

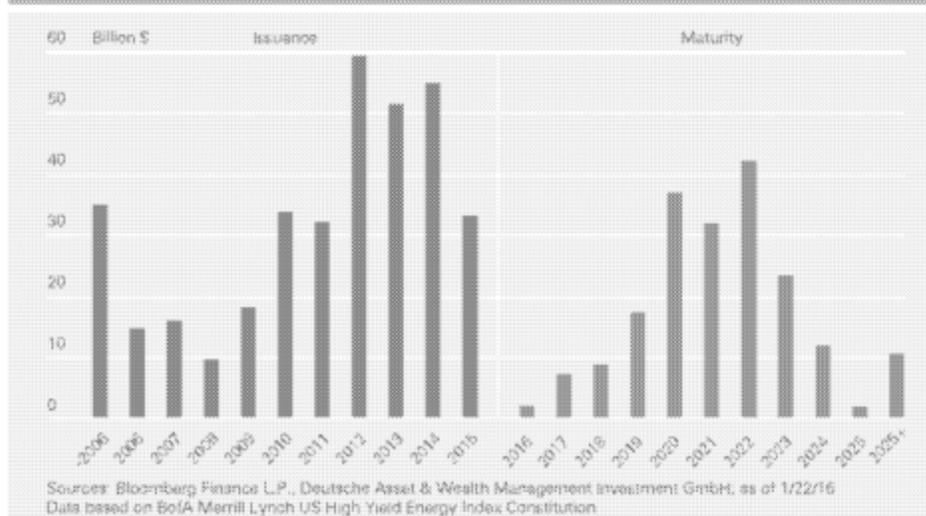
Several reasons probably account for this.

There is sheer size, of course. Energy became the single largest sector in the U.S. high-yield market during the shale boom. At current market values, it still accounts for about 11%. Exploration and production only accounts for 3.5% to 4%, and better quality issuers within this group have started to look cheap.

Not so long ago, oil indeed looked like a “known problem”. The effects looked certain to be contained to a relatively small part of the U.S. high-yield segment. However, other activities have some exposure to falling oil prices as well, especially if the initial decline is followed by a long slump. Whether a pipeline operator with operations near the Bakken shale rigs, say, will get into trouble partly depends on how soon oil prices – and with it shale production – will recover. In assessing such risks, fundamentals matter. For example, you would need to consider where exactly the assets of the pipeline operator are and if, say, they could be used for imports instead. Sentiment and technicals are important factors, too. It is often not that easy to separate these three factors, especially when it comes to high-yield bonds. If an issuer defaults, an investor risks losing everything. And that becomes more likely if spreads widen and issuers find it harder to refinance. So, it is rational for investors to require a higher yield in anticipation, in turn widening spreads further. This becomes a particular issue when tough credit conditions are expected to last for a while.

For much of the past year, optimists have pointed to the maturity profile of high-yield issuers and the fact that only 1% needs to be refinanced in 2016. However, that portion steadily rises from 2017 on, until it reaches a peak of about 22% in 2022. The picture is similar for high-yield issuers in the energy sector. With fear growing that oil prices will be lower for longer, and spreads higher, this means more companies will be at risk of defaulting during the next few years. Moreover, more companies in the same sector defaulting at roughly the same time may result in forced sales. Already, bankruptcies in the second half of 2016 rose to 28, compared to 13 in the first half.

U.S. high-yield energy bond past issuance and future redemptions



Financing conditions are worsening

Some \$360bn worth of HY bonds have been issued by U.S. energy companies since 2003, most of it from shale oil and gas producers. Redemption is not an urgent issue in the next three years, with only \$35.5bn due until 2019. The most important message of the chart, however, is that financing conditions are worsening. While in the first half (1H) of 2015 new equity worth \$14.6bn and \$23.9bn worth of bonds was issued, this declined to \$3.3bn and \$4.6bn (Source: Dealogic) in 2H2015. This would suggest declining production before too long, as U.S. shale-oil output is to a significant extent a function of how much money is invested.

Past performance is not indicative of future returns. No assurance can be given that any forecast, investment objectives and / or expected returns will be achieved. Allocations are subject to change without notice. Forecasts are based on assumptions, estimates, opinions and hypothetical models that may prove to be incorrect. Source: Deutsche Asset & Wealth Management Investment GmbH, as of 02/2016