



United States

Credit  
HY Strategy  
IG Strategy

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## US Credit Strategy

### Volatility This High Tends To Last

Aftershocks lasting for weeks/months usually follow spikes like this  
As the dust from initial shake-up in global risk assets last week began to settle, markets turned to soul-searching. Was that a flash crash or not? How much did poor summer liquidity contribute? What part did new regulations play? Did markets "overreact", or was the move supported by deteriorating macro fundamentals? Will the Fed hike or do QE4? Rarely did opinions appear to vary this greatly over such a wide set of important issues.

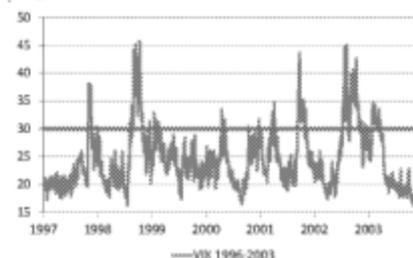
The extent of volatility was of course incredible. From a 7x sigma move in equities and all-time high change in vol of vol on Monday, to 700pts of total travel distance by S&P500 during the week, to four consecutive days of 6x-plus sigma moves in oil, recent trading sessions were nothing short of extraordinary. One particular development that gained some attention but still lacks proper appreciation by the market, in our view, is a failure to price dozens of equity ETFs on last Monday opening, a development that could have long-lasting repercussions for this \$2trln AUM industry. As it often happens, this surprise development exposed how far off the reality perceptions stood on the topic of liquidity. Whereas so many pundits predicted the day when HY/IG ETFs will fail to clear, plain-vanilla equity ETFs failed to do so, while no issues were reported in credit space.

The VIX index has closed at above 30pts for three days in a row early last week, and returned there this Tuesday. The significance of this level comes from historical experience shown in two graphs on the right. Here, for the sake of better readability, we have broken down its time series to 1997-2003 and 2007-2011, and highlighted the 30pt level with a red line (2004-2006 and 2012-2015 are omitted as the index never reached 30pts in those years). The graphs seem to suggest that once volatility jumps to 30pts on the VIX scale, it tends to stay there for at least a few weeks or even months, with a total of seven distinct periods confirming this observation.

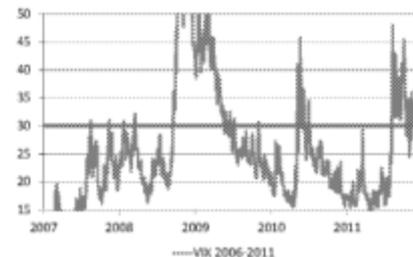
The only exceptions that happened during the past 20 years have taken place in early 2000 and late 2007/early 2008. So technically speaking, even periods of quick reversal from a 30pt VIX levels have previously proven to be prescient indicators of more volatility to come down the road. We would thus caution our readers not to be too quick in dismissing what happened over the past two weeks as simple "overreaction". We explore the volatility angle of this developing story in greater detail on the following pages.

In the credit world, spreads have naturally widened during this past week, albeit to a much lesser extent than what would have been expected given the volatility in equities. Our DM USD HY index has widened initially from 550bp earlier last week to 600 by Monday, and then retraced most of that range, closing at 566. In IG, the identical range was 157 - 165 - 163. Negative fund flows have reemerged in credit, with EPFR showing \$5bn out of HY last week, the sevenths-largest reading on record. Combined HY outflows since June have claimed \$18bn, compared to a \$38bn withdrawal in 2H 2014. The takeaway here is that HY market's ability to offset outflows was poorer in this episode compared to 2H 2014, as evidenced by a similar degree of widening (+130bp last 3 mo vs +150bp in 2014) on half the size of outflows.

Figure 1: VIX index 1997-2003



VIX index 2006-2011



Source: Deutsche Bank