



United States

Credit
 HY Strategy
 IG Strategy

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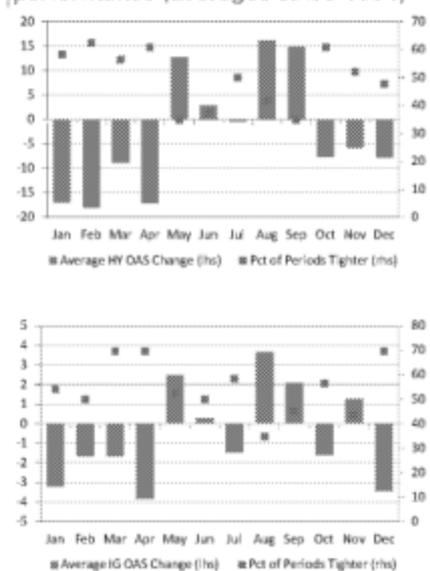
Taking Spread-per-Turn to Sector Level

Seasonally-strong issuance period is about to take a break, but not retire
 Credit markets remained relatively stable over the past week, even as the equities and 10yr rates fully reversed their post-FOMC moves. HY spreads tightened 6 bps, with CCCs underperforming, and single-Bs showing a slight edge over the index. IG moved a basis point wider. Volatility remained high in FX, where EUR is now on its fourth round of retracing its very wide post-FOMC range of 1.06 to 1.11. Rates volatility, high to begin with, has jumped even further and now exceeds its recent peak level reached on Oct 15th, the day of a 7-sigma move in 10yr Treasuries. HY flows have stabilized in recent sessions, following wild swings between strong inflows in Feb and outflows in early March. Hidden behind this relative stability are continued outflows from HY open-ended funds (-\$1.6bn in the last week), offset by intakes in ETFs. A \$10 move higher in WTI oil since early-last week failed to produce a commensurate move tighter in energy spreads (they widened at first and retraced the move later, netting zero change over the full period). Beta between oil and energy spreads has averaged \$1 move in WTI = 10bps move in our DBHYSEN index, as measured since last June. We highlighted what looked like tactical richness of 50-75bp in HY energy spreads going into last week, and therefore view absence of spread reaction to higher oil as a closing of that valuation gap.

Issuance has been going strong over the past couple of months, setting new YTD record in IG at \$340bn, and matching a previous record of \$85bn in HY (same as 2013). In interpreting and extrapolating from these numbers, our readers should keep in mind that March happens to be the strongest month of issuance activity from seasonal standpoint in both IG and HY (measured on a pct of market size basis since 1998, so normalized for market growth). Naturally, one would expect to see some slowdown in a subsequent period, and our historical data shows exactly that – April averaged the slowest issuance pace of any month in the first half the year in IG, and 2nd-slowest in HY (after February). This technical backdrop may help explain why April is also one of the strongest months from seasonal spread-performance standpoint, averaging a tightening of 17bps in HY and 4bp in IG (Figure 1). April also caps the five-month stretch of seasonally strongest months for credit, with May opening the door to a seasonally weak part of the year.

Macro picture remains weak(ish) as measured by real activity indicators, with the most recent sub-consensus readings coming in from durable goods, existing home sales, and Q4 GDP. These indicators continue to be contradicted by employment trends, such as jobless claims and payrolls, and thus it is becoming increasingly important to determine which side prevails here. We tend to think that real economic activity should hold a sway over employment trends in that such activity ultimately determines the need for labor, and not the other way around. For this reason, we continue to believe that as the US economy loses more momentum over the next few months, the Fed would likely find it difficult to remain on a sustainable rate-hiking path beyond the first few moves, if any at all. Thus we find macro picture to be on the side of credit investors, more so of those seeking safer yields, and not reaching all the way down to riskiest parts of the market. With IG spreads sitting in the middle of our expected range (120-140), and HY at its tight end (475-550), we keep a preference for IG over HY here.

Figure 1: Seasonality in credit spread performance (averages since 1991)



Source: Deutsche Bank