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INSIGHT

MONTHLY COMMENTARY

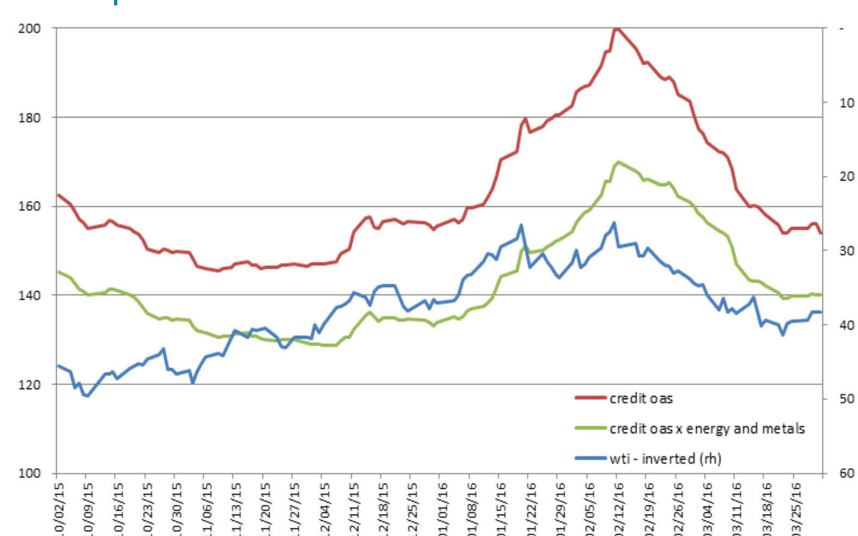
March Credit Update

TAMMY KARP | APRIL 1, 2016

After a lousy start to the year, risk assets made an impressive recovery in March, recouping all of the year-to-date widening. A new round of European Central Bank (ECB) QE, dovish Yellen speak, a weaker dollar and higher commodity prices were the main drivers. Macro concerns and Brexit fears seem to have taken a back seat, for the moment at least, to the prospect of low rates forever and corporate bond buying from a central bank.

The ECB announced more stimulus, including negative lending rates on new TLTRO's and an expansion of its bond purchase program. In an effort to spur lending, banks that meet certain criteria would be able to borrow funds via the LTRO at the deposit rate of negative 40bps. The ECB's monthly bond purchase program will increase by 20 bln (euro) to 80 bln starting in April, and will now include euro-denominated investment grade corporate bonds issued by non-bank companies established in the euro area. The size of the Euro IG non-financial QE- eligible corporate market is estimated at 750 bln euros. The full details and parameters of the corporate sector purchase program will be forthcoming. Many questions remain including: how the purchases will be effectuated (directly by ECB or via asset manager), how will purchases be spread across the different countries, what are the maturity and issue size restrictions, and whether purchases can be made via the primary market. While the immediate aftermath of the ECB's actions was a boost in demand for risk assets, the longer term outcomes are yet to be seen – specifically, how the ECB's underwriting of credit risk translates into real economic growth. There is certainly the risk that the amplification of cheap credit will further encourage corporations to add leverage, thereby prolonging the cycle – and the day of reckoning.

Credit Index Spread vs. Crude



Source: Bloomberg, Barclays

Tammy Karp
Managing Director
U.S. Fixed Income

Ms. Karp is a Managing Director in the U.S. 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.

U.S. Corp. vs. Euro Corp Spreads

Key	Axis	Name	Last	Minimum		Maximum	
	left	Euro-Aggregate: Corporates - OAS	130.655	75.137	02/25/2015	167.352	02/11/2016
	left	U.S. Corporate Investment Grade - OAS	163.065	96.688	06/23/2014	214.948	02/12/2016

Source: Barclays

Credit Spreads and Yields

Key	Axis	Name	Last	Minimum		Maximum	
	right	U.S. Credit - OAS	154.126	120.599	04/23/2015	199.808	02/12/2016
	left	U.S. Credit - Yield ...	3.097	2.757	04/03/2015	3.584	12/29/2015

Source: Barclays

March Credit Update

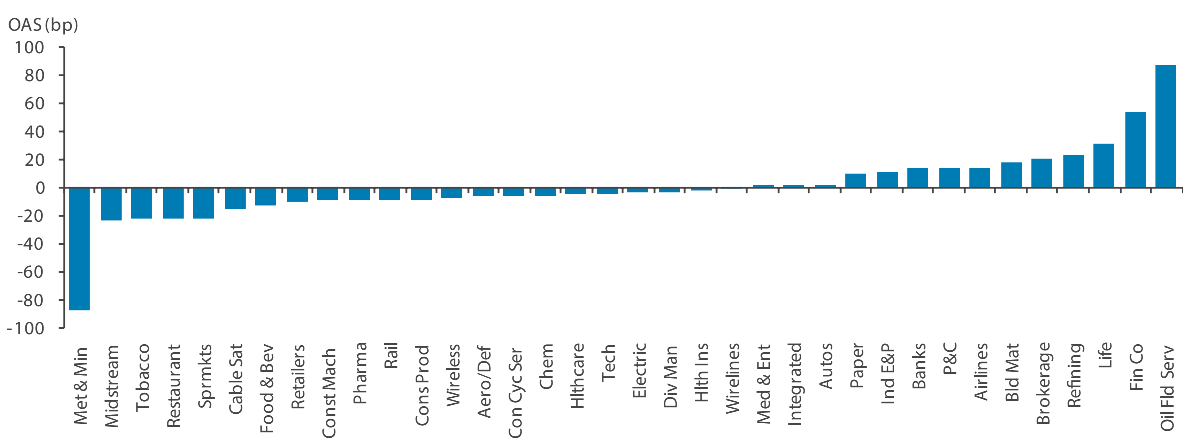
Index Performance: After touching the wides (4yr wides) of +200 on 2/12, credit spreads have rallied back to +154, recovering all of the year to date widening. The credit index was 30 basis points tighter in March, posting an excess return of 2.36% and total return of 2.52%. Industrials and higher beta sectors outperformed, led by BBB's, energy, metals and sovereigns.Commodity prices recovered off the lows, and as a result, metals were 70 bps tighter on the month, bringing the ytd excess return to 7.56%. Independent energy spreads tightened 155 bps in March (from +498 over to +343), bringing the ytd excess return to -.9%, and midstream sector spreads tightened 102 bps in March, posting a 2.92% ytd excess return. Next best performing sectors (outside of commodity related) were telecom (-43 bps), cable (-41 bps) and media (-42 bps). There were several catalysts to the tightening in the communications sectors: In the media and cable sectors, earnings were generally healthy as advertising revenues were strong and subscriber trends were positive. In the telecom sector, VZ tendered for ~ $12 bln of U.S. debt using the proceeds from wireline asset sales. This was positive from both a technical (investors need to replace the exposure) and fundamental perspective. Given the company's goal of getting back to pre- VOD (VZW stake acquisition) leverage (<2x) and ratings (low single A) by 2018-2019, this is a step in the right direction.

March Credit Index Returns:

	Month-to-Date Excess Return	Month-to-Date Total Return	Option-Adjusted Spread	Option-Adjusted Spread Month-to-Date Change
Credit Index	2.36%	2.52%	154	-30
Industrials	3.33%	3.49%	168	-42
Financials	1.55%	1.72%	155	-23
Utilities	1.14%	1.26%	151	-12
Municipals	0.95%	1.04%	178	-5
Sovereigns	3.06%	3.21%	191	-29

Source: Barclays

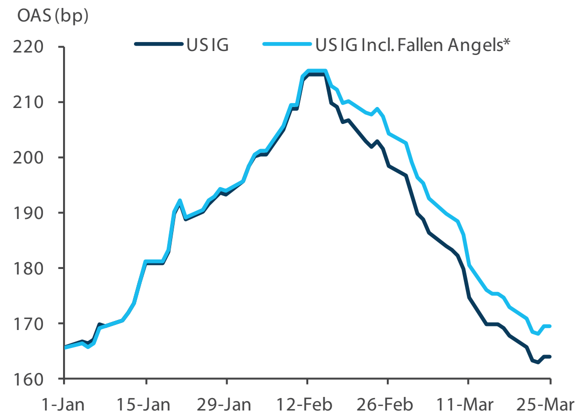
Year-to-Date Spread Moves by Sector, Relative to the U.S. Corporate Index



Source: Barclays Research

Note: Includes credits downgraded to high high yield in 2016, to control for compositional effects.

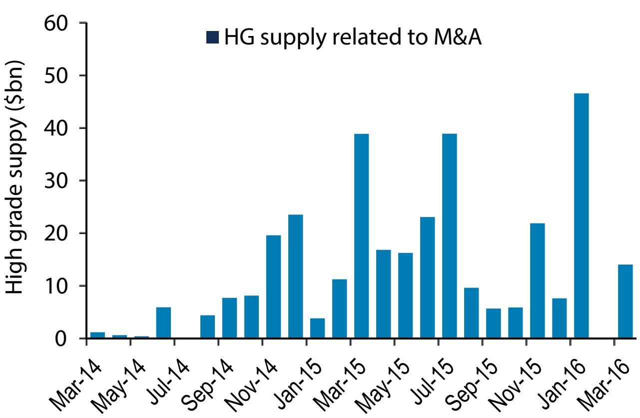
Corporate Index Spreads – Back to Beginning of Year Levels



Source: Barclays Research
*Includes issuers that have fallen to high yield in 2016.

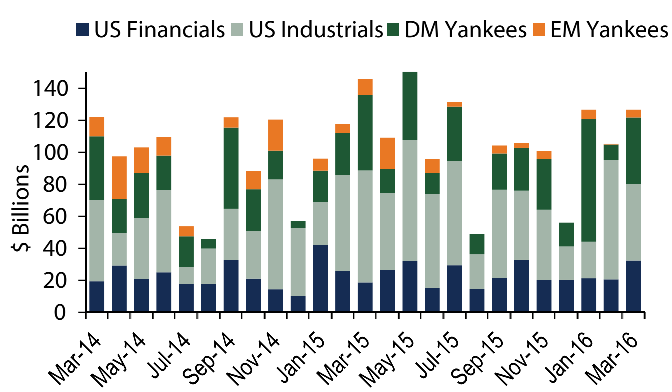
Supply: IG issuance totaled $126 bln in March. Financial issuance dominated, accounting for about 60% of supply as M&A related industrial issuance was relatively modest. The largest financial deal came from BRK, issuing $9 bln bonds across several maturities to help fund the PCP acquisition (5yrs printed at +90, 10yrs at +130). Several Yankee banks came to market, including UBS (10yr sr holdco priced at +235) and Lloyds (10yr sub holdco @ +278). M&A related issuance included BRK, NWL ($8 bln multi tranche deal to fund Jarden acquisition, 10yrs priced at 235, 30yrs at 285), SYK ($3.5 bln across 4 tranches), and SYY ($2.5 bln across 4 tranches). April supply volumes are expected to be lighter than March, given earnings blackout periods, but still above the $100 bln mark.

HG Supply Related to M&A



Source: BofA Merrill Lynch Global Research

Monthly IG Supply



Source: BofA Merrill Lynch Global Research

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865 South Figueroa Street | Los Angeles, California 90017 | 213 244 0000 | @TCWGroup