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# Credit Market Update

July 2020

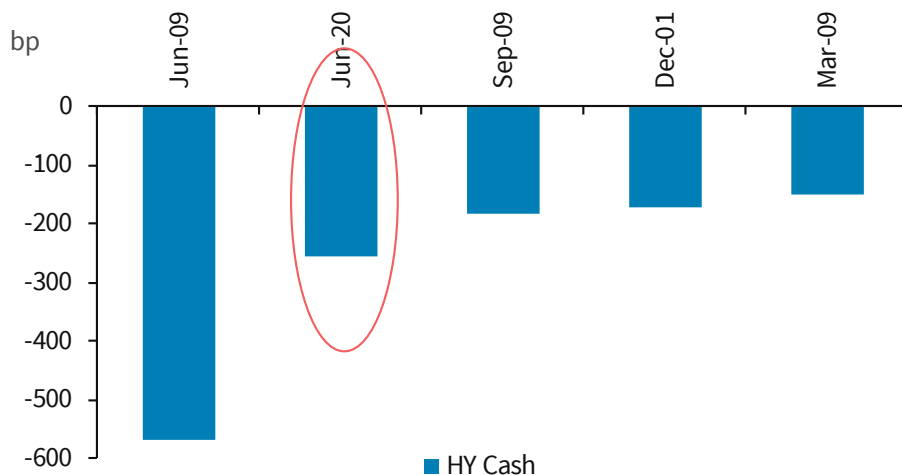
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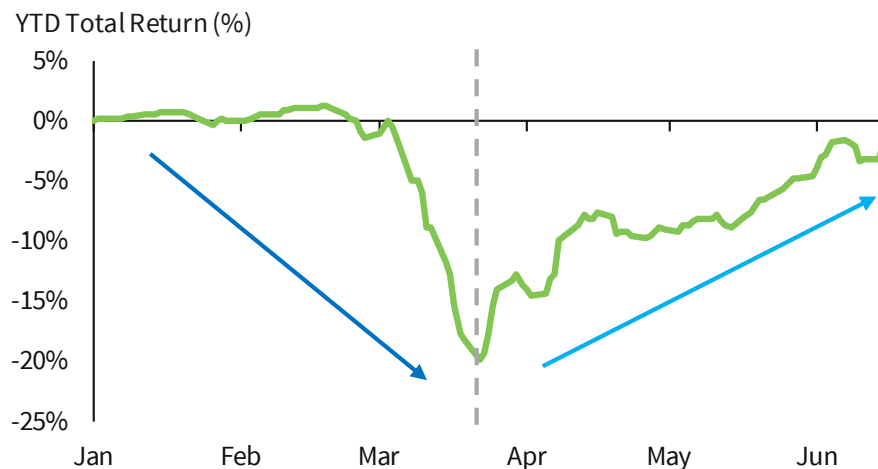
PLEASE SEE ANALYST CERTIFICATIONS AND IMPORTANT DISCLOSURES BEGINNING AFTER PAGE 17.

# Credit rebounded significantly in the second quarter as a reversal in flows helped erase much of the negative returns from first quarter

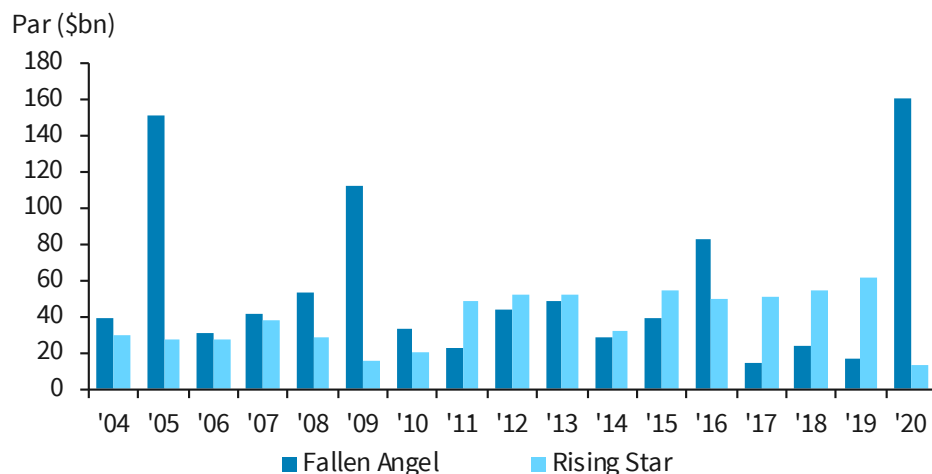
## Second Best Quarterly Spread Perf.\*



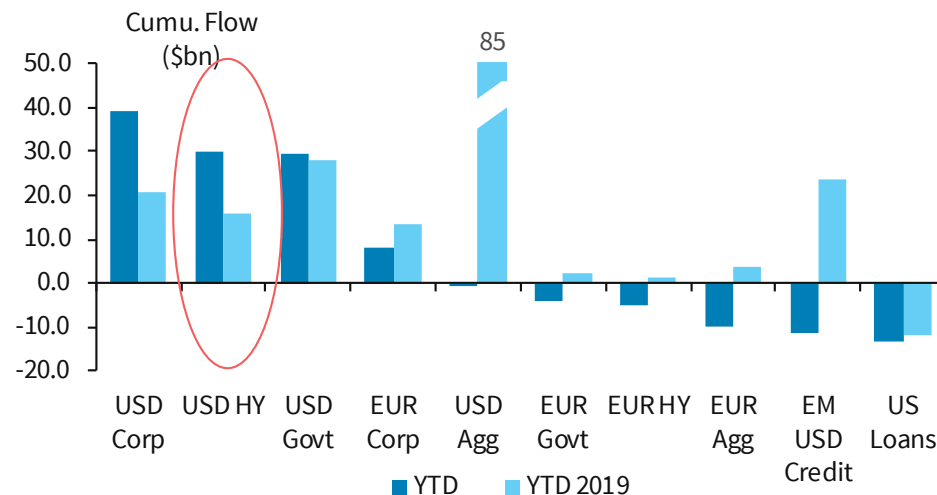
## HY Erased Most of YTD Losses



## Fallen Angel vs Rising Star Volume



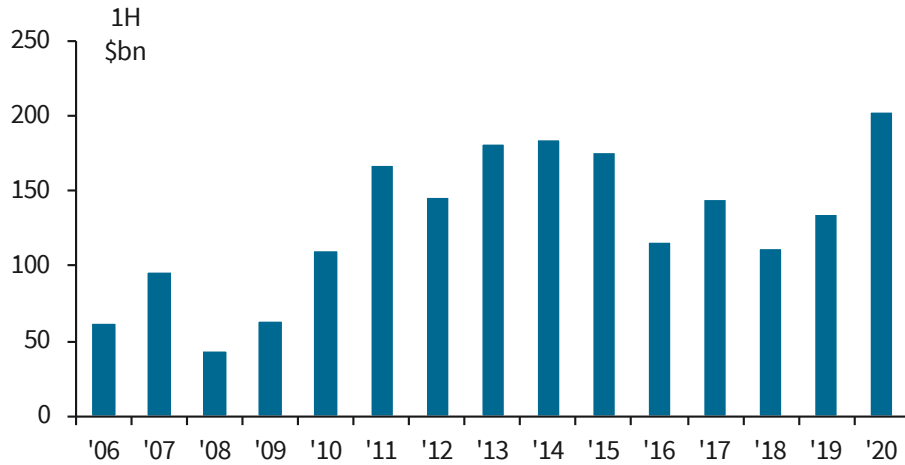
## Robust Fund Flows Doubling the 2019 Pace



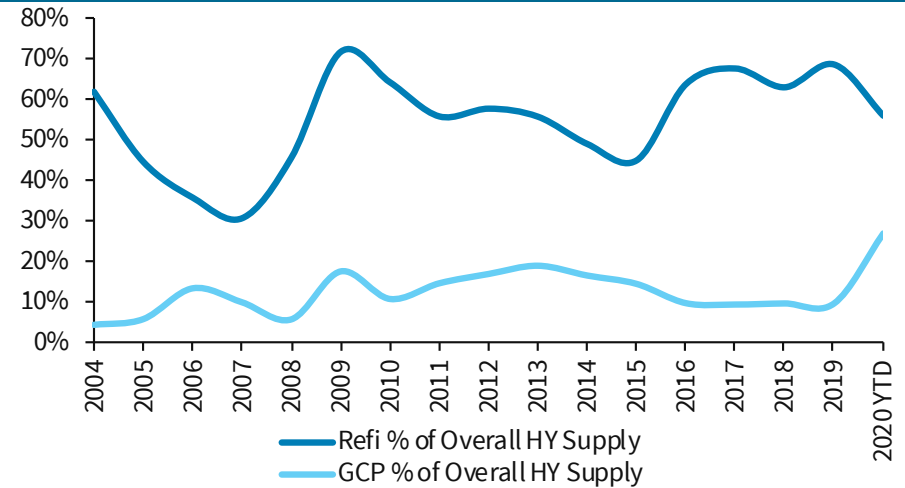
Note: \* Since 2005. Source for all charts: Bloomberg, EPFR, BarclaysResearch

# Record supply has been very well received as investors have shown an especially strong appetite for secured bonds

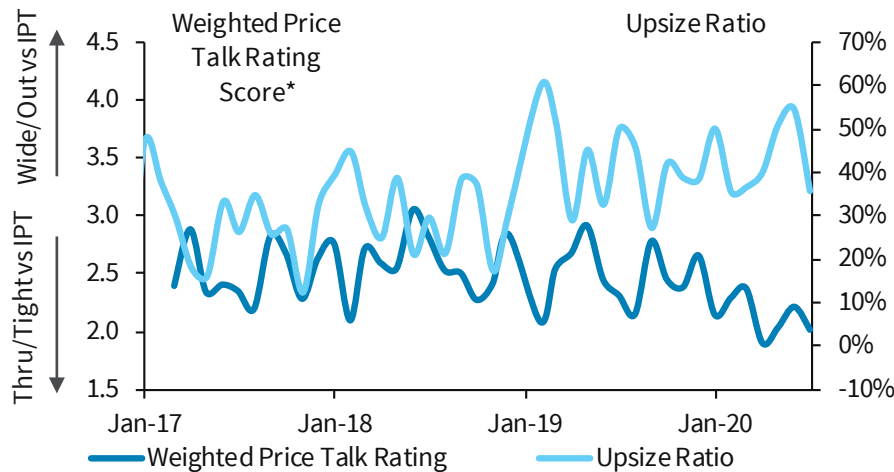
## Pace of HY Bond Issuance at Highs



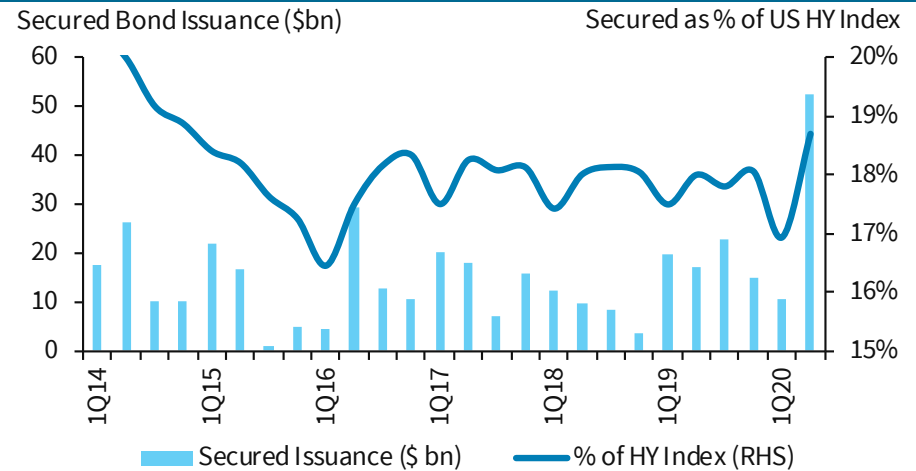
## Notable Pickup of GCP in Use of Proceeds



## Demand for HY Bond Has Been Strong



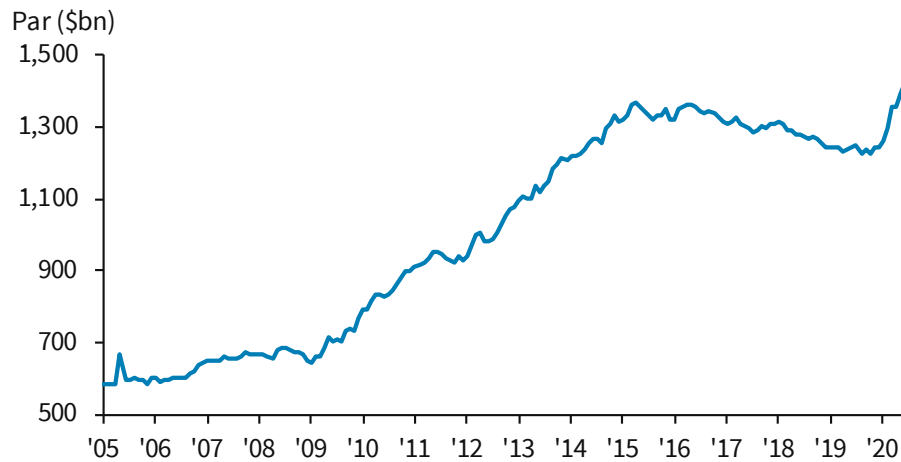
## Secured Bonds Make up 19% of HY Index



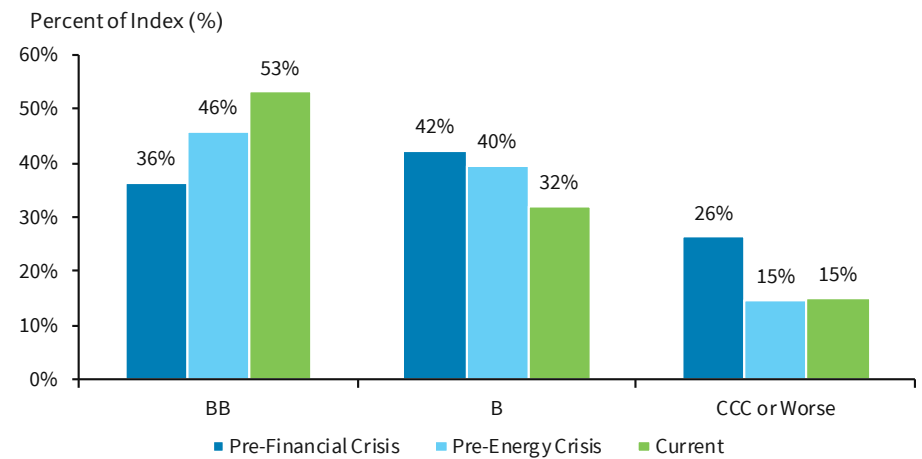
\*: Price talkrating score is a qualitative measure to gauge where the bond was finally syndicated versus initial price talk. Price talkrating is a numeric scale, where 1=thru, 2=tight, 3=mid, 4=wide and 5=out versus the IPT. For more detail, see "[Lessons from Other Low-90s Price Periods](#)," June 12, 2020. Source for all charts: Bloomberg, S&P LCD, Barclays Research

# After shrinking for several years, the high yield market is growing again from new issue and fallen angels, which has improved the overall quality

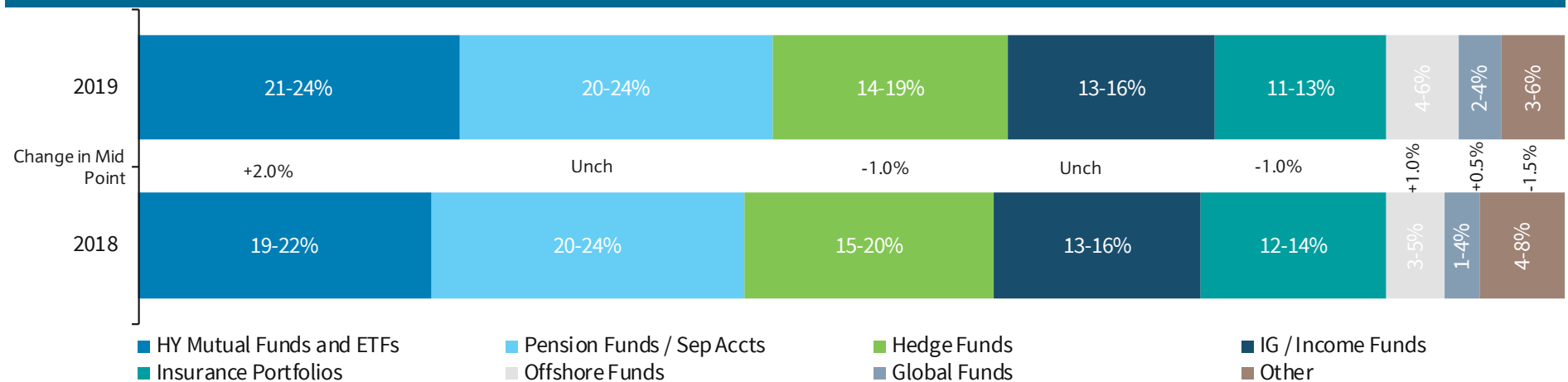
## HY Market Size Has Rebounded



## HY Now of Higher Quality Than Prior Crises



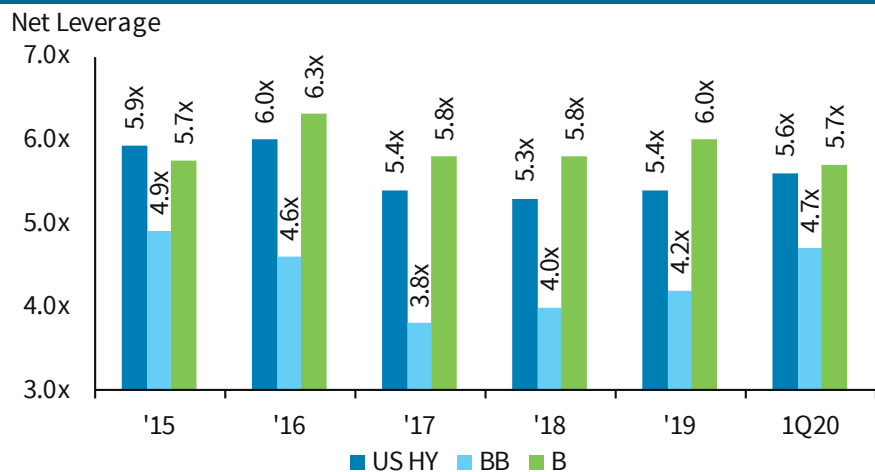
## High Yield Ownership Breakdown



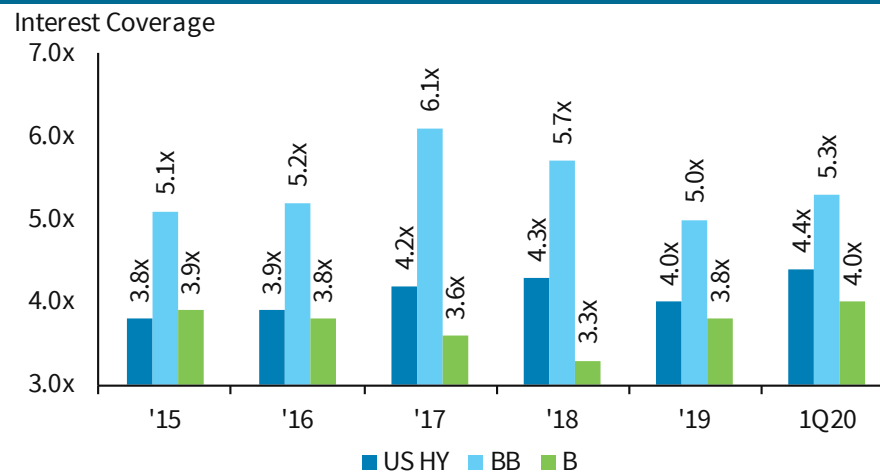
Source for all charts: Lipper, Bloomberg, EPFR, Bloomberg Barclays Indices, Barclays Research, CEF Connect, HFR, Federal Reserve, SNL Financial, company filings

HY leverage ticked up 0.2x in Q1 but could be up additional 0.8x in Q2 based on RTY EBITDA estimates, even before accounting for higher debt levels

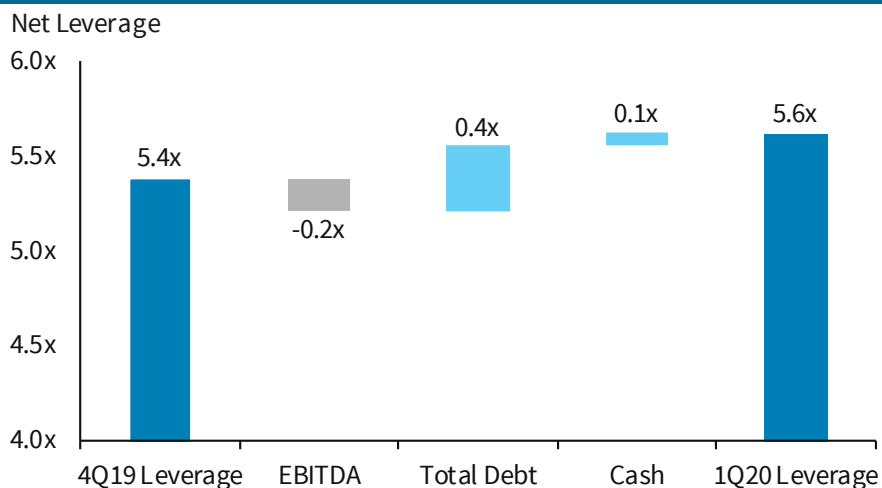
### US HY Leverage Increased to 5.6x in Q1



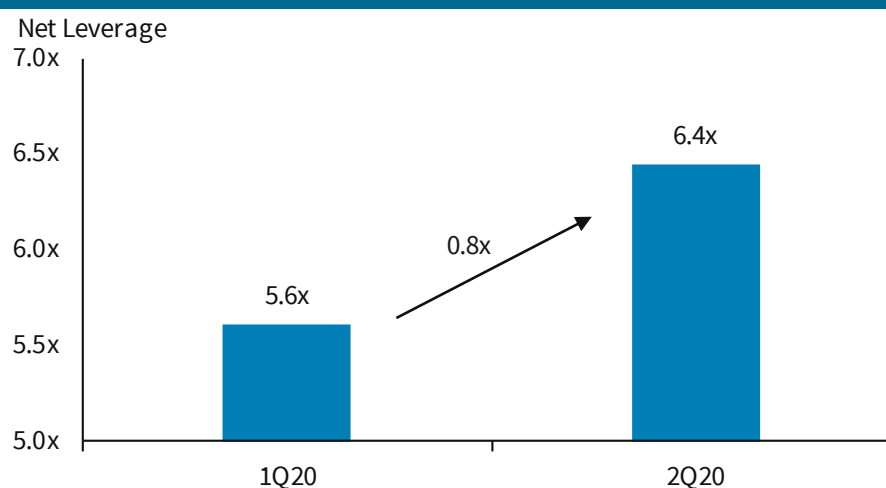
### Interest Coverage Was Higher



### Higher Leverage as a Result of More Debt



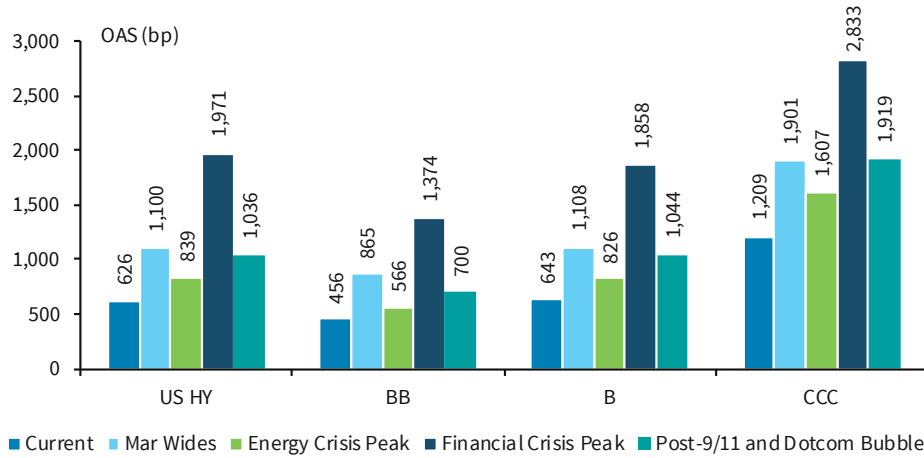
### Q2 Lev. up Solely on Proj. EBITDA Decline



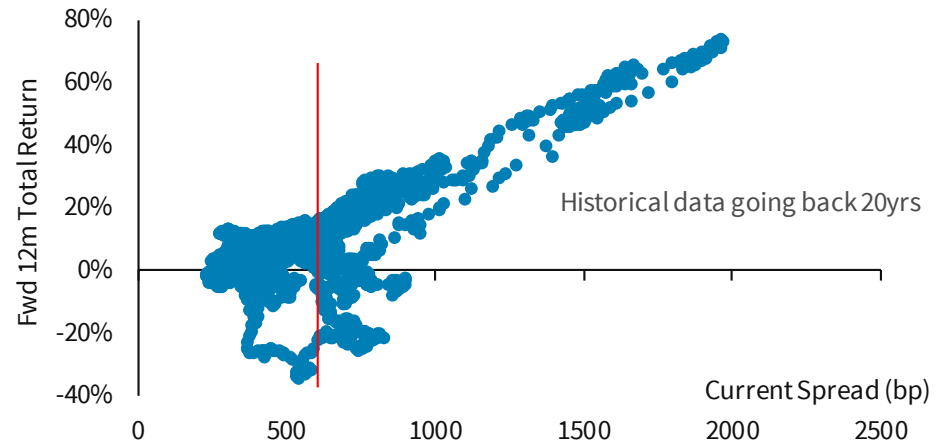
For more detail, see "[Leverage on the Rise](#)," June 5, 2020. Source for all charts: Bloomberg, CapIQ, Barclays Research

# Credit performance never hit the extremes of the financial crisis, but thus far HY has proved to be a good investment again at >800bp

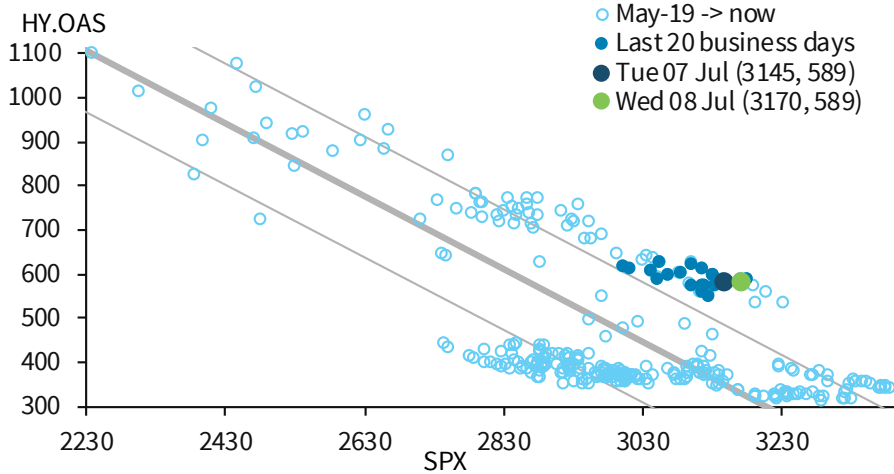
## HY Now vs 2008 and Post-9/11 Wides



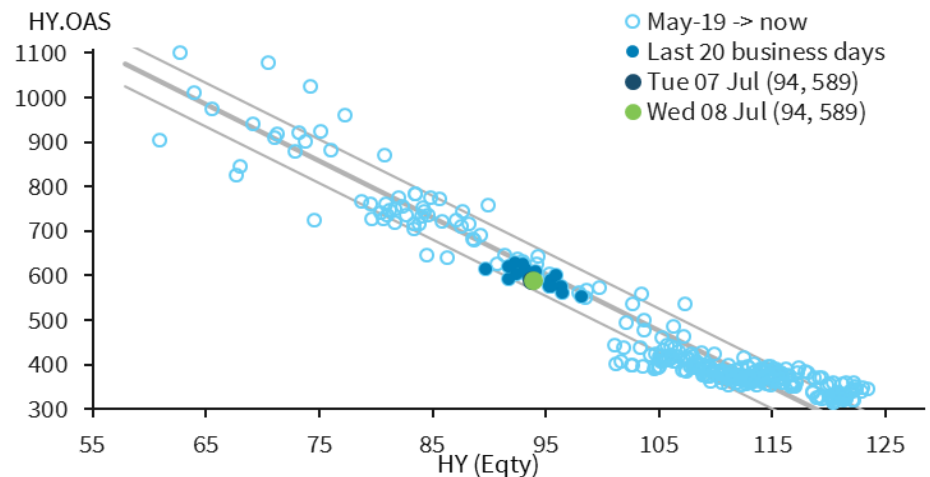
## HY OAS vs Forward Returns



## HY-SPX Correlation Has Broken Down



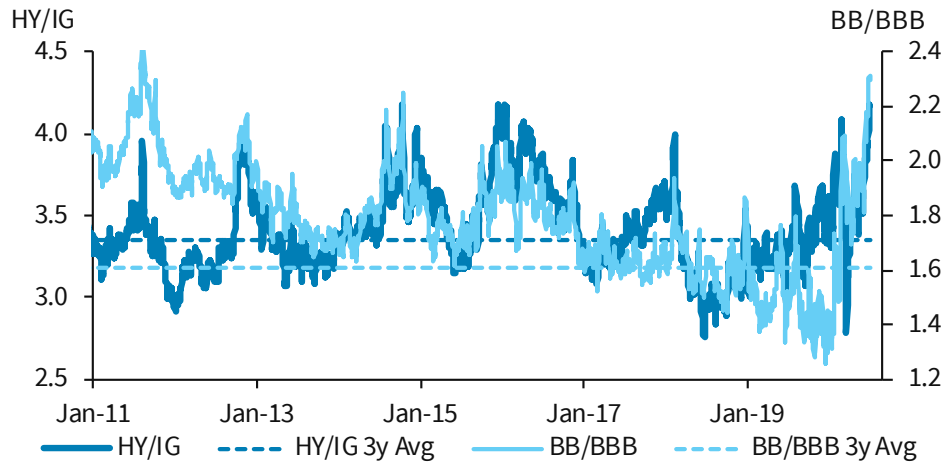
## HY vs Matched Equities\* Is More in Line



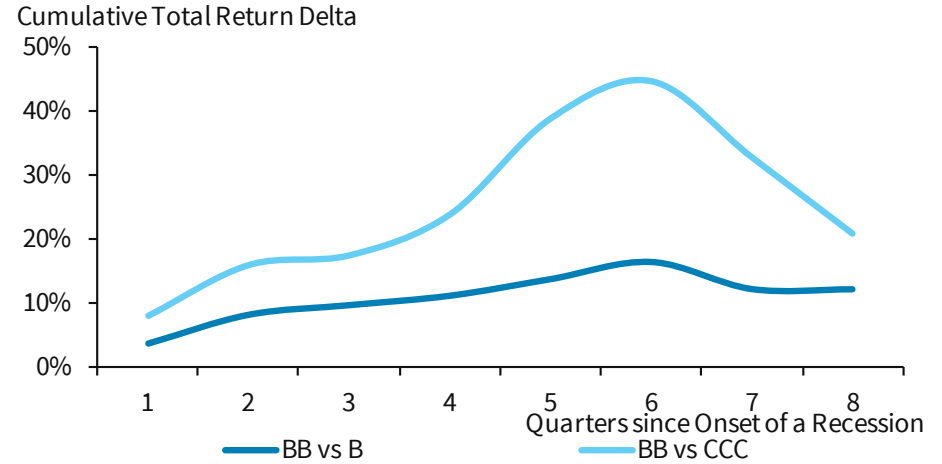
\*HY matched equities index composed of 225 tickers that accounted for approximately 55% of the HY cash index MV as of 12/31/18.  
Source for all charts: Bloomberg, Bloomberg Barclays Indices, Barclays Research

# BBs tend to outperform in HY for extended periods when the market is under stress, but this time they have also underperformed BBBs

## HY/IG Spread Ratio Now at the Highs



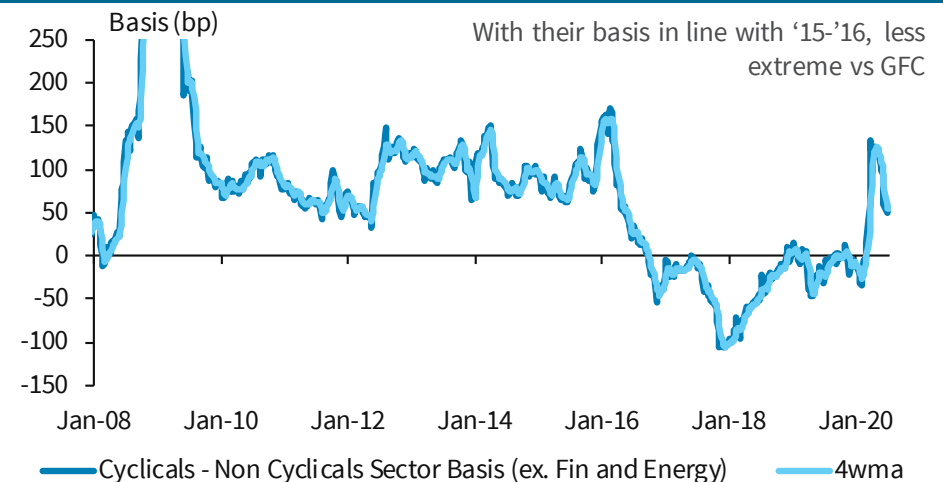
## BBs Greatly Outperformed in Recessions



## BB Outperformance Started Last Quarter

Quarter-end	BB	B	CCC	BB vs B	BB vs CCC
6/30/2020	11.54%	8.64%	9.10%	<b>2.90%</b>	<b>2.44%</b>
3/31/2020	-10.15%	-12.97%	-20.55%	<b>2.82%</b>	<b>10.40%</b>
12/31/2019	2.45%	2.61%	3.74%	-0.17%	-1.29%
9/30/2019	2.03%	1.65%	-1.76%	0.38%	3.79%
6/30/2019	3.08%	2.66%	0.29%	0.42%	2.79%
3/31/2019	7.21%	7.21%	7.15%	0.00%	0.06%
12/31/2018	-2.91%	-4.35%	-9.28%	<b>1.44%</b>	<b>6.37%</b>
9/30/2018	2.32%	2.29%	2.73%	0.03%	-0.41%
6/30/2018	-0.17%	1.42%	2.87%	-1.59%	-3.04%
3/31/2018	-1.60%	-0.55%	0.30%	-1.05%	-1.90%
12/31/2017	0.39%	0.36%	1.02%	0.03%	-0.63%

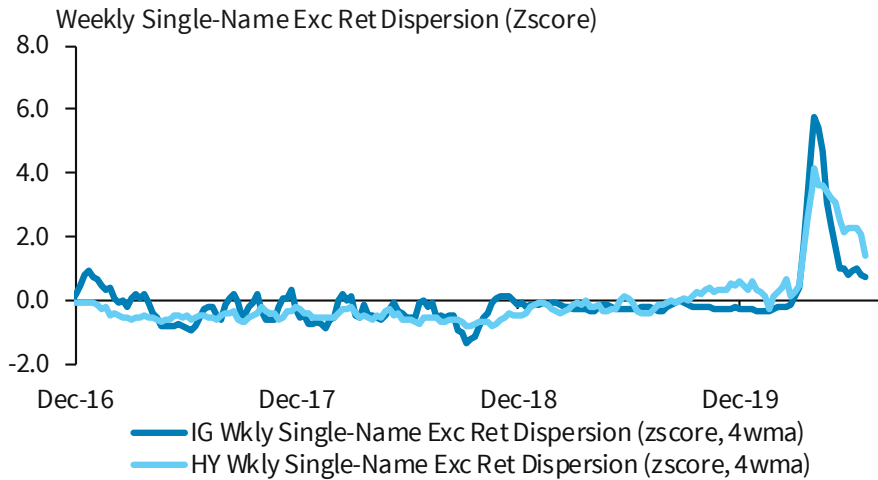
## Cyclicals Lagged Defensives in Mkt Stress



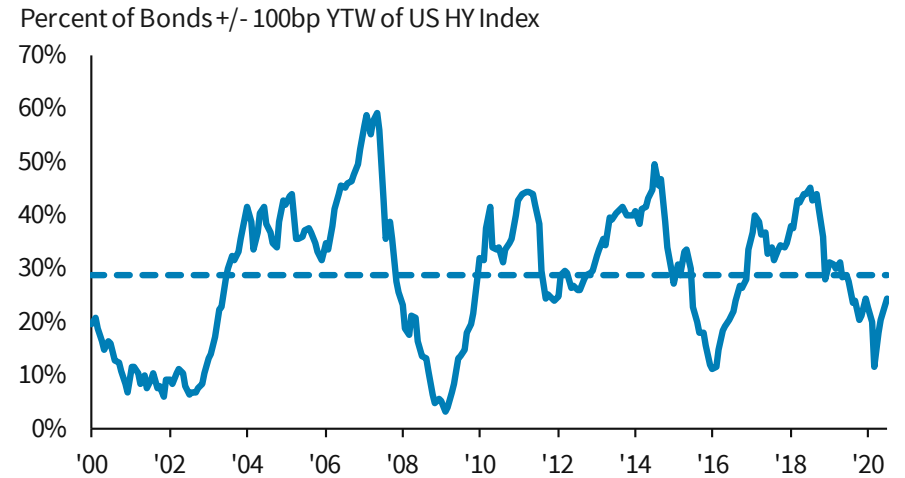
Source for all charts: Bloomberg, BarclaysResearch

Dispersion remains elevated in HY, including for BBs. Given the low yield environment, we find BBs trading above the index yield attractive

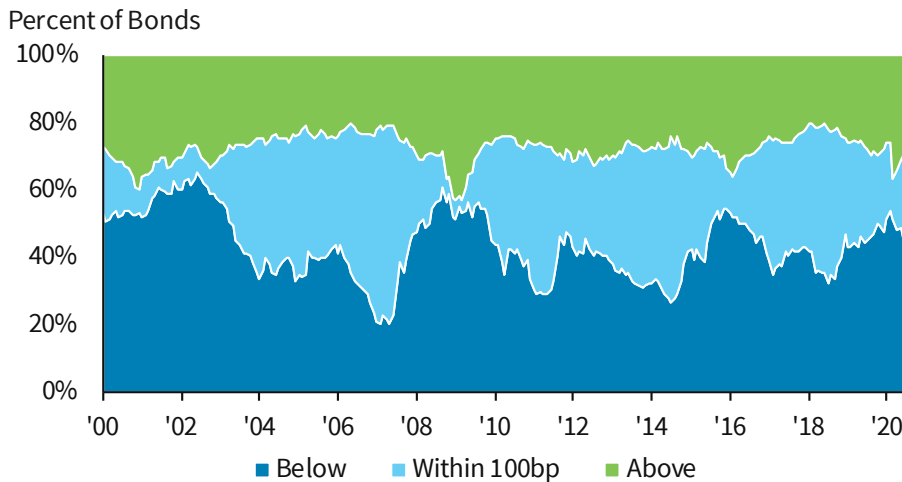
### Single-Name Dispersion Is Higher in HY



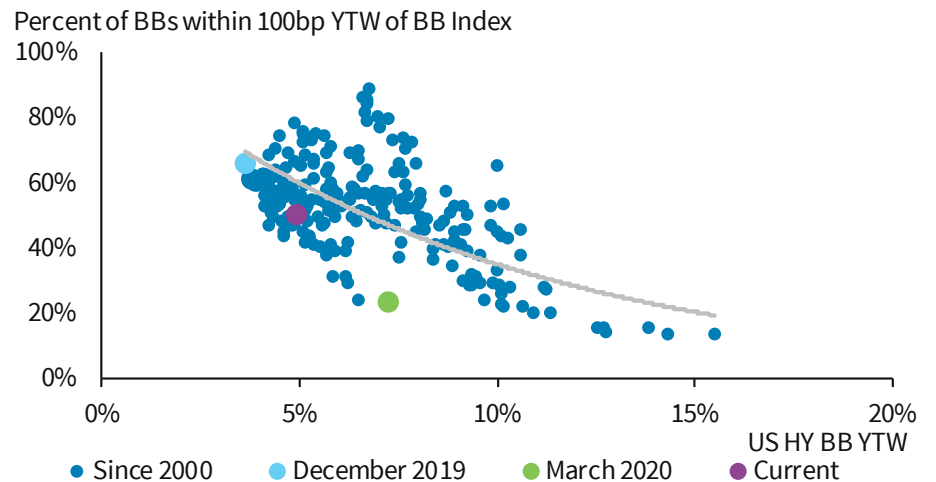
### # of Bonds within 100bp of HY Idx Yld Is Low



### More Yielding above and below Index



### BBs Remain below Regression-Imp. Level

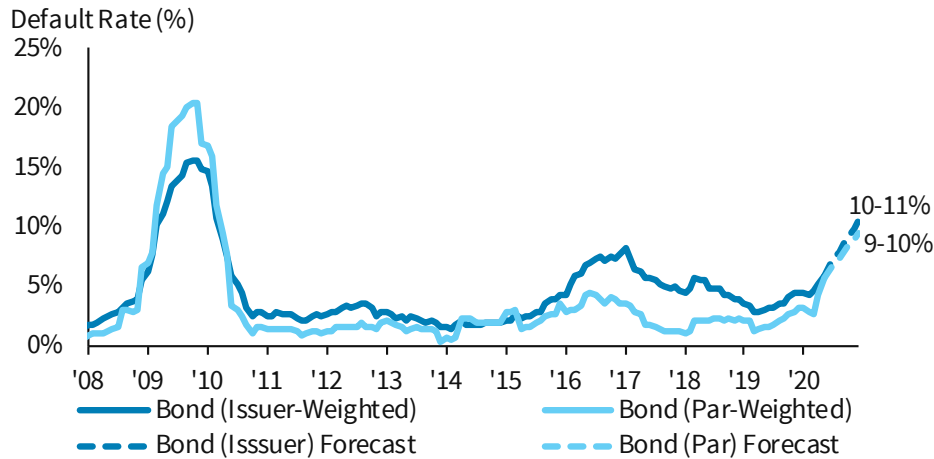


For more detail, see "[Elevated Dispersion Dredges up Cheap BBs](#)," June 26, 2020. Source for all charts: Bloomberg, Barclays Research

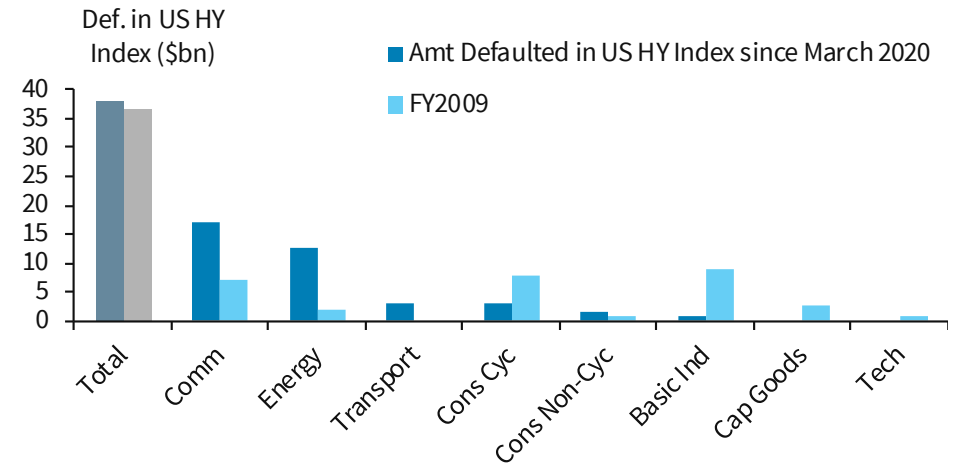


# HY performance has been weighed on by elevated default volumes, driven by the comm and energy sectors; lower recovery value is a potential risk

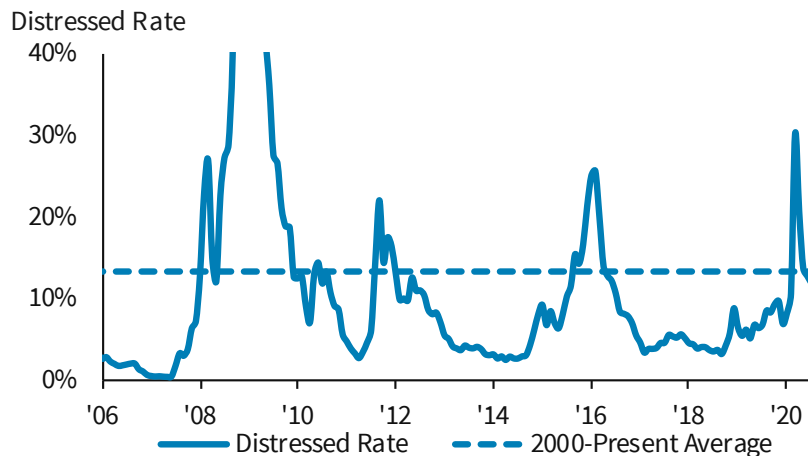
## Default Rate Has Picked Up



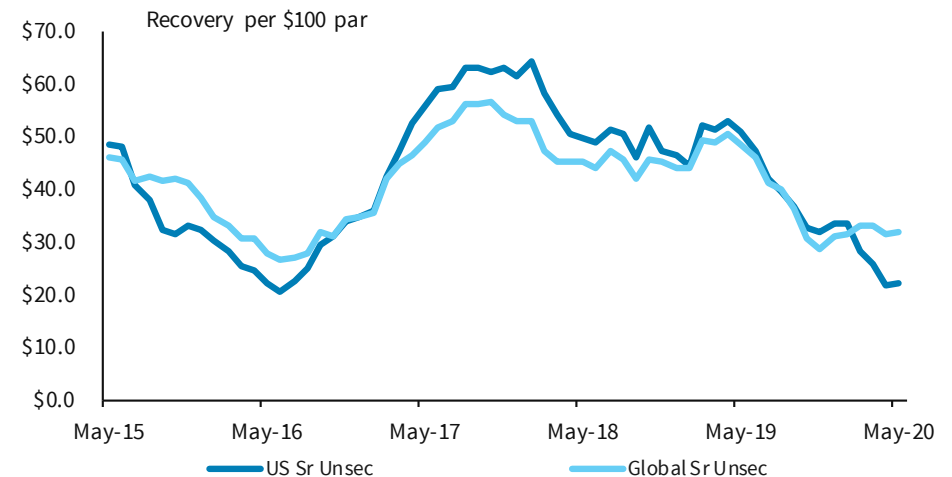
## Defaults Driven by Comm and Energy



## High Yield Distressed Rate (>1000bp)



## Trailing 12m Recovery Value



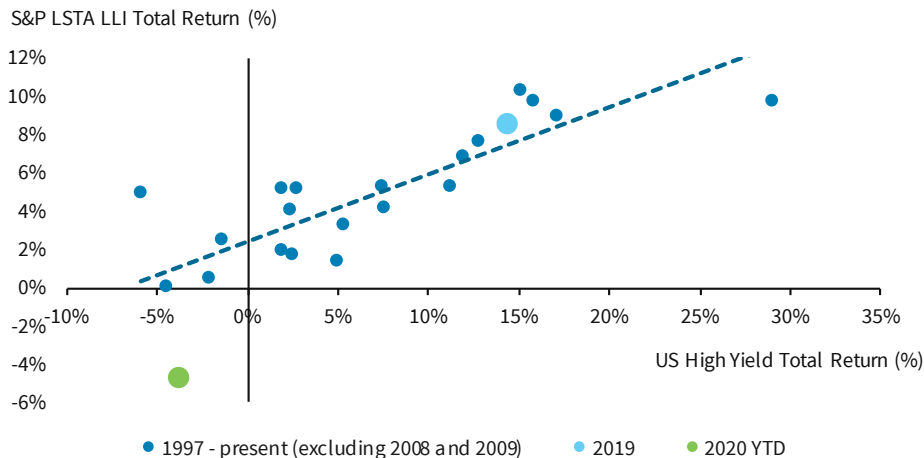
Source for all charts: Bloomberg, Moody's, Barclays Research

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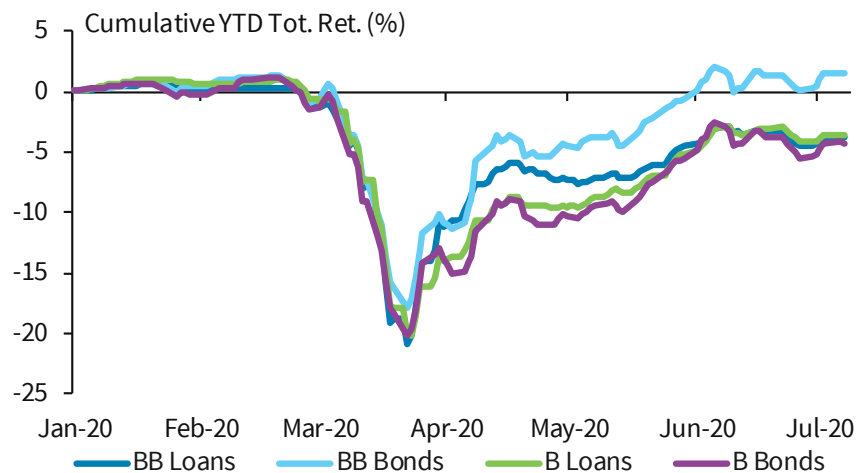
# Leveraged Loans and CLOs

# Despite significantly lower supply, loans have underperformed high yield, especially for BBs

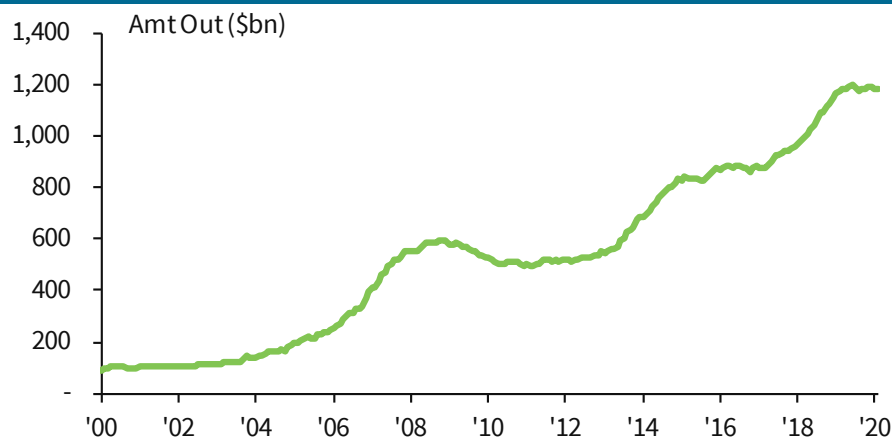
## Historical Loan vs High Yield Returns



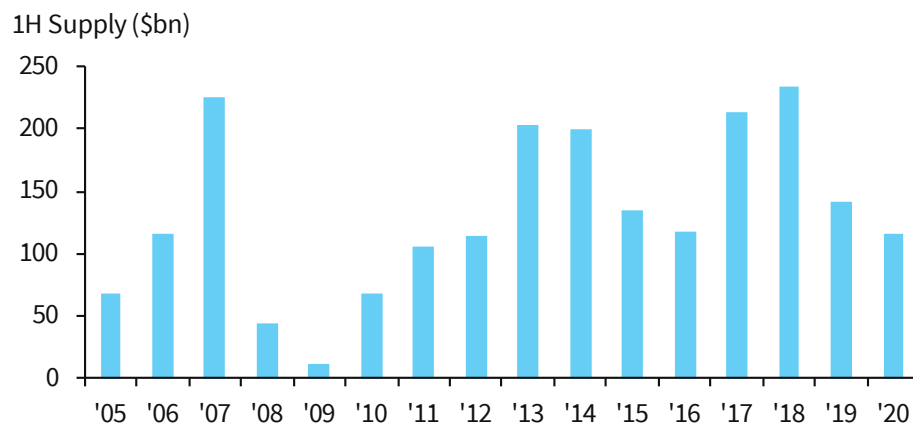
## Loan vs High Yield Ratings Breakdown



## Size of US Loan Market



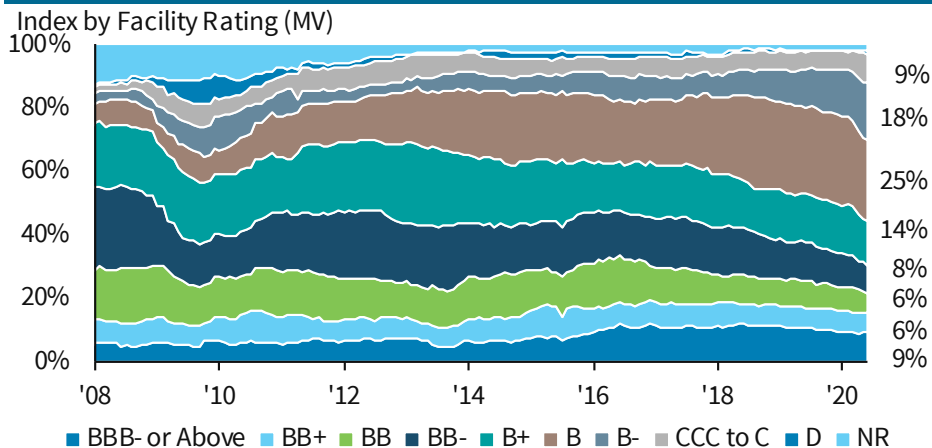
## Loan New Issue



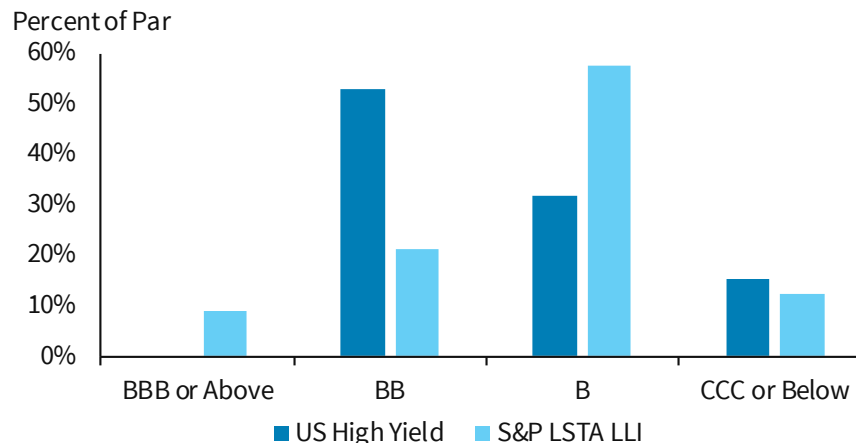
Source for all charts: S&P LSTA, Bloomberg, Bloomberg Barclays Indices, Barclays Research

# The deterioration in loan quality has accelerated with significant downgrades in 1H20 as the crisis peaked

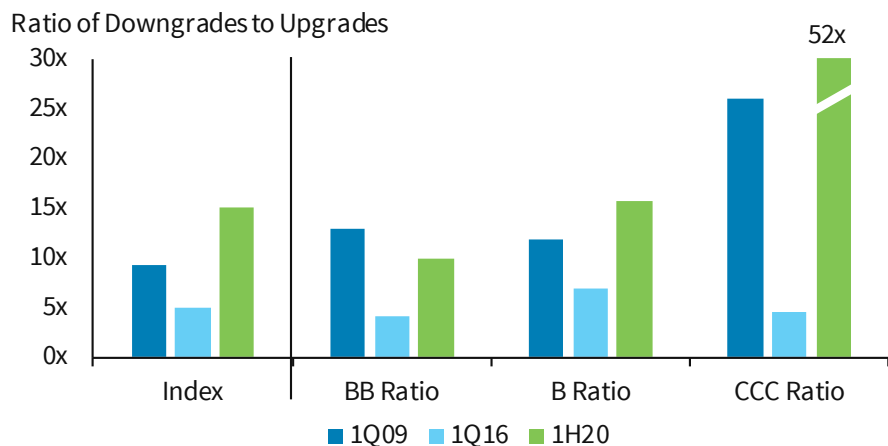
## Loan Market Ratings Evolution



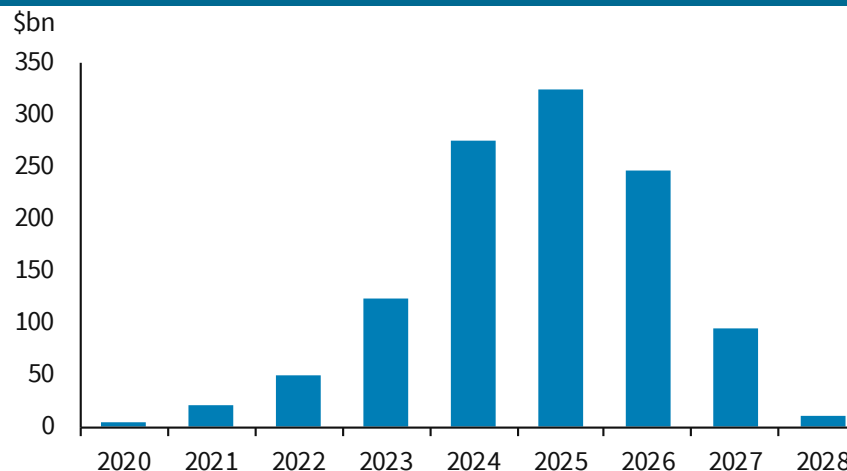
## Loan vs High Yield Ratings Breakdown



## Downgrade/Upgrade Ratio by Ratings



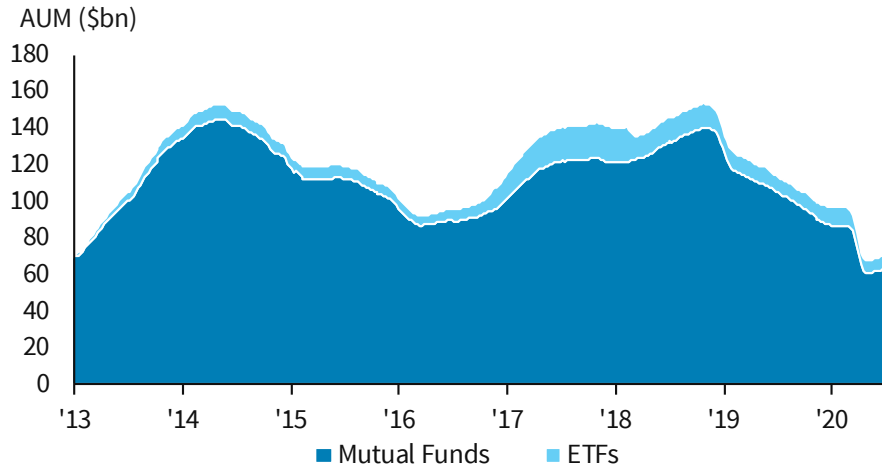
## Loan Maturity Wall



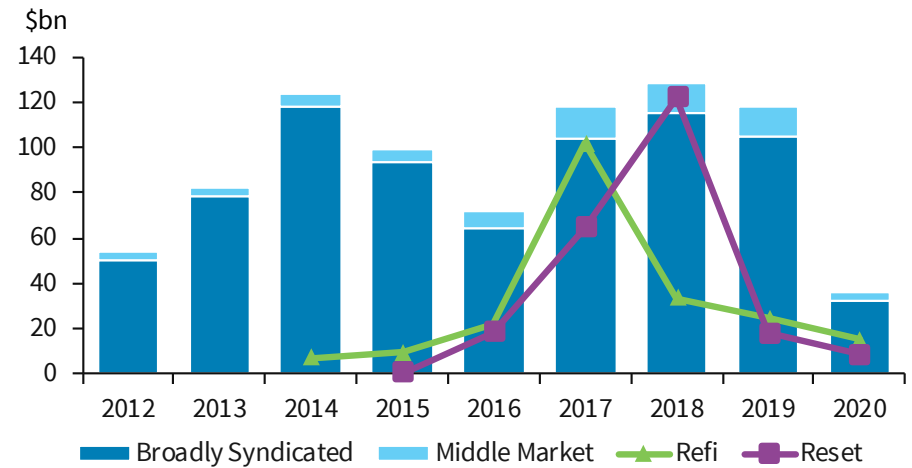
Source for all charts: Bloomberg, S&P LCD, BarclaysResearch

# CLOs are the largest owner of the loan market, but issuance has been down substantially this year

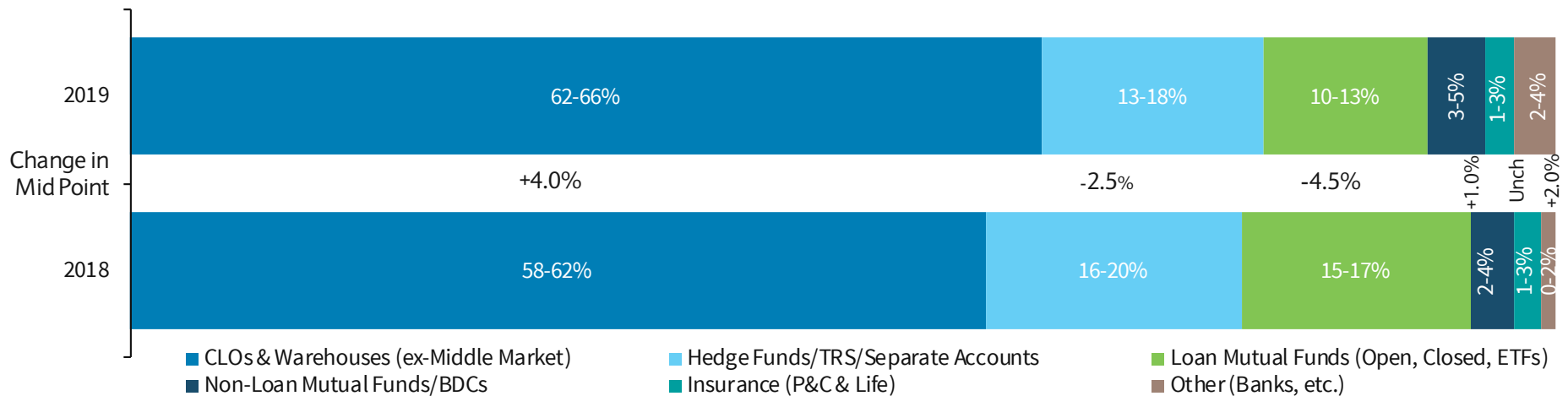
## Loan Mutual Fund and ETF AUM



## CLO Annual Issuance



## Loan Ownership Breakdown

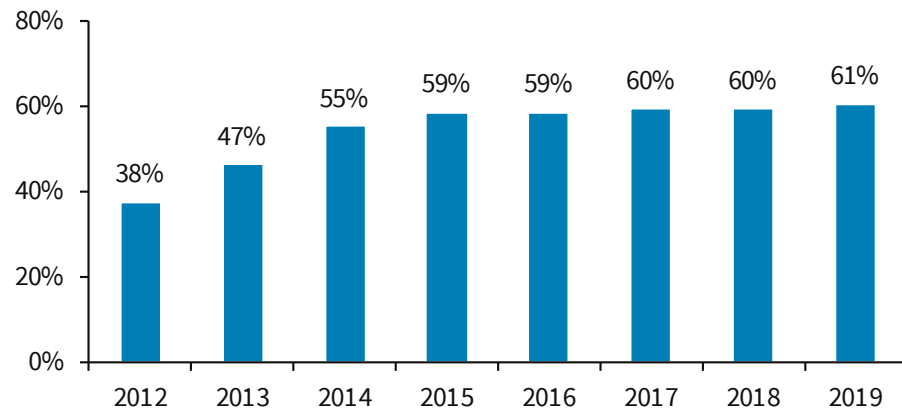


Source for all charts: Lipper, Bloomberg, EPFR, Bloomberg Barclays Indices, Barclays Research, CEF Connect, HFR, Federal Reserve, SNL Financial, Company Filings, Intex, S&P LSTA

# The loan market came into this crisis with higher leverage and riskier lending practices than other parts of the credit market

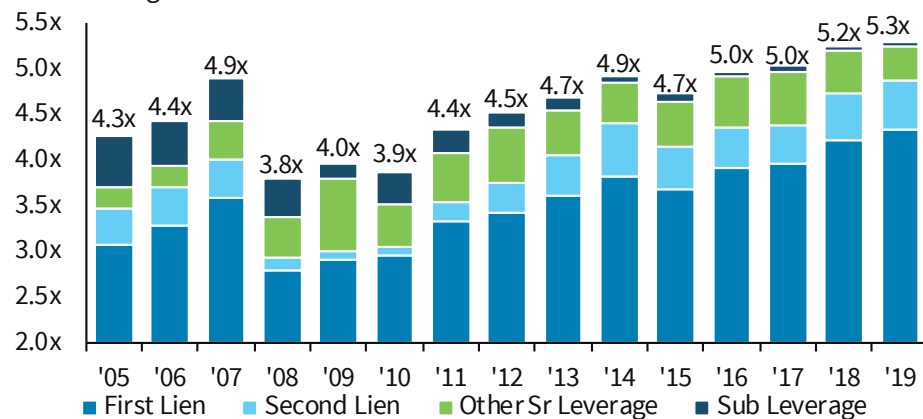
## Loan-Only Issuers

Loan Only Issuers as Percent of Index



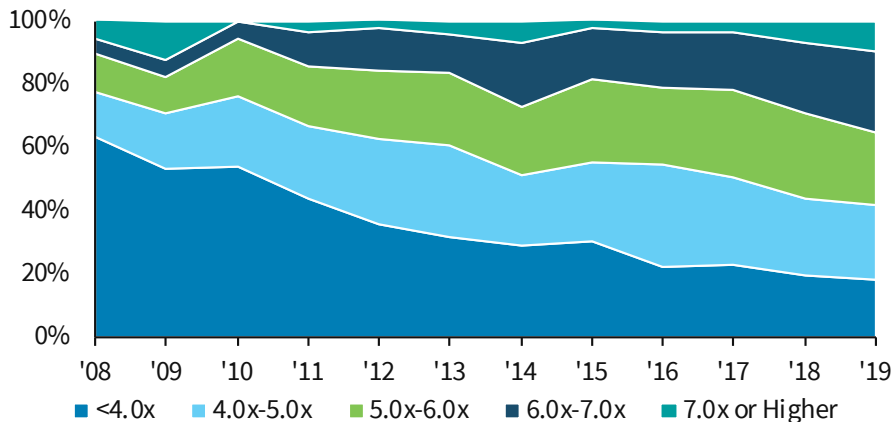
## Large Corp Loan New Issue Leverage

Net Leverage



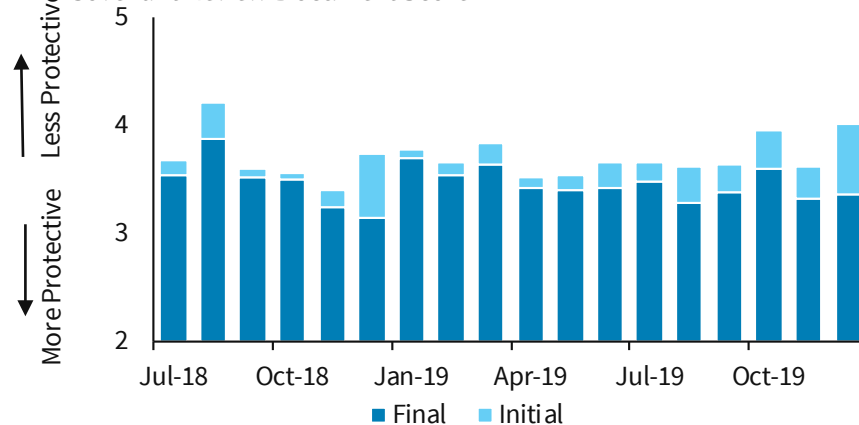
## Issuance by Leverage

Percent of New Issues



## New Issue Loan Terms

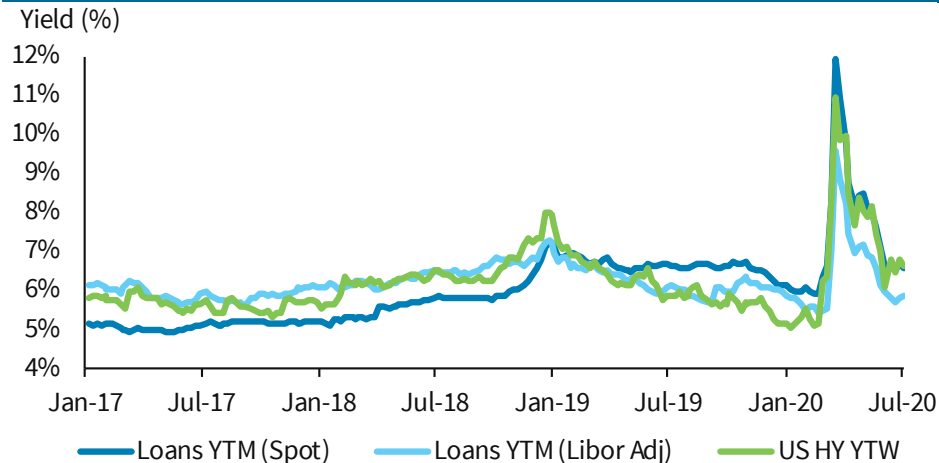
Covenant Review Document Score



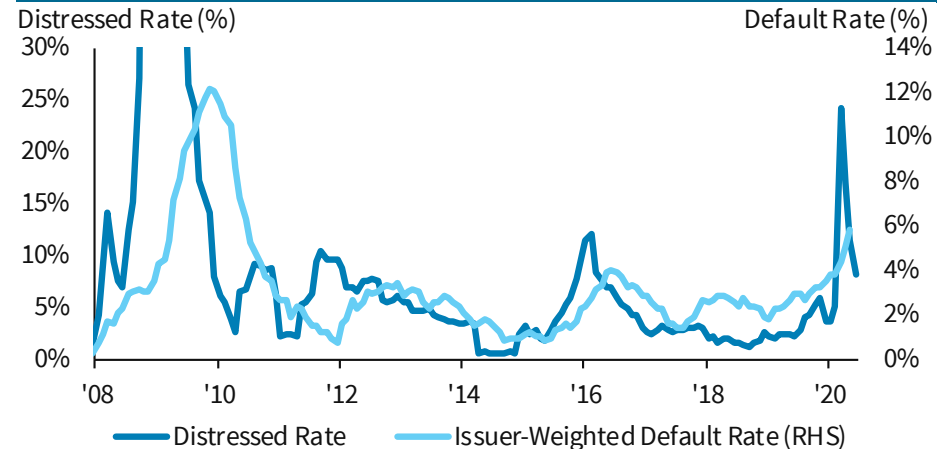
Source for all charts: Bloomberg, BarclaysResearch, S&P LSTA, Covenant Review

# Sector breakdown of the loan market is more favorable than high yield when it comes to a potential pickup in defaults

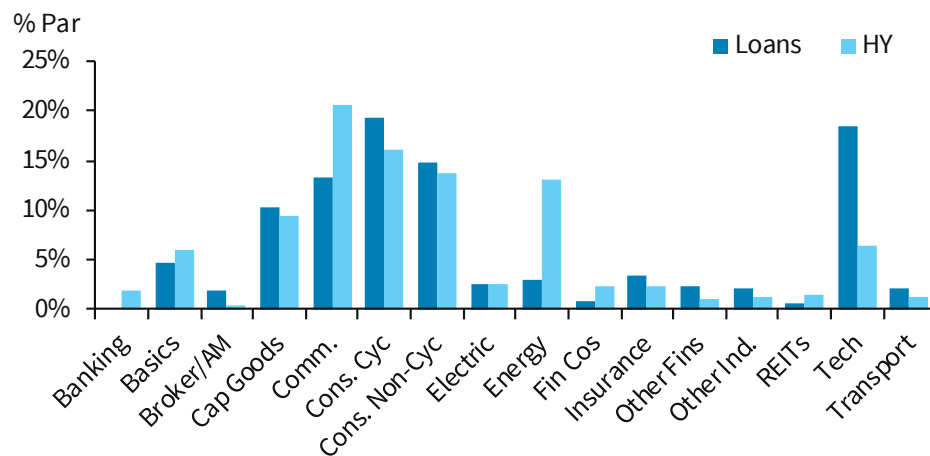
## Bond vs Loan Yields (Spot & Fwd Curve)



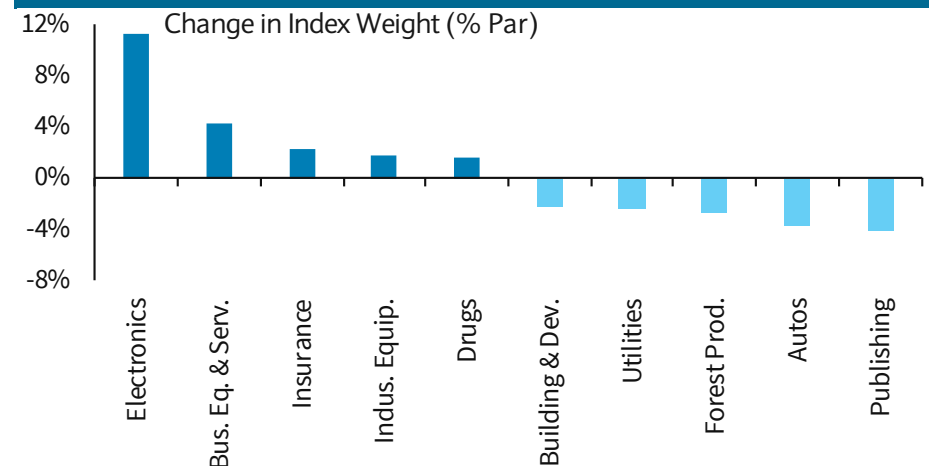
## Loan Distressed Ratio (<\$80)



## Sector Breakdown Loans vs HY



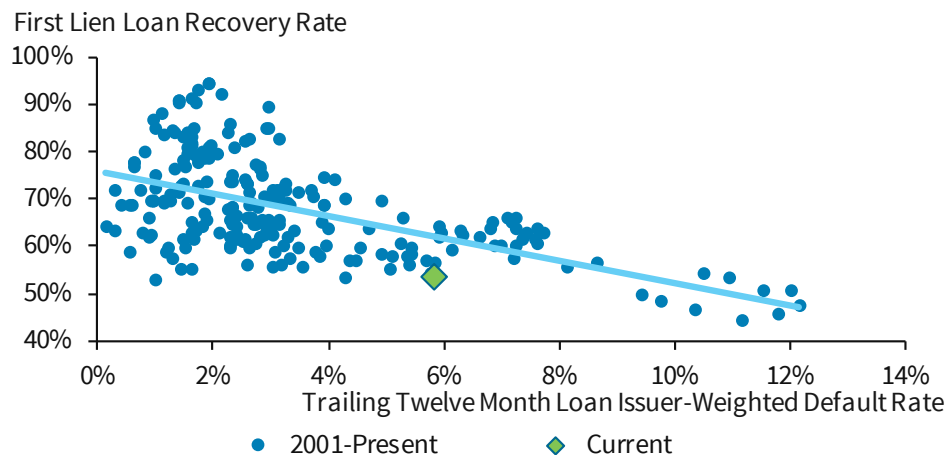
## Change in Loan Sectors since 2006/07



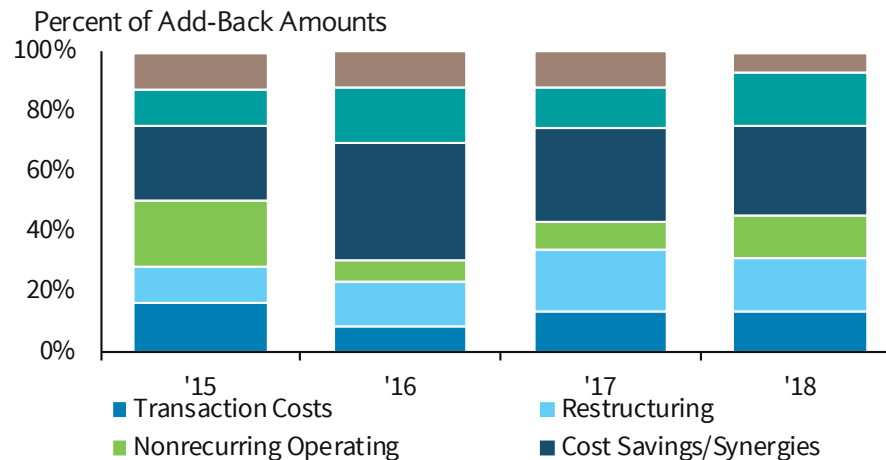
Source for all charts: Bloomberg, S&P LCD, BarclaysResearch

# We believe recoveries are likely to decline 10pts in the next cycle as higher leverage and add-backs are offset by greater enterprise value

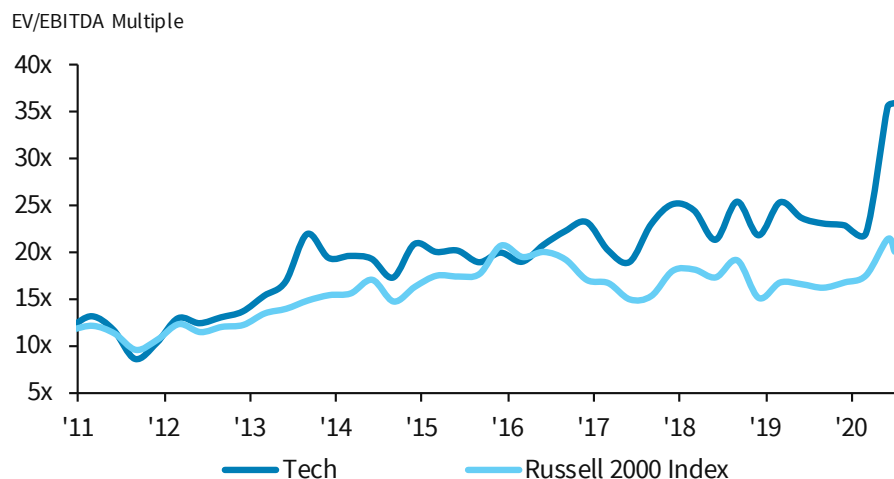
## Defaults Rates vs Recoveries



## New Issue Add-backs by Type



## Enterprise Value Multiples for Russell 2000



## Average Add-backs by Transactions

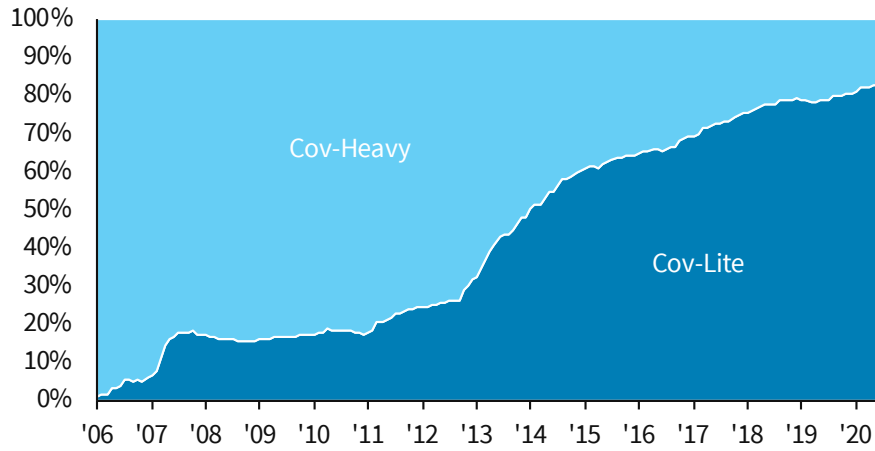
	Add-back/marketing EBITDA	Add-back/reported
LBO	25.9%	49.1%
M&A	28.9%	48.1%
Average	27.6%	48.5%

Source for all charts: Bloomberg, BarclaysResearch, S&P, Covenant Review, Moody's



# Leveraged finance revolvers typically contain a springing maintenance covenant even if the term loan is covenant-lite

## Lev Loans are Mostly Cov-Lite



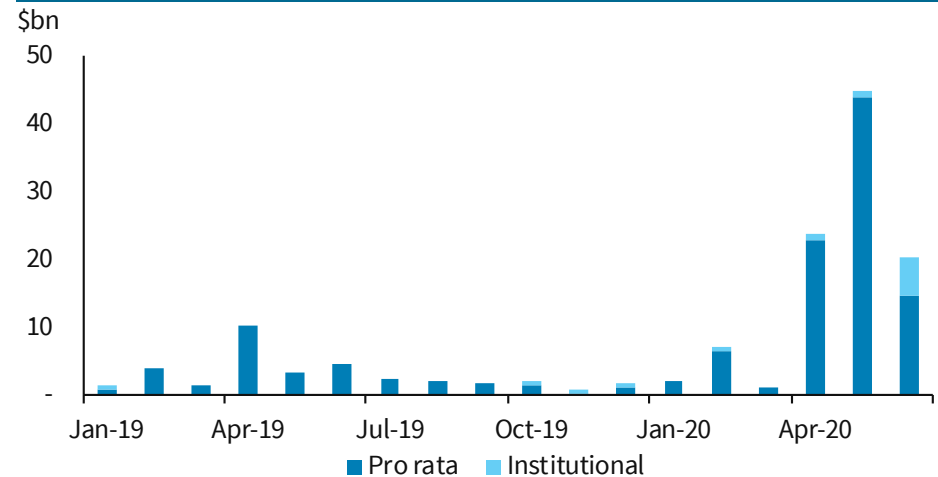
## Recovery Differences Lead to Diff. in LGD

Debt Type	Dec '89 - Dec '92	Jun '99 - Apr '04	Dec '08 - Aug '10	Post-Crisis*	Outside of the Default Cycles**
All Revolvers	88%	81%	90%	91%	88%
Term Loans	87%	71%	71%	63%	82%

## Revolver Springing Covenants

Year	Springing trigger	Net first lien maintenance covenant	Net FL maintenance covenant headroom (sponsored only)
2017	32.34%	6.64	2.45
2018	33.46%	6.80	2.70
2019	34.64%	7.05	2.80
LTM	34.21%	7.07	2.87

## U.S. Loan Covenant-Relief Amendments



Source for all charts: Moody's S&P LCD, Covenant Review, Bloomberg, Barclays Research

# Analyst Certifications and Important Disclosures

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## Analyst Certification(s)

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### Overweight (OW):

For sectors rated against the Bloomberg Barclays U.S. Credit Index, the Bloomberg Barclays Pan-European Credit Index, the Bloomberg Barclays EM Asia USD High Grade Credit Index or the Bloomberg Barclays EM USD Corporate and Quasi-Sovereign Index, the analyst expects the six-month excess return of the sector to exceed the six-month excess return of the relevant index.

For sectors rated against the Bloomberg Barclays U.S. High Yield 2% Issuer Capped Credit Index, the Bloomberg Barclays Pan-European High Yield 3% Issuer Capped Credit Index excluding Financials, the Bloomberg Barclays Pan-European High Yield Finance Index or the Bloomberg Barclays EM Asia USD High Yield Corporate Credit Index, the analyst expects the six-month total return of the sector to exceed the six-month total return of the relevant index.

### Market Weight (MW):

For sectors rated against the Bloomberg Barclays U.S. Credit Index, the Bloomberg Barclays Pan-European Credit Index, the Bloomberg Barclays EM Asia USD High Grade Credit Index or the Bloomberg Barclays EM USD Corporate and Quasi-Sovereign Index, the analyst expects the six-month excess return of the sector to be in line with the six-month excess return of the relevant index.

For sectors rated against the Bloomberg Barclays U.S. High Yield 2% Issuer Capped Credit Index, the Bloomberg Barclays Pan-European High Yield 3% Issuer Capped Credit Index excluding Financials, the Bloomberg Barclays Pan-European High Yield Finance Index or the Bloomberg Barclays EM Asia USD High Yield Corporate Credit Index, the analyst expects the six-month total return of the sector to be in line with the six-month total return of the relevant index.

# Important Disclosures (continued)

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## **Underweight (UW):**

For sectors rated against the Bloomberg Barclays U.S. Credit Index, the Bloomberg Bardays Pan-European Credit Index, the Bloomberg Barclays EM Asia USD High Grade Credit Index or the Bloomberg Barclays EM USD Corporate and Quasi-Sovereign Index, the analyst expects the six-month excess return of the sector to be less than the six-month excess return of the relevant index.

For sectors rated against the Bloomberg Barclays U.S. High Yield 2% Issuer Capped Credit Index, the Bloomberg Bardays Pan-European High Yield 3% Issuer Capped Credit Index excluding Financials, the Bloomberg Barclays Pan-European High Yield Finance Index or the Bloomberg Bardays EM Asia USD High Yield Corporate Credit Index, the analyst expects the six-month total return of the sector to be less than the six-month total return of the relevant index.

## **Sector definitions:**

Sectors in U.S. High Grade Research are defined using the sector definitions of the Bloomberg Barclays U.S. Credit Index and are rated against the Bloomberg Barclays U.S. Credit Index.

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To view sector definitions and monthly sector returns for Asia, EEMEA and Latin America Research, go to <https://live.barcap.com/go/research/EMSectorReturns> on Barclays Live.

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For all High Grade issuers covered in the US, Europe or Asia, and for all issuers in Latin America and EEMEA, the credit rating system is based on the analyst's view of the expected excess return over a six-month period of the issuer's index-eligible corporate debt securities\* relative to the expected excess return of the relevant sector, as specified on the report.

**Overweight (OW):** The analyst expects the six-month excess return of the issuer's index-eligible corporate debt securities to exceed the six-month expected excess return of the relevant sector.

**Market Weight (MW):** The analyst expects the six-month excess return of the issuer's index-eligible corporate debt securities to be in line with the six-month expected excess return of the relevant sector.

**Underweight (UW):** The analyst expects the six-month excess return of the issuer's index-eligible corporate debt securities to be less than the six-month expected excess return of the relevant sector.

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# Important Disclosures (continued)

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**Market Weight (MW):** The analyst expects the six-month total return of the debt security subject to this rating to be in line with the six-month expected total return of the relevant sector.

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