



In terms of relative value we find IG to be priced most attractively here, although this is unlikely to prevent it from widening in absolute terms, if broad market volatility persists. A +120bp repricing in HY over the past three months has moved valuations closer to reality, in our opinion, although it continues to trade 50-75bp tight to IG, and 75-85bp tight to implied volatility in equities, FX, and rates. At the same time HY is trading 65bp wide to a basket of issuer-matched equities adjusted for leverage (via debt/EV ratios), and this still suggests to us further vulnerability in broader equity space. Finally, September is the last month of the May-Sept seasonally-weak stretch in credit (Figure 3). Our targets in US credit thus remain 650bp all-in HY and 575bp ex-energy (+85bp and +70bp from here respectively), and 170bp in IG (+6bp).

The Fed

Last week's volatility naturally triggered a discussion whether the Fed is going to be able to proceed with its intentions to raise rates in the near future. Earlier voices and opinions on this matter seemed to side on with the view that it is unlikely to be able to do so, and interest rate derivatives have shown a substantially lower probability of the move in September. And yet Fed speakers who had a chance to react to recent events publicly recently have mostly sided with the narrative that while additional level of uncertainty has been introduced by recent volatility, the initial move in September, and even October, are still very much on the table. As a result, the forwards were still pricing in three full, and potentially four rate hikes before Dec 2016, and the 2yr Treasury yield was at 72bp, or 3bp away from its 2015 highs, at the time of this writing.

This reaction is not surprising to us, as we have expressed our opinion that the bar is set very high for the Fed to pull the plug on its intentions to raise rates later this year. We continue to believe that it would take a lot more than S&P500 at 5% below its average level in 2015, where it stands today, for the Fed to seriously consider changing its plans. We would have to see more volatility and more negative (and sustained) reaction in US markets before the Fed is forced to step back. And while this view almost creates a breeding ground for more volatility, it also sets the stage for its eventual undoing as the risk of Fed weighing in against the market weakness will remain ever more present in coming weeks and months.

The full list of our existing and past trade recommendations is available under <https://gm.db.com/welcome.html> >> Legal >> US Credit Strategy.