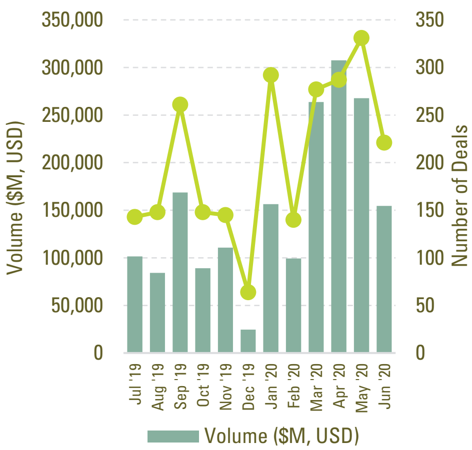
COVID-19 Research Update

Global Fixed Income Themes & Market Conditions

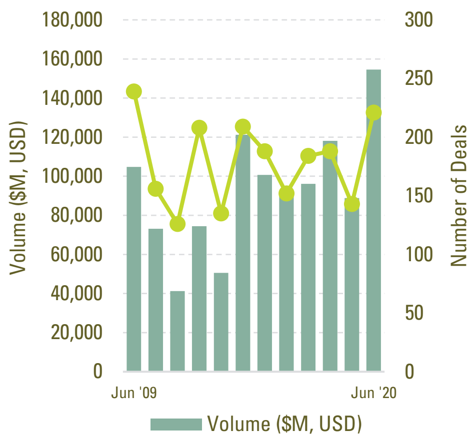
As expected, U.S. investment grade credit new issuance activity has started to taper off as spreads compressed. **Figure 1** shows that new issuance within this segment has started to revert to levels seen at the beginning of the year. While month-over-month activity has slowed, overall new issuance on a year-over-year basis remains strong, as depicted in **Figure 2**.

Figure 1 Rolling Monthly U.S. Investment Grade New Issuance As of 6/25/2020



Source: Bloomberg (© 2020, Bloomberg Finance LP)

Figure 2 Year-Over-Year U.S. Investment Grade New Issuance As of 6/25/2020

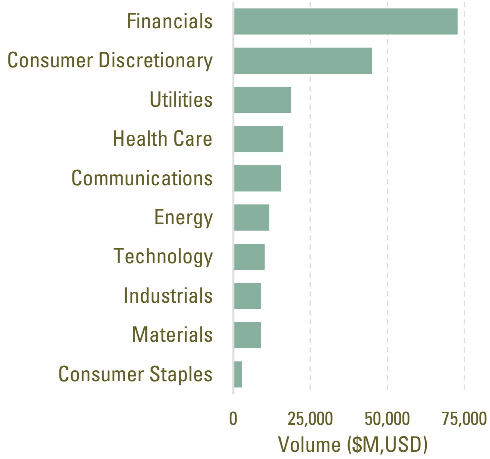


Source: Bloomberg (© 2020, Bloomberg Finance LP)

Financials have steadfastly tapped debt markets to maintain their well-capitalized balance sheets amidst an economic slowdown, while consumer discretionary issuers have been positioning themselves for a snapback in consumption. The strong rebound in May retail transactions likely fueled interest in new issuance within this sector. See **Figure 3**.

Investment grade corporate credit has been buttressed by Federal Reserve (Fed) policy since the onset of the coronavirus-related crisis. We believe the Fed could lend additional support to the lower-quality segments of U.S. credit markets, particularly if economic activity once again comes to a standstill, volatility in commodity prices reemerges, or if second quarter earnings register well below market expectations.

Figure 3 U.S. Investment-Grade New Issuance by Sector June 2020



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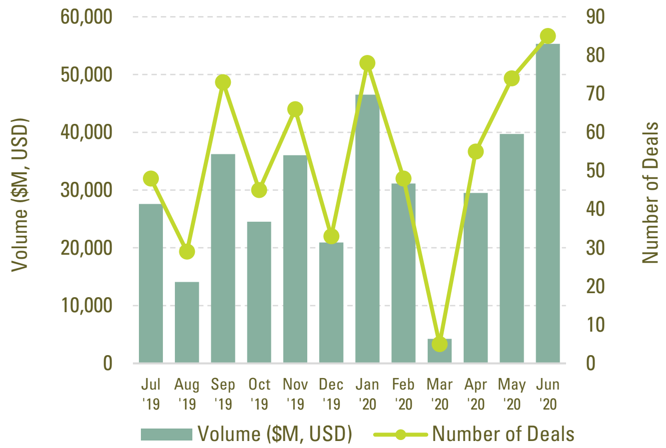
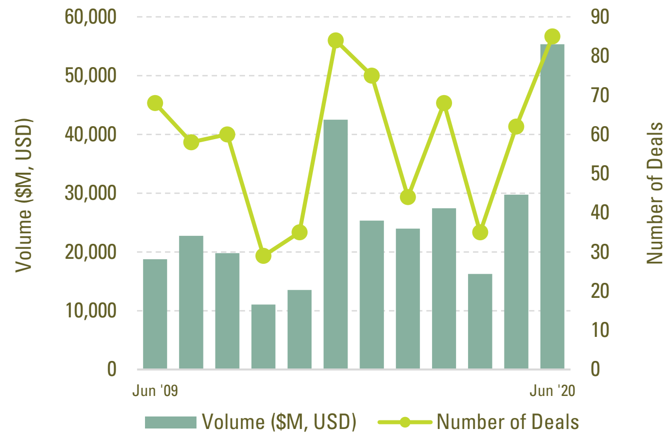
Investors may already be anticipating additional central bank support, as U.S. high yield new issuance continued to substantially increase month-over-month, and nearly doubled when compared to June 2019. See **Figures 4** and **5**.

Figure 4 Rolling Monthly U.S. High Yield New Issuance
As of 6/25/2020



Source: Bloomberg (© 2020, Bloomberg Finance LP)

Figure 5 Year-Over-Year U.S. High Yield New Issuance
As of 6/25/2020



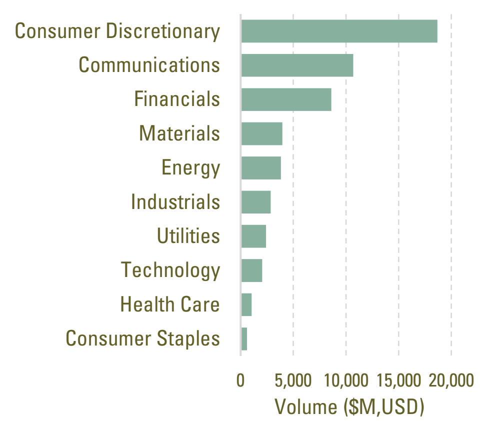
Source: Bloomberg (© 2020, Bloomberg Finance LP)

Although the value of these U.S. high yield deals is roughly one-third of total activity within the investment grade universe, the uptick in new issuance suggests that investors are interested in new spread compression opportunities. The increase in demand may also suggest the Fed could once again widen the scope of its purchases to include more high yield issuers.

Akin to the U.S. investment grade credit market, high yield new issuance was largely concentrated in the consumer discretionary and financials sectors. However, the communications sector also participated in high yield new issuance, given the increasing reliance on these technologies and mediums as Americans continue to work and entertain at home. See **Figure 6**.

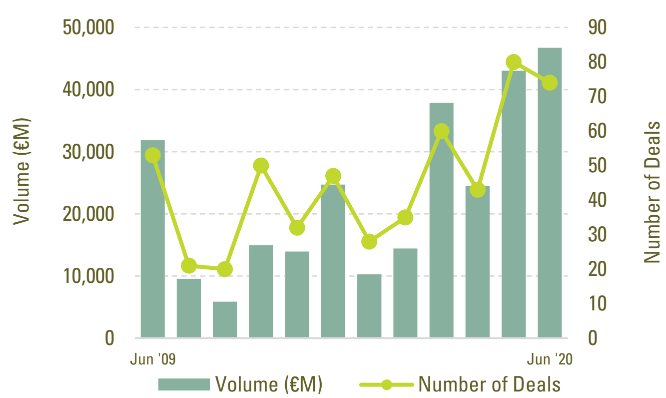
The waning momentum within investment grade new issuance also extends to Europe, where monthly activity has started to marginally decline, though annual levels remain elevated (**Figures 7** and **8**). Generally, valuations on euro-denominated investment grade corporate credit have historically been rich and will likely to continue to be so long as the European Central Bank continues to buy these bonds. However, the cost for U.S. investors to hedge the euro has notably declined in 2020 due to the Fed's rate cuts.

Figure 6 U.S. High Yield New Issuance by Sector
June 2020



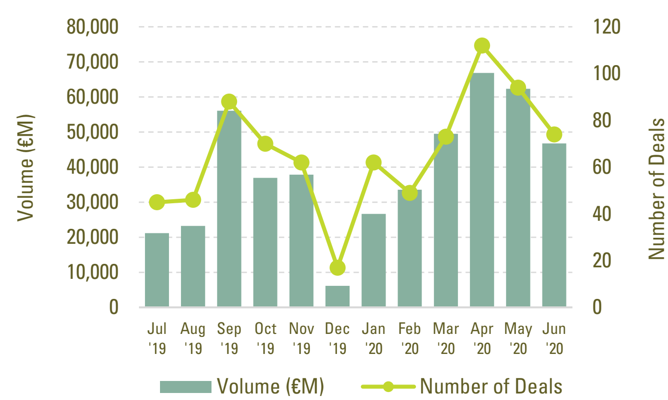
Source: Bloomberg (© 2020, Bloomberg Finance LP

Figure 7 Year-Over-Year EUR Investment Grade New Issuance
As of 6/25/2020



Source: Bloomberg (© 2020, Bloomberg Finance LP)

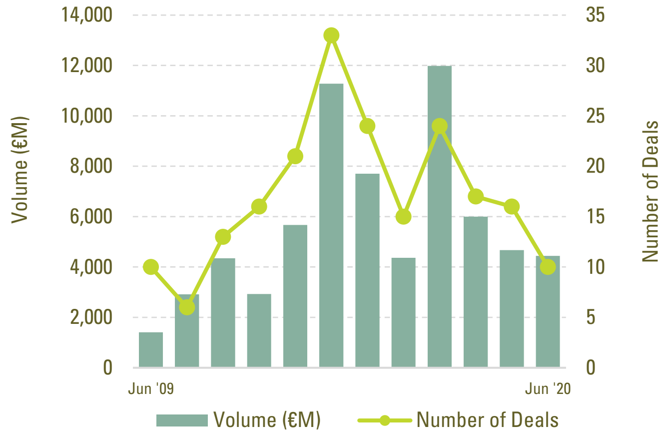
Figure 8 Rolling Monthly EUR Investment Grade New Issuance
As of 6/25/2020



Source: Bloomberg (© 2020, Bloomberg Finance LP)

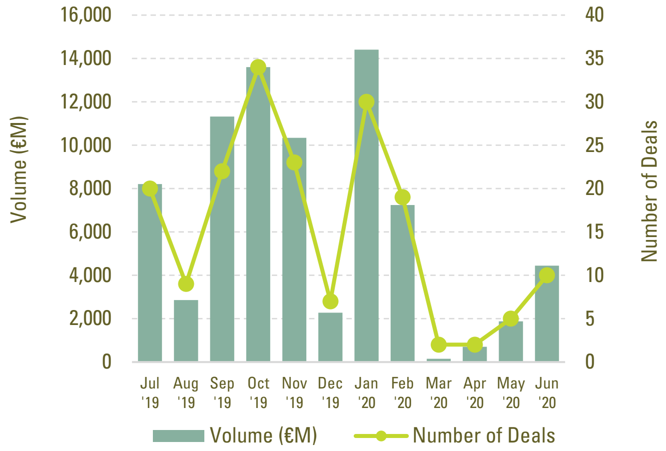
The European high yield universe is relatively nascent when compared to the U.S., but this segment has also recently experienced an increase in investor demand, as noted in **Figures 9** and **10**. These lower-rated issuers could receive support from the ECB, as well as the anticipated economic recovery in the eurozone—which seems to be leading the U.S.

Figure 9 Year-Over-Year Western Europe High Yield New Issuance
As of 6/25/2020



Source: Bloomberg (© 2020, Bloomberg Finance LP)

Figure 10 Rolling Monthly Western Europe High Yield New Issuance
As of 6/25/2020



Source: Bloomberg (© 2020, Bloomberg Finance LP)

Investors willing to maintain longer-term credit exposure may consider opportunities within potential fallen angels in the U.S. and Europe. Similar to past cycles, the energy sector could experience the largest wave of downgrades if crude oil prices remain suppressed. It is difficult to get the timing right; therefore, rigorous bottom-up analysis is needed to ensure company fundamentals are strong enough to withstand higher borrowing costs, profit loss, and reduced cash flows that could result from a ratings downgrade.