



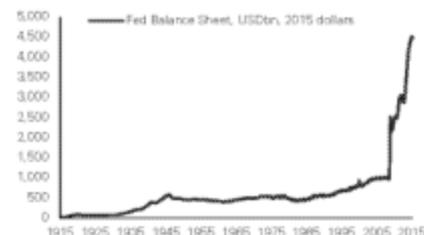
Back to school – The edge of normality

What a summer we've had. Greece has slipped back into the shadows but was at the centre of global financial markets as the market entered holiday season. As we return, China, commodity and EM woes dominate. If that's not enough, in two weeks the Fed will embark on one of their most eagerly anticipated policy meetings over the last decade. In this note we update our views on credit markets and take stock after the holiday season as we go 'back to school'.

One of the biggest problems we face is that there is no historical template for current global market conditions so we're all flying blind to a large degree. Never before have so many of the most important countries in the world printed so much money and left base rates so low for so long. Also never before has the most economically influential country in the world (the US of course) tried to start a slow process of reversing said extraordinary policy. We've also not seen a country as big as China see such rapid growth over such a short space of time (a few decades) without major busts along the way, especially when credit growth has been so extraordinary. So there is no road map for this journey, only educated (hopefully) predictions.

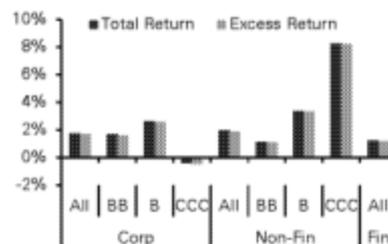
We've continued to be bullish European credit (especially HY) even though we've long felt that the only thing preventing another financial crisis has been extraordinary central bank liquidity and general interventions from the global authorities. Although we probably should have lightened up on occasions this year, Figure 2 shows that HY total returns have been decent and excess returns positive in 2015 which is impressive given the volatility. EUR IG has seen a mild negative total return year, while GBP IG has been slightly positive. Both markets have provided negative excess returns given the small positive total return in Bunds and Gilts, but the under-performance has been relatively mild and the out-performance strong relative to the USD market. These are shown for the three currencies in Figure 3.

Figure 1: Federal Reserve Balance Sheet (Real Adjusted) since 1915



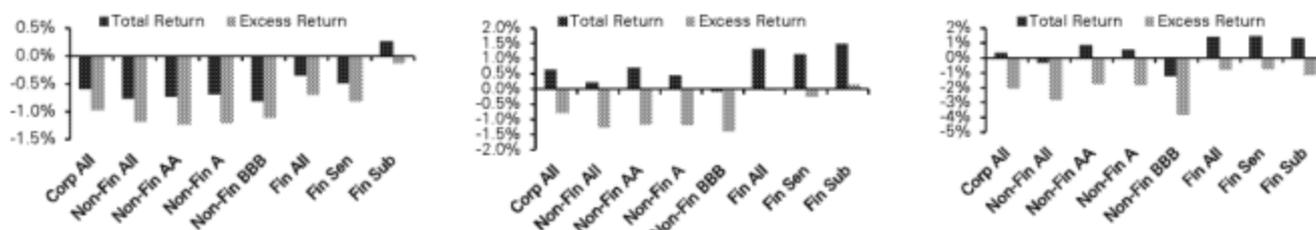
Source: Deutsche Bank, Haver, St. Louis Fed, Bloomberg Finance LLP

Figure 2: EUR HY YTD Total and Excess Returns



Note: Excess returns calculated by subtracting 1-5yr Bund total return from HY index total return.
 Source: Deutsche Bank, Mark-it Group

Figure 3: IG YTD Total and Excess Returns – EUR (left), GBP (middle) and USD (right)



Source: Deutsche Bank, Mark-it Group

Our view overall is that the global financial system is so fragile, the global economy so lethargic and asset prices generally so high (with exceptions) that it near forces central banks into a continuation of easy monetary conditions. Perhaps even easier over the coming months and years than they currently expect. This fits in with our 'Plate Spinning' analogy that central banks are periodically required to rush to re-spin the plates to prevent them crashing down given the problems beneath the surface that liquidity is covering up. We think this era will last for a number of years to come.

So we expect central bank liquidity to remain abundant and credit fundamentals outside of the Commodity sector (mostly a US problem which we expand on in this note) to remain fairly stable. Meanwhile spreads across