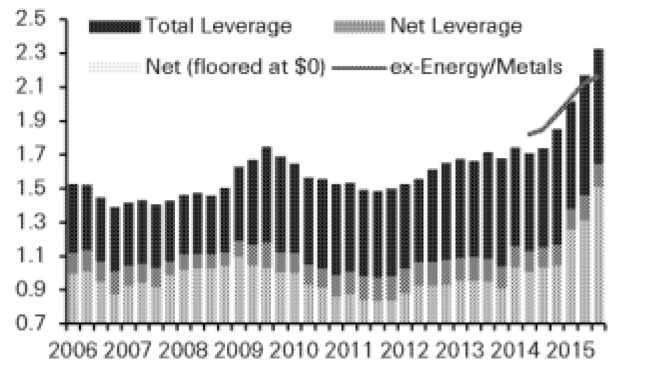
European Credit Strategy: To follow the US or march to its own beat?

Credit markets do have a late cycle feel about them but it will likely make a big difference to performance over the next 12 months if this cycle ends in 2016 or extends until at least 2017.

Fundamentals – US deteriorating, Europe steadier but past peak

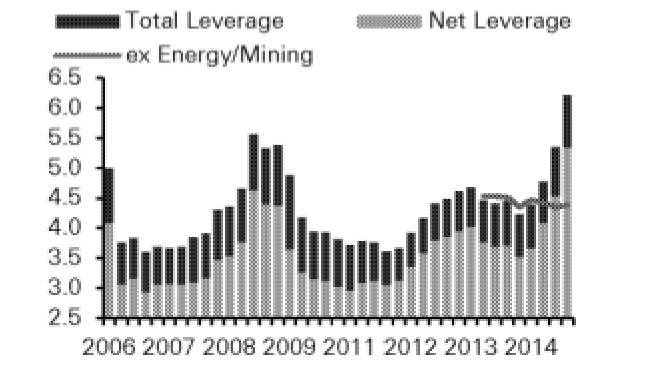
As Oleg Melentyev has alluded to in his US section, US credit quality has deteriorated. However Europe credit quality remains much more stable.

Figure 1: US IG total and net leverage



Source: Deutsche Bank Research

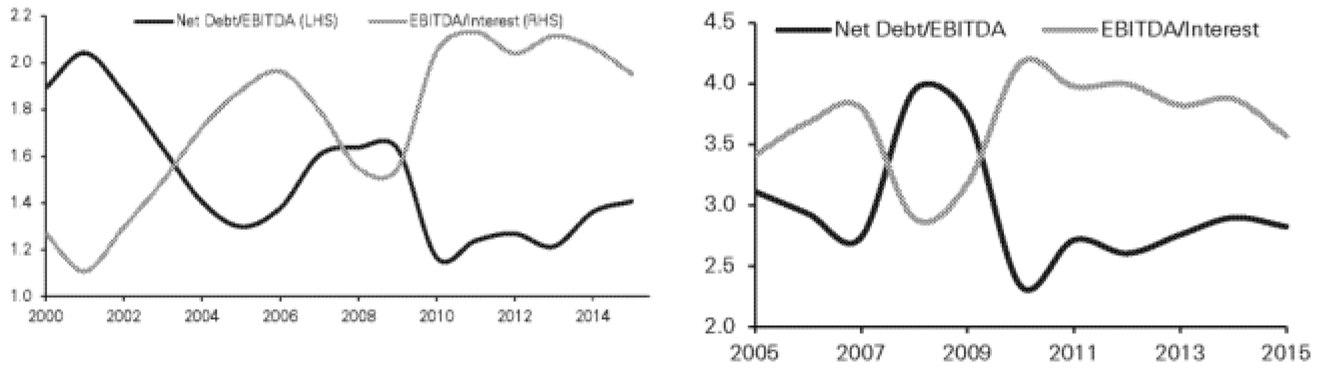
Figure 2: US HY total and net leverage



Source: Deutsche Bank Research

In Europe there are sign that earnings have been drifting lower but debt accumulation has been nowhere near as aggressive as in the US market thus helping the ratios. European credit has far less exposure to the Energy and Materials sectors, which has helped create some of the divergence.

Figure 3: Euro IG (left) and HY (right) credit fundamentals



Source: Deutsche Bank Research, Bloomberg Finance LP

Another reason for diverging fundamentals has been corporate activity. US M&A has risen much more sharply than in Europe. For share buybacks the divergence between the US and Europe is even more extreme. Europe has actually seen less in buybacks in 2015 than what was seen over the past decade whereas the US volume remains historically high even if not quite reaching peak levels.