

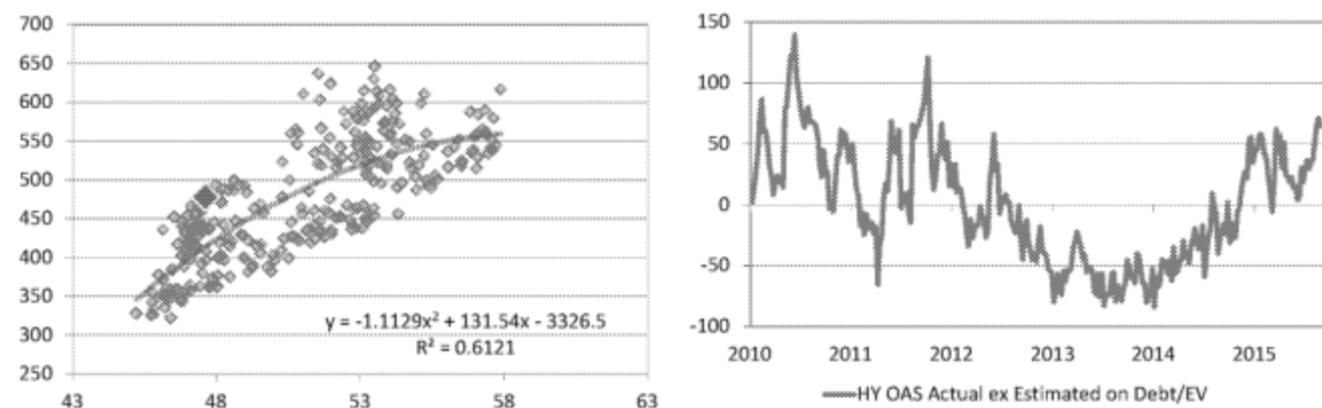


Following the recent moves across asset classes, our relative value models are showing HY as being 50-75bp tight to IG, and 75-85bp tight to implied volatility in equities, FX, and rates. Additionally, we estimate that HY bonds are trading about 65bps wide relative to their equity valuations, as shown in Figure 2 below. In other words, equities still appear to be the most overpriced asset in our relative valuation framework.

To arrive at our relative equity-vs-HY signal, we take all public HY issuers with a minimum of \$1bn of debt outstanding and Total Debt/Enterprise Value ratio in the range of 20% - 85%. The cutoff points here are used to exclude low-levered names with little meaningful spread sensitivity to equity values, and those deeply distressed names with D/EVs approaching 100%. Live equity valuations are reflected in this calculation as components of enterprise value. We then aggregate these values up to a market level and apply total debt weights capped at 2% to each issuer D/EV metric. On the bond side, we take 5yr benchmark-sized most recently issued senior unsecured bond spread levels, and aggregate them up using the same weighting methodology. The resulting combination provides a clean view of relative bond-vs-equity valuations adjusted for leverage and matched issuer-by-issuer. Each dot on the scatter plot represents a weekly observation going back to Jan 2010. Our sample includes only about 120 issuers, given the restrictions on bond liquidity/issuer size described above.

At current levels, spreads in are about 65bps wide to respective debt/EV readings, or equity valuations adjusted for leverage.

Figure 2: US HY Issuer spreads vs Debt/Enterprise Ratio, combined for the market, total-debt weighted



Source: Deutsche Bank

Other measures of relative value we have recently introduced, the proportion of distressed issuers in HY stood at 18.3% in US, versus 23.6% in EM following market repricing. Our argument here remains that this differential should be substantially wider (more EM names trading distressed vs US), given that EM HY market has twice as much weight in commodity names relative to US.

Furthermore, our GDP-weighted basket of EM currencies devalued further in recent days, losing 2% since Aug 21, and bringing the cumulative devaluation in EM to 41% since a year ago. This factor is important in two respects: (a) it points to potential headwinds many EM corp issuers are facing in servicing their USD denominated debt; and (2) currencies continued to devalue even over the past week on top of extreme weakness going into it. As we have