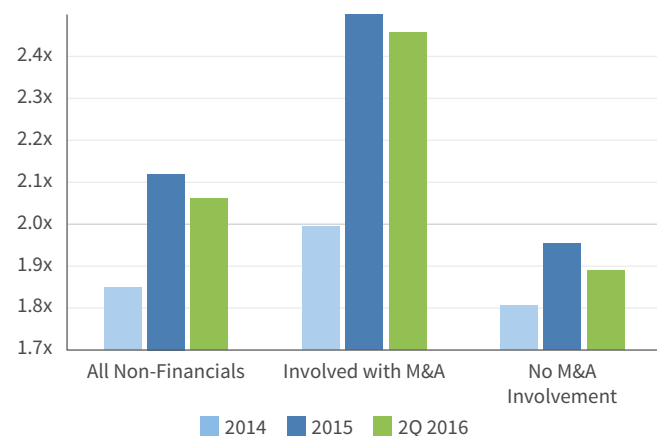
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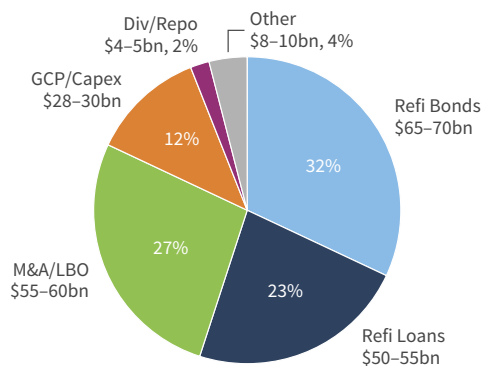
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Net Debt/1y Fwd EBITDA



Performance from December 3, 2015 close to December 10, 2015, close.  
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**FIGURE 1. Mortgages underperformed Treasury hedges**

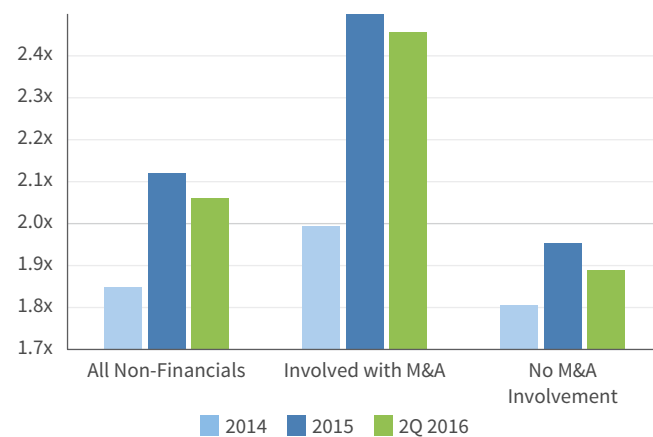
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**FIGURE 2. ...but showing a touch of weakness in the South**

Using Bloomberg median estimate.  
Source: Bloomberg, Barclays Research

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Net Debt/1y Fwd EBITDA



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**FIGURE 2. Funding costs remain on the high side**

	Wednesday	Last Week	4-Week
Credit Index	135	137	136
CDX.IG 26 (bp)	72	71	72
HY Index (\$)	98.46	97.78	97.84
CDX.HY 26 (\$)	104.60	104.50	104.39
Leveraged Loan	93.89	93.72	93.74

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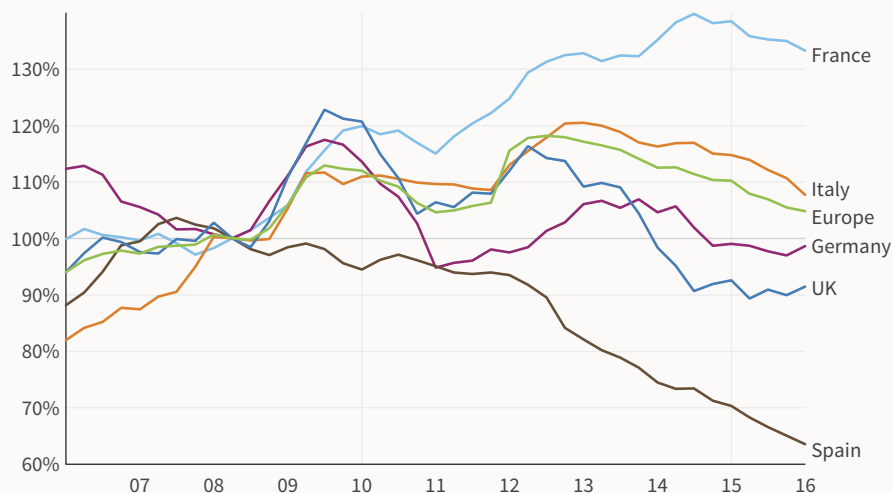
### Different Headings

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### Time Warner Cable to sell TWC 2020 notes

FIGURE 1. Key metrics

Q2 2008 = 100%



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Ticker	Coupon	Maturity	Issue Size	Barclay Old	Barclay New	Ratings			Price	OAS (bp)	YTW %
NBL	6.500	15 Mar 23	\$650	OW	OW	Baa1 dev	BBB pos	BBB sta	\$12.00	693	8.50
	6.625	10 Jan 28	\$650	OW	MW	Baa1 dev	BBB pos	BBB sta	\$12.00	693	8.50
MRO	6.625	10 Jan 28	\$650	MW	MW	Baa3 dev	BBB- pos	BBB- sta	\$12.00	693	8.50
	6.625	10 Jan 28	\$650	UW	MW	Baa3 dev	BBB- pos	BBB- sta	\$12.00	693	8.50
APA	6.500	15 Mar 23	\$650	MW	MW	Baa3 dev	BBB- pos	BBB- sta	\$12.00	693	8.50
	6.625	10 Jan 28	\$650	MW	MW	Baa3 dev	BBB- pos	BBB- sta	\$12.00	693	8.50
DVN	6.625	10 Jan 28	\$650	OW	OW	Baa3 dev	BBB- pos	BBB- sta	\$12.00	693	8.50
	6.625	10 Jan 28	\$650	MW	MW	Baa3 dev	BBB- pos	BBB- sta	\$12.00	693	8.50

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FIGURE 3. Earnings power at various loss ratios

2015-2018	Earnings Power at Various Loss Ratios (\$/shr)										
Seasoning Curve	2015	2016	2017	2018	2019*	2020	2021	2022	2023	2024	2025
2005	\$0.93	\$1.05	\$1.02	\$0.96	\$0.91	\$0.76	\$0.67	\$0.61	\$0.38	\$0.48	\$0.60
2006	\$0.92	\$1.00	\$0.85	\$0.69	\$0.57	\$0.32	\$0.30	\$0.40	\$0.20	\$0.36	\$0.52
2007	\$0.89	\$0.89	\$0.62	\$0.42	\$0.29	\$0.06	\$0.22	\$0.39	\$0.21	\$0.39	\$0.54
2008	\$0.92	\$0.97	\$0.88	\$0.86	\$0.87	\$0.85	\$0.90	\$0.92	\$0.76	\$0.80	\$0.85
2009	\$0.94	\$1.09	\$1.15	\$1.22	\$1.29	\$1.30	\$1.22	\$1.16	\$1.02	\$0.99	\$1.00
2010	\$0.94	\$1.09	\$1.16	\$1.23	\$1.31	\$1.33	\$1.27	\$1.18	\$1.04	\$1.01	\$1.01
2011	\$0.95	\$1.10	\$1.16	\$1.24	\$1.32	\$1.34	\$1.29	\$1.19	\$1.05	\$1.02	\$1.02
2012	\$0.95	\$1.10	\$1.16	\$1.24	\$1.32	\$1.35	\$1.29	\$1.19	\$1.05	\$1.02	\$1.02
Normalized	\$0.84	\$0.91	\$0.93	\$0.93	\$0.92	\$0.93	\$0.90	\$0.90	\$0.94	\$1.00	\$1.06
Seminormal	\$0.94	\$1.08	\$1.12	\$1.11	\$1.11	\$1.08	\$1.06	\$1.03	\$0.88	\$0.90	\$0.93

At 13x our 2014E EPS, we believe the IPO (priced at W7,700) was conducted at a steep discount to fair value. With global online travel peers trading in the range of 17-35x 2014E P/E, and considering INT's earnings growth outlook, we see upside from the current price level. Source: Barclays Research

### **Analyst Certification**

I, Henry Skeoch, hereby certify (1) that the views expressed in this research report accurately reflect my personal views about any or all of the subject securities or issuers referred to in this research report and (2) no part of my compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this research report.

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BRCF2242



## US Credit Alpha

# Rally Resumed

Recent context of supportive technicals and adequate economic and corporate fundamentals continues to be the dominant driver of spread performance

## Overview ..... 2

After slowing in mid-July, the big 2016 rally in credit has resumed in the past two weeks. The recent context of supportive technicals and adequate economic and corporate fundamentals continues to be the dominant driver of spread performance.

## Focus

## CDS Index Option Basics ..... 4

CDS index options – which give the right to buy or sell index protection at a predetermined strike and time in the future – have grown significantly in recent years, evolving into a much more balanced market. Even so, one impediment to investing in CDS options is that they tend to be clouded in 'Greeks and geeks' terminology, which they need not be, as their applications tend to be relatively straightforward. We address this hurdle by providing a detailed and practical introduction to CDS option trading.

## Investment Grade and High Yield

## Steady Ownership in Commodities ..... 30

Year-to-date, the overall ownership breakdown of commodity credits has remained generally steady despite \$58bn of fallen angel volumes in the sector, and forced selling has been less severe than expected. Insurance companies continue to have a significant underweight on investment grade commodity securities; however, the share was this low before the downgrades occurred six months ago, and they appear to have retained a significant ownership share in the securities that did get downgraded. There has also been a notable increase in mutual fund ownership of securities rated BB or better.

## Structured Credit

## CLO Equity Returns Get Squeezed ..... 35

As Libor and swap rates have risen more than ABS spreads have tightened, yields across all structured credit products have increased. In this environment, we still think CLOs and private SLABS look most attractive, though CLO equity returns will be lower.

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## Consumer Products

**Market Weight** from Overweight

### CLX

**Market Weight**

Moody's	S&P	Fitch
<b>Baa3</b>	<b>BBB-</b>	<b>BBB-</b>
developing	positive	stable

### KMB

**Market Weight**

Moody's	S&P	Fitch
<b>Baa3</b>	<b>BBB-</b>	<b>BBB-</b>
developing	positive	stable

## Food and Beverage

**Market Weight** from Overweight

### CPB

**Market Weight**

Moody's	S&P	Fitch
<b>Baa3</b>	<b>BBB-</b>	<b>BBB-</b>
developing	positive	stable

Ticker	Coupon	Maturity	OAS (bp)	YLD (%)	Price
<b>CLX</b>	6.500	15 Mar 23	693	8.50	\$12.00
<b>CLX</b>	6.625	10 Jan 28	693	8.50	\$12.00
<b>CPB</b>	6.500	15 Mar 23	693	8.50	\$14.00
<b>CPB</b>	6.625	10 Jan 28	693	8.50	\$15.00

Source: Barclays  
All spreads and yields as of XXX

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## Consumer Products

Sector Rating **Market Weight**  
from Overweight

CLX		Market Weight
Moody's	Developing	Baa3
S&P	Positive	BBB-
Fitch	Stable	BBB-

KMB		Overweight
Moody's	Developing	Baa3
S&P	Positive	BBB-
Fitch	Stable	BBB-

## Food and Beverage

Sector Rating **Overweight**  
Unchanged

CPB		Overweight
Moody's	Developing	Baa3
S&P	Positive	BBB-
Fitch	Stable	BBB-

Ticker	Coupon	Maturity	OAS (bp)	YLD (%)	Price
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Source: Barclays  
All spreads and yields as of XXX

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Stock Rating **Overweight**  
Unchanged

Industry View **Positive**  
Unchanged

Price Target **USD 142.00**  
Unchanged

Price (27-Oct-2016) **USD 110.83**

Potential Upside/Downside **+28.1%**

Tickers **AET**

Market Cap (USD mn) **38,879**

Shares Outstanding (mn) **350.80**

Free Float (%) **99.45**

52 Wk Avg Daily Volume (mn) **2.7**

52 Wk Avg Daily Value (USD mn) **303.80**

Dividend Yield (%) **0.9**

Return on Equity TTM (%) **14.55**

Current BVPS (USD) **50.49**

Source: Thomson Reuters

## Price Performance Exchange-NYSE

52 Week Range  
**USD 123.57–92.42**



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