

## MONTHLY COMMENTARY

## January Credit Update

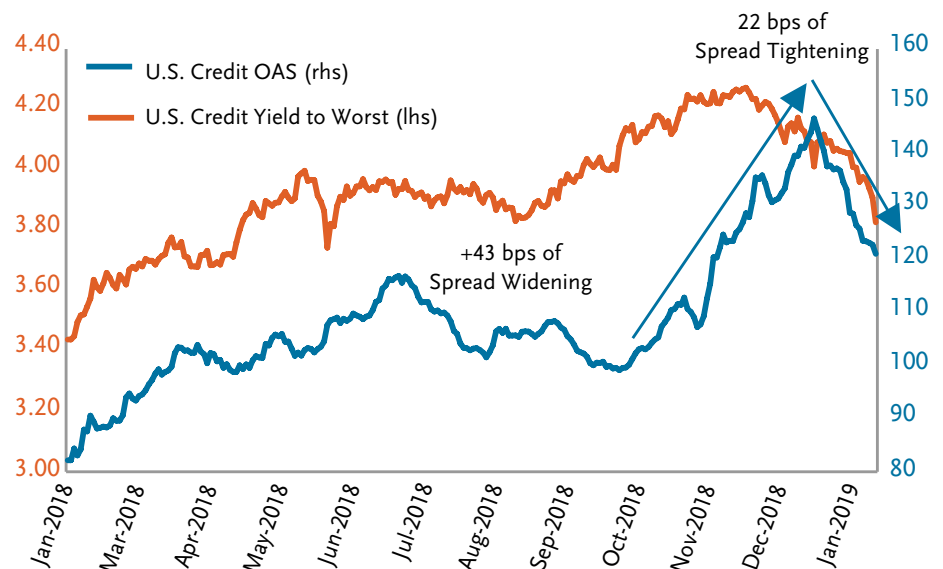
TAMMY KARP | 7 FEBRUARY 2019

After three consecutive months of spread widening, the IG credit markets mounted a meaningful comeback in January. The whipsaw in both credit spreads and market sentiment came on the heels of more “dovish” Fed rhetoric, with the implications being that the “Fed put” continues to be the panacea to slowing global growth and an aging credit cycle. The volatility in credit spreads has been notable – 43 basis points (bps) of widening over three months followed by 22 basis points of tightening in January.

As spreads approached +150 over, the value proposition improved, allowing us to take advantage of opportunities to selectively add credit exposure, in line with our dollar cost averaging investment philosophy. However, we are mindful of the fact that the underlying issues have not abated -deteriorating credit fundamentals, massive growth in the credit markets, worsening liquidity conditions and rising idiosyncratic risks. As such we continue to maintain a conservative approach to credit, which includes investing in the more senior parts of the capital structure and in less cyclical sectors.

## IG Credit Index Yields and Spreads

Credit Index OAS of +121 was 22 bps Tighter in January



Source: Bloomberg Barclays

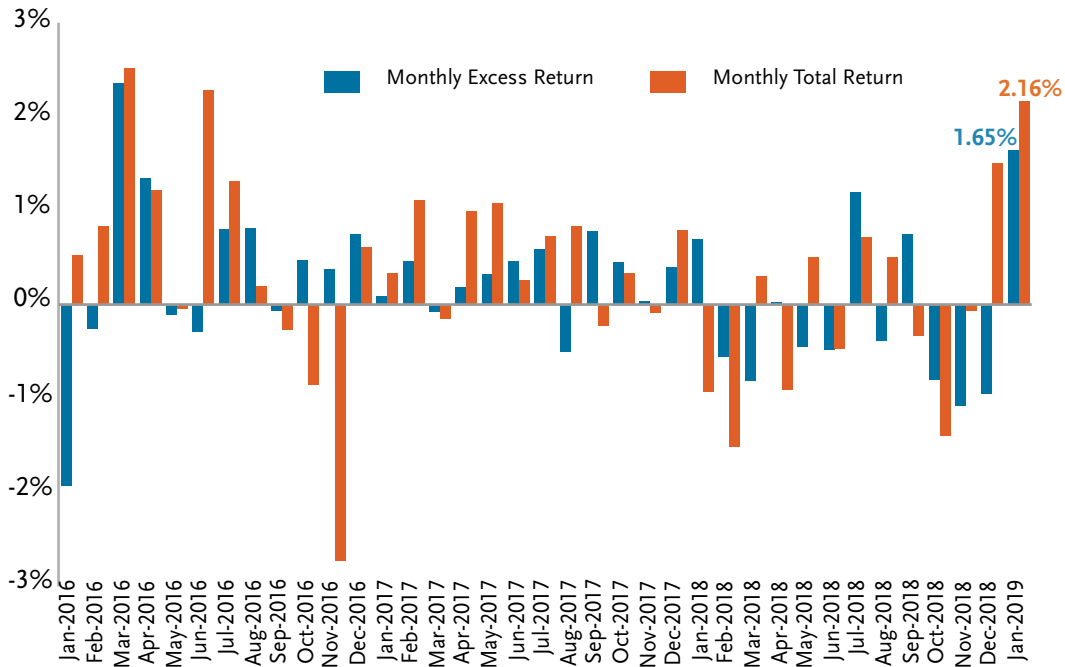


**Tammy Karp**  
Managing Director  
Fixed Income

Ms. Karp is a Managing Director in the Fixed Income group where she trades investment grade and cross over securities. Ms. Karp joined TCW in 2009 during the acquisition of Metropolitan West Asset Management LLC (MetWest). Prior to joining MetWest in 1997, she was with the fixed income department at The Capital Group. Ms. Karp earned her BS in Business from University of Arizona.

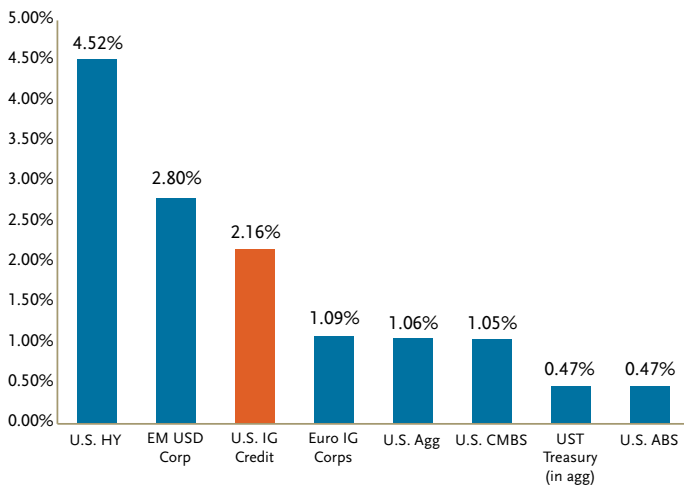


Annual Excess and Total Returns  
Best Monthly Returns Since 2016



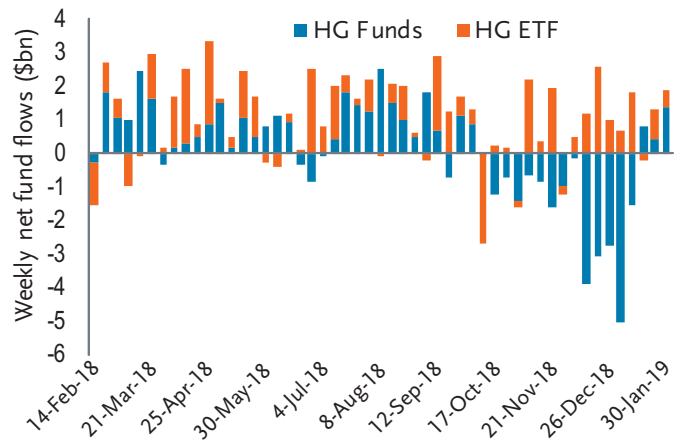
Source: Bloomberg Barclays

January Total Returns for Various Fixed Income Classes



Source: Bloomberg Barclays

IG Fund Flows Have Improved as of Late

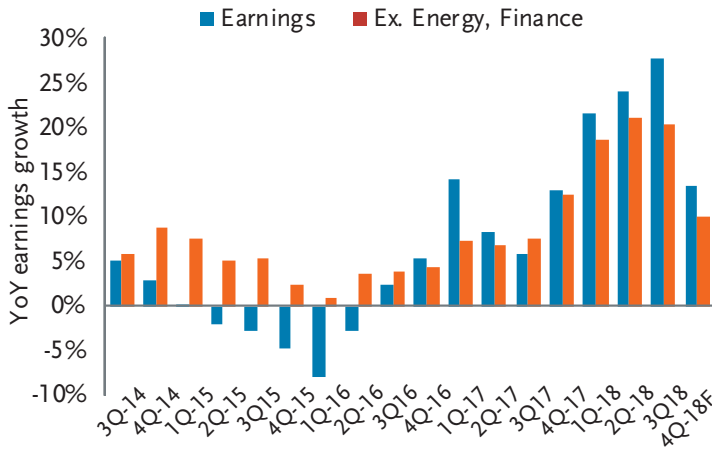


Source: EPFR Global

Note: Data are for US-domiciled funds only

# January Credit Update

## Earnings Growth has Slowed but Still Robust at 13.4% 4Q Earnings Recap



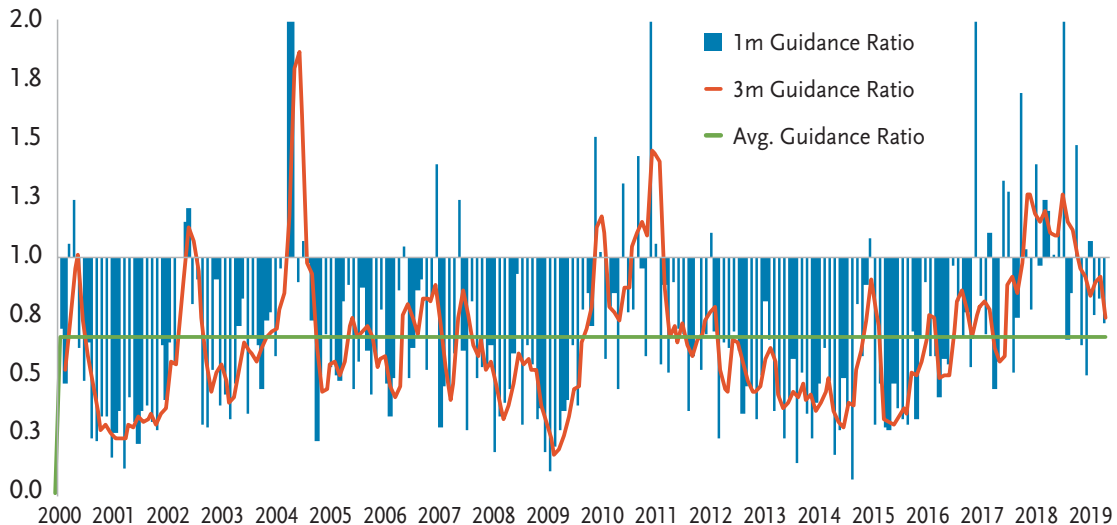
Source: BofA Merrill Lynch Global Research, FactSet  
Note: 4Q18 based on the actual results when available and consensus estimates otherwise

## 4Q Earnings for IG Issuer by Sector

Sector	Earnings Growth (YoY)	Sale Growth (YoY)
Aerospace/Defense	40.6%	10.9%
Automobiles	-14.6%	-0.2%
Banks/Brokers	24.2%	1.8%
Basic Materials	11.1%	9.7%
Consumer Products	0.1%	-2.2%
Energy	57.4%	14.5%
Finance	-17.6%	-15.6%
Food, Bev, & Bottling	10.2%	1.8%
Health Care	9.4%	7.5%
Industrial Products	8.1%	1.0%
Insurance	8.1%	3.1%
Media & Entertainment	6.7%	10.8%
REITs	3.4%	3.3%
Retail	16.4%	4.8%
Technology	7.0%	3.8%
Telecom	29.1%	8.9%
Transportation	30.6%	7.1%
Utilities	-7.1%	-2.1%
Other	8.7%	2.9%
<b>Total US HG public co's</b>	<b>13.4%</b>	<b>5.6%</b>
<b>Total ex. Financials</b>	<b>13.2%</b>	<b>6.2%</b>
<b>Total ex. Energy</b>	<b>10.9%</b>	<b>4.5%</b>
<b>Total ex Fin. &amp; Energy</b>	<b>10.0%</b>	<b>5.0%</b>
<b>Yankee and private co's</b>	<b>n.a.</b>	<b>n.a.</b>

Source: BofA Merrill Lynch Global Research, Factset  
Based on actual results when available and consensus estimates otherwise

## While Management Forward Guidance is Weaker S&P 500 Management Guidance Ratio (#Above vs. #Below Consensus)



Source: Bloomberg, FactSet, BofA Merrill Lynch US Equity & US Quant Strategy

# January Credit Update

## Index Performance

The credit index OAS of +121 bps over Treasuries was 22 bps tighter on the month. Stable Treasury yields and tighter spreads produced positive total and excess returns of +2.16% and +1.65% respectively. Every sector in the IG credit universe posted positive excess returns though lower beta, higher quality underperformed (muni's, rails, utes (x pcg)). Cyclical and BBBs outperformed, a partial reversal of the decompression we saw in 2018. Within energy, independent E&Ps (-42 bps), midstream (-34 bps) and refiners (-33 bps) outperformed as oil prices rose \$8 to above \$50/barrel. Tobacco spreads remediated somewhat, tightening 35 bps in January after 111 bps of widening in 2018. MO (Altria) was one of 16 issuers to fall out of the single A index last year – on M&A-related re-leveraging.

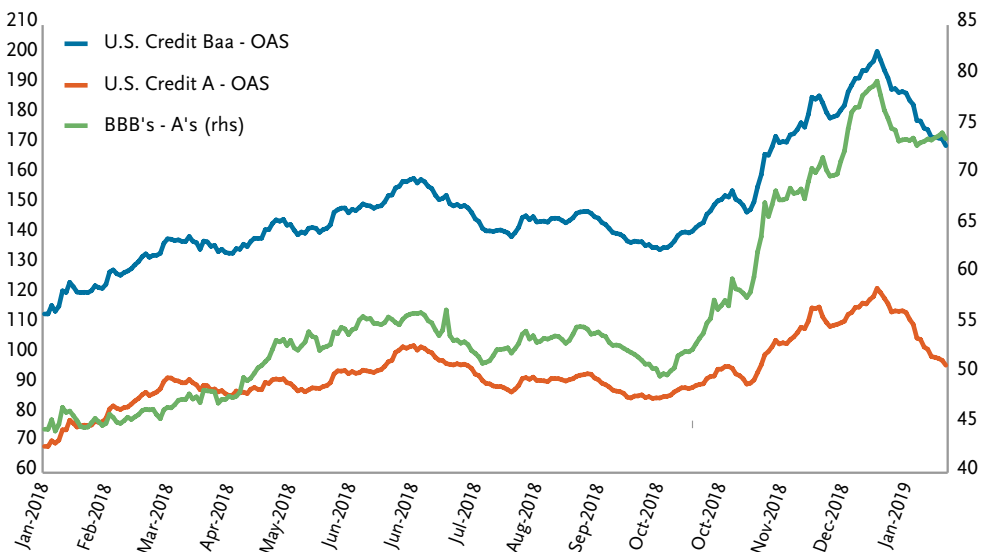
PCG (PG&E) filed for bankruptcy on January 29 in the face of significant liabilities related to the 2017 and 2018 California wildfires. Approximately \$17 bln notional of index-eligible debt dropped out of the IG index on January 31, 2019 (without ever entering the HY index). At the heart of the issue is inverse condemnation, which applies strict liability to utilities regardless of negligence or fault. While legislation (SB901) passed in September of last year intended to put a path in place for California utilities to socialize some of the liabilities from the fires, regulators and legislators appeared to lack the political will to act expeditiously. Given the complexity of this issue, the bankruptcy process could be lengthy. The lack of true legislative reform on the issue of inverse condemnation has directly impacted the other two California utilities (EIX and SRE) who have suffered ratings pressure and spread widening as a result.

### January Index Returns

	January Excess Return	January Total Return	1/31/19 OAS	Monthly OAS Change	
Credit Index	1.65%	2.16%	121	-22	
Industrials	1.99%	2.53%	133	-24	
Financials	1.84%	2.33%	119	-28	
Utilities*	0.38%	0.97%	127	-17	* -2 bps x PCG
Municipals	0.45%	1.09%	136	-3	
Sovereigns	2.21%	2.79%	139	-22	
AA	0.96%	1.44%	66	-15	
A	1.61%	2.13%	96	-22	
BBB	2.07%	2.60%	170	-27	

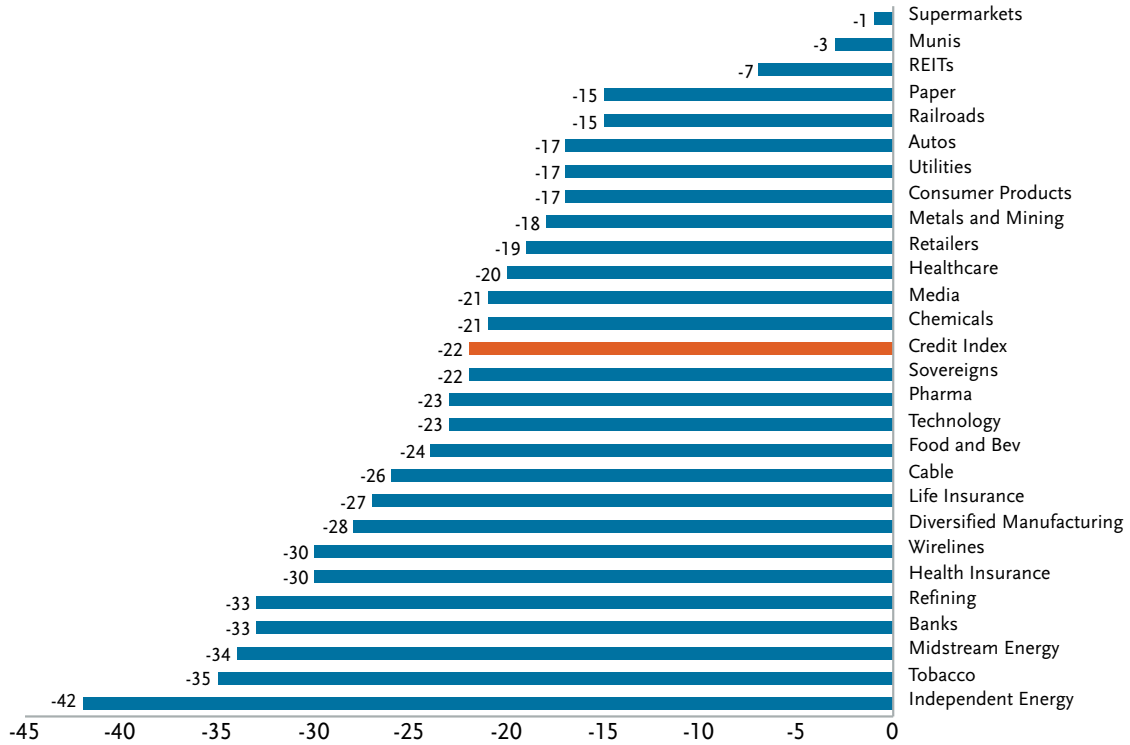
Source: Bloomberg Barclays

### BBB's vs. A's Spread Compressed by 5 bps but Still Wide of 12 Month Average



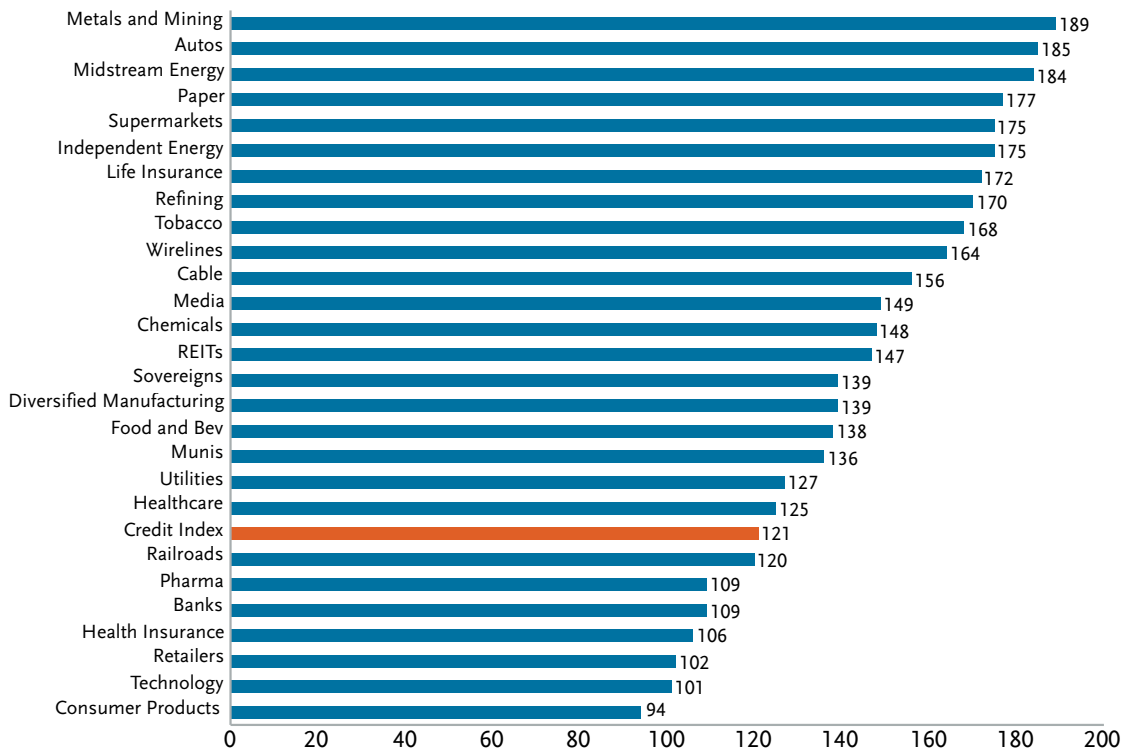
Source: Barclays Capital

January OAS Changes



Source: Barclays Capital

January 31, 2019 Sector OAS



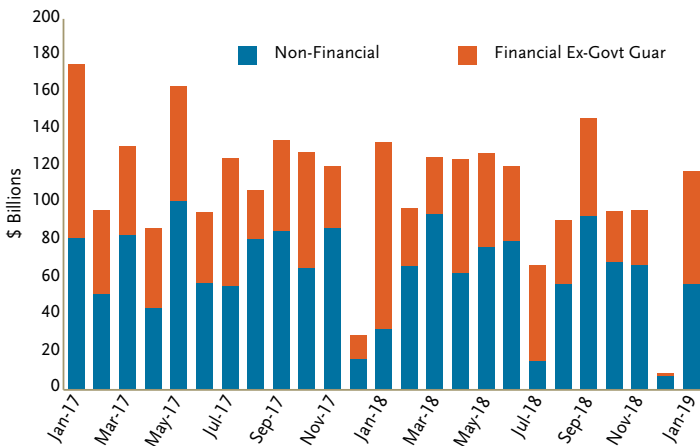
Source: Barclays Capital

# January Credit Update

## Investment Grade Supply

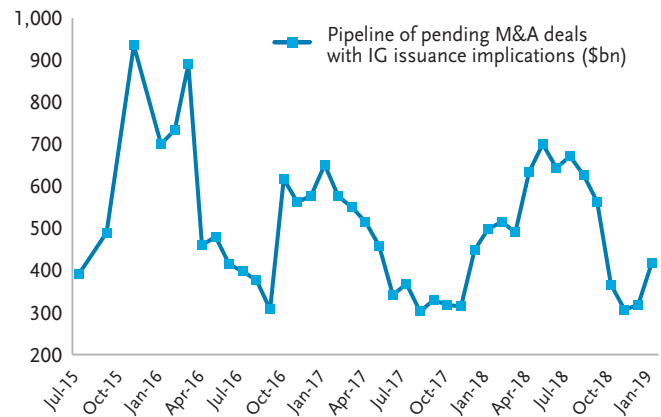
Despite the growing backlog of issuers that were sidelined in December, January new issue volumes of \$118 bln were well below the five-year average of \$150 bln. Industrial issuance of \$57 bln was in line with the January average while financial issuance underwhelmed at \$61 bln, a 40% year-over-year decline. Supply related to M&A was negligible though the recent increase in North American M&A volumes should lead to more bond issuance. New issues concessions during the first half of January were significant (15-25 bps) but fully remediated by the end of the month as market sentiment improved. Overall investor demand was strong as demonstrated by the average break performance of -8 bps though several deals performed significantly better, including Abibb (Inbev), Ford and ETP. Abibb issued \$15.5 bln across five tranches; 10yrs priced at +205 and were 20 bps tighter by the next trading day. On January 3, Ford Motor Credit issued \$2.75 bln in 2- and 3-year notes at a spread of +270 and +325 respectively. Deal performance was strong with bonds trading 25 bps through pricing within 24 hours. On January 8, ETP issued \$4 bln in bonds across three maturities; 10yrs priced at +255, 30yrs at +325. This deal was also 20 bps tighter by the end of the subsequent trading day. ■

IG Monthly New Issue Volumes



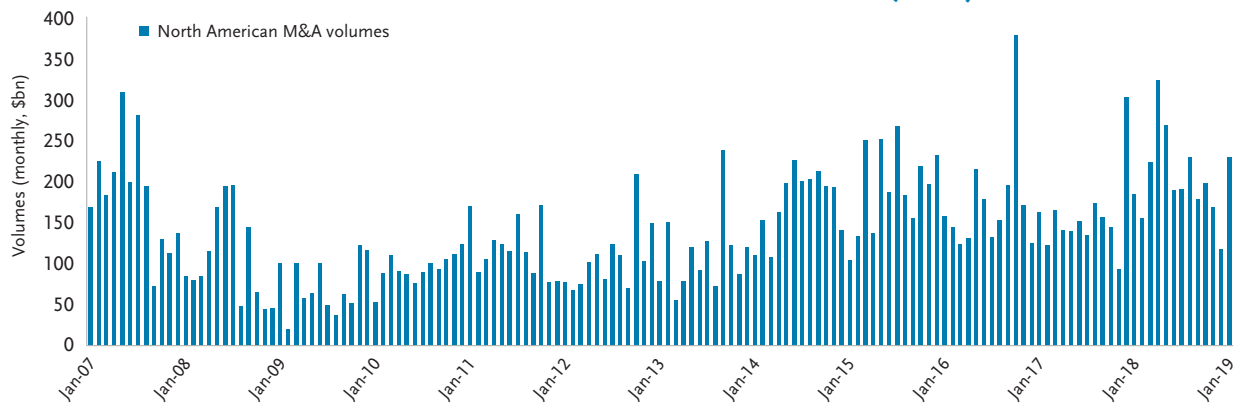
Source: BofA Merrill Lynch Global Research

The Pipeline of M&A Deals That Will Need Funding has Increased



Source: BofA Merrill Lynch Global Research, Bloomberg

Due to an Increase in M&A Volumes Which Were \$231 bln in January '19



Source: BofA Merrill Lynch Global Research, Bloomberg

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