3 US BBB IG spreads are back to historical recessionary levels

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Valuations of US corporate bonds have returned to levels consistent with those reached during the last recessions or systemic crises. This is true for both investment grade and speculative grade securities, although to different degrees according to the specific rating categories and/or sectors. The graphs show that the spreads of BBB-rated corporate bonds, in particular, are currently in line with the peaks reached in the recession of the early 1990s and with the average levels of the subsequent recession of the early 2000s. Although comparison with the recession experienced in the aftermath of the GFC is trickier, it is evident in this case too that current spreads are compatible with the initial phase of that experience, and finally it is also interesting to note that they are aligned with the peaks reached following the European sovereign crisis. Historical comparison for A-rated corporate bonds looks less extreme, as the recent increase in the risk premium does not yet appear to have reached the same recessionary territory.

The main driver is the usual suspect, namely the commodity & oil driven industry

The collapse in oil and commodity prices is the main factor behind the rise in US IG spreads: the energy and metals & mining sectors both currently pay an average spread of approximately 1,700 basis points and about 600 b.p., respectively, in the HY and IG US credit markets, vs. an average spread paid by other sectors of 660 b.p. and 164 b.p. respectively for investment grade and speculative grade. The higher risk premium demanded by investors anticipates an increasing trend of credit events, though this trend is already evident in the HY segment. Energy companies now have a failure rate close to 10%, which is set to rise further, with good chance that it will reach the 15% range in the coming months. At the moment, defaulting companies are almost exclusively lower rated (CCC) and belong to subsectors related to energy extraction and production activity. It is also important to note that the smaller capitalised companies are the most affected by credit events: in the coming months and quarters, however, higher default levels among mid-rated (B) companies with higher capitalisations is likely in light of oil and commodity price levels.

It is not only the number of HY defaults that is on the rise – the number of fallen angels is too

If in the HY market a surging distress ratio reflects an increase in bankruptcies, in the IG market it mainly reflects the increased risk of downgrades to HY status, especially for companies exposed to oil. Here too the number of fallen angels is already increasing: in 2015 the value of the dollar debt that “fell” into the HY field increased to about $151 billion, from about $60 billion in 2014 and about $65 billion in 2013. The ratio of downgrades to upgrades has also increased due to the changed outlook of the sectors most exposed to the fall in energy prices. Then, the energy sector is among the most heavily-weighted in the BBB segment where it accounts for 14% of securities, compared to a more modest 12% within the overall IG universe. The latest indications from the rating agencies confirm that the downward pressure remains on ratings and on the rating outlooks of a number of companies in the sector.

The comparison of spreads with macro leading indicators

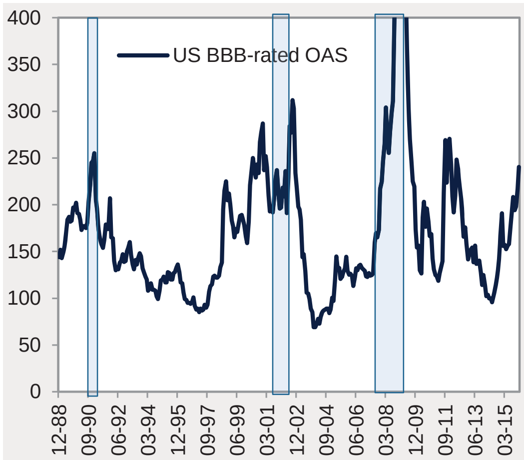
The graphs show a strong historical correlation between US IG spreads and the ISM manufacturing index: the latter has been below the threshold of 50 for some months now, although it remains close to the threshold. On the contrary, the gap has widened considerably compared to the non-manufacturing ISM index, which is still well above the threshold of 50 and consistent with future GDP growth in the 2% area. We know that the role

The essential

Valuations of BBB US corporate bonds have returned to levels consistent with those reached during the last recessions or systemic crises. The main driver is the usual suspect, namely the commodity & oil driven industry and the trend reflects the increased risk of downgrades to HY status, especially for companies vulnerable to the fall of oil price.

The comparison of spreads with macro leading indicators shows a strong correlation with the ISM manufacturing index, currently slightly below the threshold of 50, but it also shows a rising gap with the non-manufacturing ISM index, still consistent with future GDP growth in the 2% area. Then, the scenario implied in the current spread levels of US IG companies not only appear to be close to that of a typical historic recession but are also clearly decoupling from the still positive signals coming from the service sector.

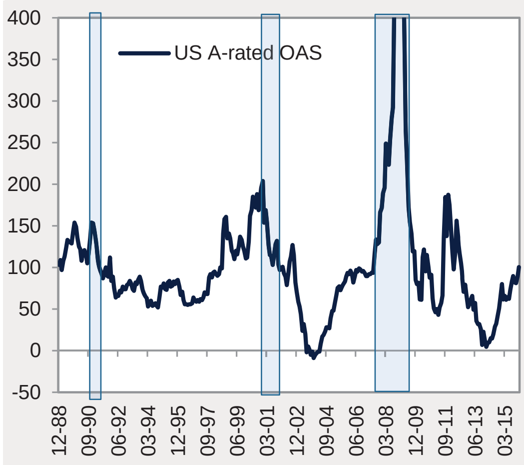
1 US BBB spreads are back to recessionary levels



Source: Bloomberg, Amundi Research

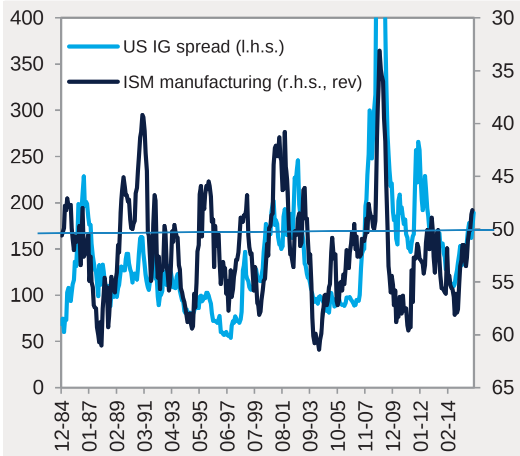
of services is dominant in the US economy, contributing about 80% of the country's entire GDP: the appreciation of the dollar and the negative impact of oil has undoubtedly weighed on the manufacturing sector, but domestic demand is expected to benefit most of the IG companies belonging to other sectors, particularly those exposed to energy consumption. Roughly speaking, then, the scenario implied in the current spread levels of US IG companies not only appear to be close to that of a typical historic recession but are also clearly decoupling from the still positive signals coming from the service sector, which are supportive to domestic growth.

2 **US A spreads not yet in recessionary levels**



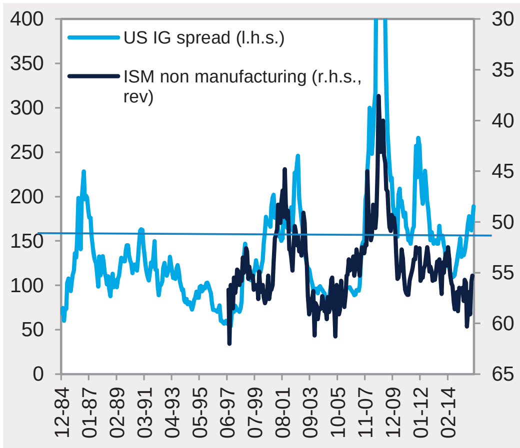
Source: Bloomberg, Amundi Research

3 **IG OAS in line with below 50 manufacturing ISM levels**



Source: Bloomberg, Amundi Research

4 **IG OAS decoupled from non-manufacturing ISM**



Source: Bloomberg, Amundi Research

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