Aegon Asset Management

# BREAKING DOWN THE BBB MATURITY WALL OF WORRY

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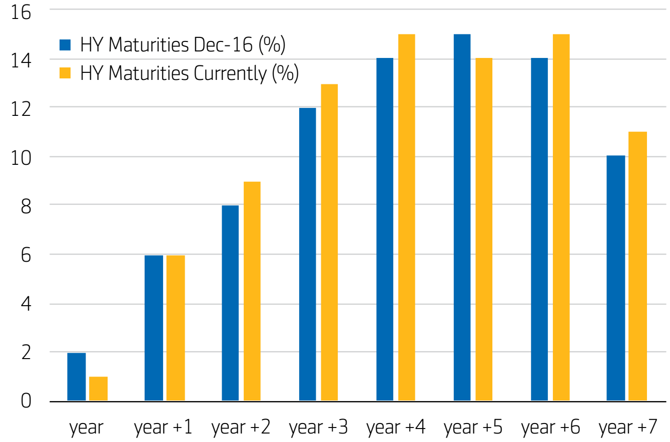
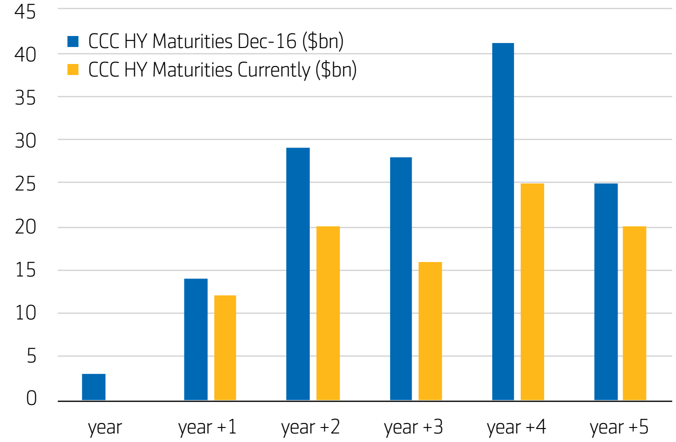
*Much has been made of BBB-rated credit in the investment grade universe. Concerns have ranged from the increased scale of BBB's to the concerns over deteriorating credit quality and rating migration risks. During the December market downdraft, we saw high yield issuance dry up and decreased investment grade market liquidity. Although market conditions have normalized, this dislocation raised concern over the potential risks related to the maturity wall of the investment grade market—particularly BBBs—in a disrupted environment where market liquidity became more challenged.*

Keeping an eye on the upcoming wall of maturities has long been a useful practice in the high yield market. During times of stress, particularly when the high yield markets become less liquid and new issuance comes to a standstill, those companies with near-term maturities are at risk of being unable to refinance these obligations, potentially triggering default, or having to issue on unfavorable terms, which can add stress to the credit profile. Based on a review of the high yield and loan markets, maturity walls (Exhibit 1 and 2), we believe those asset classes are fairly well positioned to withstand market disruption without maturities potentially triggering a spike in the default cycle as most issuers have prudently termed out their maturity profile. The high yield market has only 16% coming due over the next three years with only 1% in 2019.

Exhibit 1: Slight buildup in front end maturities & Exhibit 2: Near-term CCC risk reduced from 2016 (total notional amount)

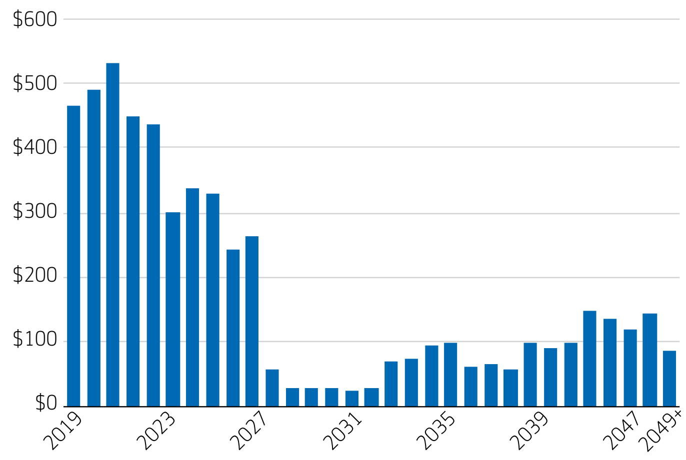



Source: Credit Suisse. As of February 19, 2019.

There has been significant growth within the BBB part of the investment grade market. This, in turn, has led to increased fear surrounding the risk of refinancing BBB maturities or, conversely, the high yield market's ability to absorb the refinancing burden of any fallen angels. There will be approximately $4.4 trillion in outstanding investment grade debt coming due over the next 20 years. The investment grade credit market has a fairly sizeable maturity wall with a heavy concentration of maturities coming in the next three years. As shown in Exhibit 3, just over 27% of the US Investment Grade Index matures in the next three years (with over 8% in the current year), another 22% in years four-six, and then the remaining 51% mature after year six. At first glance, this is a much less attractive picture than that of the high yield universe. However, we believe that while concerning on the surface, the investment grade maturity wall deserves a closer look.

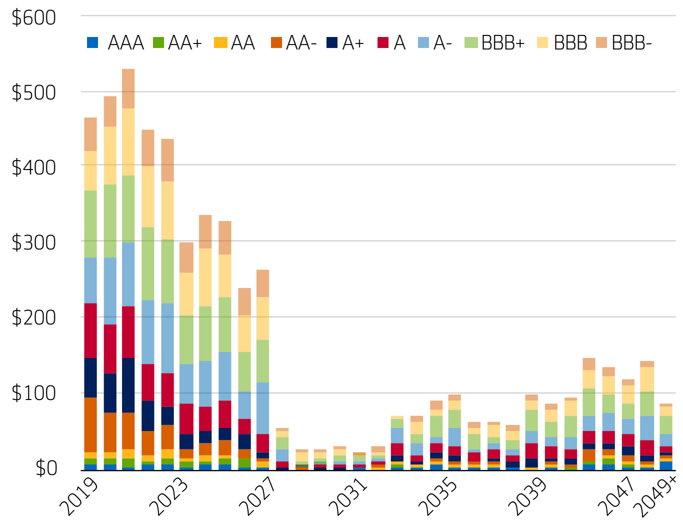
Exhibit 3: US Investment Grade Index Maturity (billions)




Source: Bloomberg L.P.

First, we think it is important to break down the maturity wall by credit quality to get a better picture of the riskiness of the refinancing needs. When we break down the chart, it quickly becomes apparent that the scale of refinancing for the riskiest investment grade issuers (BBB-) is much more manageable. Even adding in BBB credits, refinancing needs are still very manageable for the market to digest.

Exhibit 4: US investment grade index maturity by credit rating (billions)




Source: Bloomberg, L.P.

A peripheral concern related to the refinancing wall is the potential for these companies to be downgraded, another risk that we see as being overstated. We view the downgrade risk as being less of a near-term concern as we discussed in our earlier BBB piece. In addition to the continued strength of the economy, corporate earnings, and a now less restrictive Fed, we think the business and credit cycle will continue to be sound over the near-to-intermediate term, which should be supportive of giving companies time to replenish their credit profiles to levels acceptable to rating agencies. Many of these lower-rated investment grade companies also have a number of levers that they can pull in times of market strain that can be used to address maturities or support their investment grade credit profiles. These include asset sales, reductions in dividends and share buyback programs, and reducing capital expenditures among other things. We have seen some anecdotal evidence on this front by companies like GE and AT&T. GE announced a $21 billion asset sale while AT&T added a leverage ratio to executive pay calculations.

We believe companies are also being proactive and opportunistic in looking to address these needs in advance of maturities. The recent downdraft in US Treasurys combined with reasonably stable spreads has provided companies with an opportunity to once again raise funds at reasonably attractive levels.

We think the high yield market could absorb the impact of potential downgrades. Technicals have continued to be quite strong through a combination of the continued search for yield along with ongoing shrinkage of the asset class. There is one area of concern for the high yield market: Much of the investment grade paper is longer duration, non-callable debt with minimal covenant protection, which is an atypical structure for the high yield market. Even so, we believe that when combining the strong market technicals, with our view of reasonable fundamental operating trends, the high yield market can readily absorb the refinancing needs of any investment grade debt at risk of falling to junk.

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