Global Credit Market Outlook

September 2015

September proved to be a very difficult month for credit markets. Broad based concerns over global growth, uncertainty over if and when the US Federal Reserve would begin hiking rates for the first time in 9 years, plus idiosyncratic issues of certain companies and industries, have all lead to a very pessimistic environment.

Economic releases globally also have been below expectations in recent months. US employment data for August showed signs of slowing, with 173K jobs created versus an expected 217K, industrial production dropped 0.4%, capacity utilization dropped to a weak 77.6% and factory orders declined by 1.7%, which was also weaker than anticipated. Similarly, industrial production and factory orders both dropped in Germany to 0.7% and -1.8% and missed expectations. A more pronounced slowdown in China continues to be the biggest fear. Recent data supports the view of a slowdown; however scepticism remains as to the accuracy of the data and the potential that the declines are even more severe.

Volatility lingered in the mid to high 20's for most of September, after having been in the low teens for some time. The S&P 500 dropped by almost 4.5% at the worst point in September, and ended the month down 2.5%. As is common in these types of environments, treasuries rallied with the yield curve flattening as 2 year treasuries declined by 11 basis points and 10 year treasuries declined by 18 basis points. After outperforming equity markets for much of the year, credit markets declined more significantly, with the high yield markets in both the US and Europe declining by -2.60% and -2.08% respectively. Investment Grade credit sectors also underperformed duration matched government debt, and posted significant negative excess returns in Europe.

Given the wall of worries, the Fed, as anticipated declined to raise rates at its September meeting. The market reaction was negative however, which is typically the opposite reaction to such events during this post crisis period. We would attribute this to some level of uncertainty left by not raising rates in addition to concerns about the lack of tools and reduced efficacy of central bank actions in the face of a slowing economy.

We enter the 3rd quarter earnings season with an expected decline of 6.9% in the S&P500 constituents and a drop of 3.6% in revenues. We expect that this will lead to continued M&A by firms searching for growth through acquisition due to weak organic growth opportunities.

Weakness in commodities markets continued and has weighed heavily on the credit markets. The High Yield sector has felt the greatest impact and the commodity-exposed sectors have continued to be the worst performers. The drop in these markets led to the independent energy component of the US High Yield market to post a total return -6.75% for the month.

The primary market did show a rebound in issuance, but has still been slower than recent periods due to uncertain market conditions. The US Investment Grade primary market slowed to $92.1B of new issuance and the High Yield market $19.4B for the month of September. Fund outflows have slowed, as $0.9B was withdrawn from US High Yield mutual funds and ETFs.

Investment Strategy

We are cautious in the longer term given heightened real risk of global economic weakness. We are also concerned that if commodity-driven sectors continue to be impacted by global weakness, increasing outflows could have a larger impact on pricing. However, we do believe near term, safer sectors in the High Yield market that have declined due the heightened concerns are attractive.

Sources: Bloomberg, Barclays and SSGA.

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Figure 1: Credit Market Excess Returns
Returns Over Equal Duration Treasuries (%)

	US		Europe	
By Sector (Corporates — Excess Returns)	**September**	**Year to Date 2015**	**September**	**Year to Date 2015**
Industrials	-0.52	-2.81	-1.93	-2.90
Utilities	-0.02	-2.51	-1.18	-1.82
Financials	-0.03	-0.63	-1.04	-1.51
By Ratings (Corporates — Excess Returns)				
AAA	0.03	-1.72	-0.71	-2.38
AA	-0.02	-1.08	-0.85	-1.78
A	-0.08	-1.22	-1.17	-2.00
BBB	-0.63	-3.13	-1.91	-2.42
Corporate Index (Investment Grade)	-0.33	-2.09	-1.47	-2.18
By Ratings (High Yield — Total Return)				
BB	-2.07	-0.86	-2.04	-0.87
B	-2.96	-2.72	-2.81	0.34
CCC	-2.67	-4.97	0.50	0.72
Corporate Index (High Yield — Total Return)	-2.60	-2.45	-2.08	-0.43

Proxies for the returns shown in the table are the US Corporate Index, US Corporate High Yield Index, Euro-Aggregate Corporate Index and the Pan-Euro High Yield Index.

Source: Barclays Index ratings as of September 30, 2015.

Past performance is not a guarantee of future results.

The calculation method for value added returns may show rounding differences.

Performance returns for periods of less than one year are not annualized.

Index returns are unmanaged and do not reflect the deduction of any fees or expenses. Index returns reflect all items of income, gain and loss and the reinvestment of dividends and other income.

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VIX: CBOE Volatility Index.

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