

## MONTHLY COMMENTARY

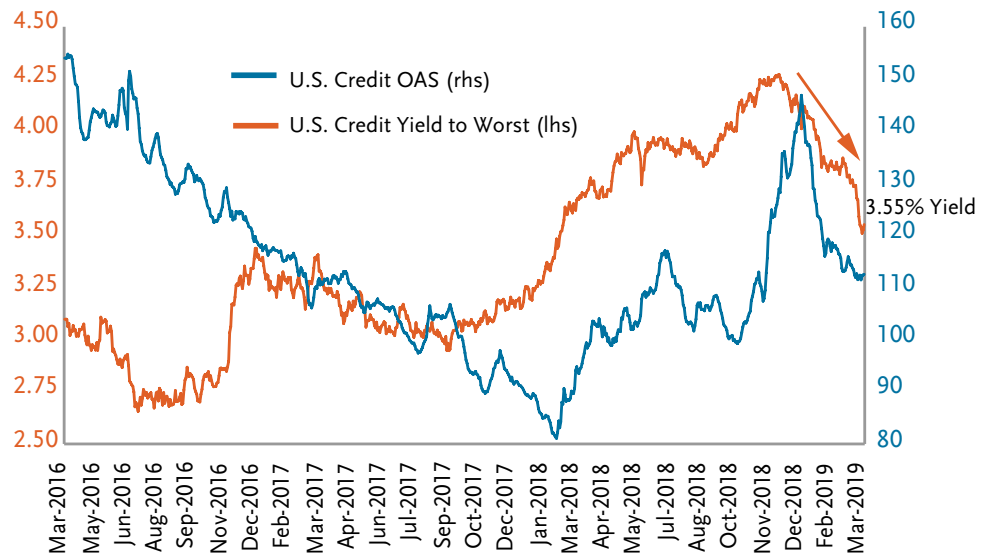
## March Credit Update

TAMMY KARP | 8 APRIL 2019

Credit index spreads were stable in March despite the macro headwinds, Brexit overhang, Turkey volatility, and late cycle fears. Moreover, the 3-month /10-year Treasury yield inversion had little to no impact on credit spreads despite its track record as a reliable recession indicator. Tighter spreads, lower yields, and beta compression occurred simultaneously as the lower for longer, reach for yield, Fed/CB put mentality was in full force. The big drop in Treasury yields generated strong (total) returns of 2.44%, the strongest monthly (total) return since March 2016. The credit index yield of 3.55% was lower by 28 basis points (bps) on the month and is 54 bps lower since the start of the year. That reach for yield resulted in beta compression with BBB's outperforming, including the recent M&A cohort of BBB's that have lagged over the last year due to concerns over late stage re-leveraging.

## Credit Index Spreads and Yields

Yields are 54 bps lower YTD while spreads are 29 bps tighter



Source: Bloomberg Barclays

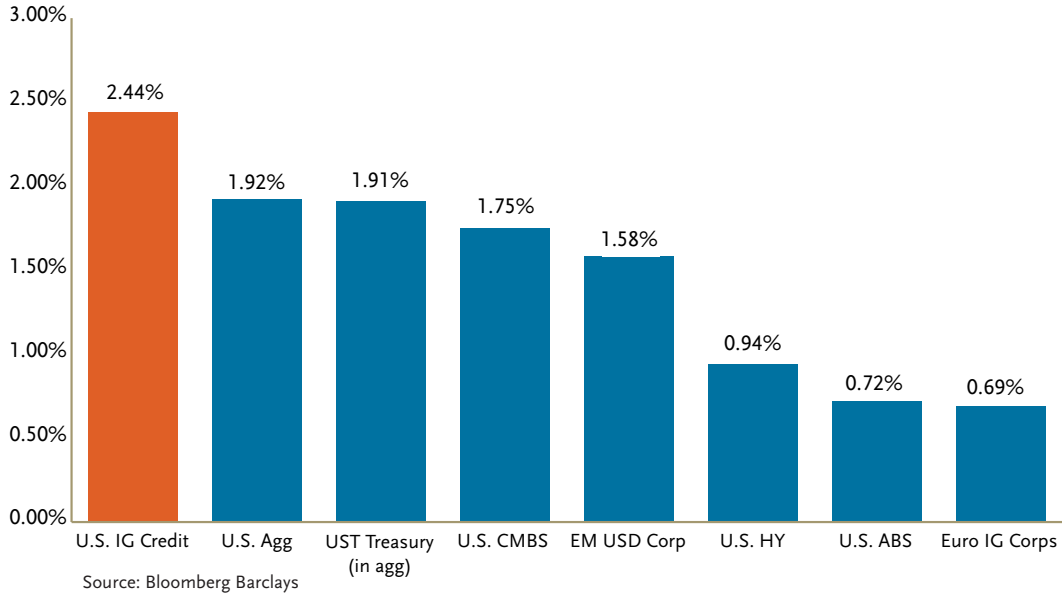


**Tammy Karp**  
Managing Director  
Fixed Income

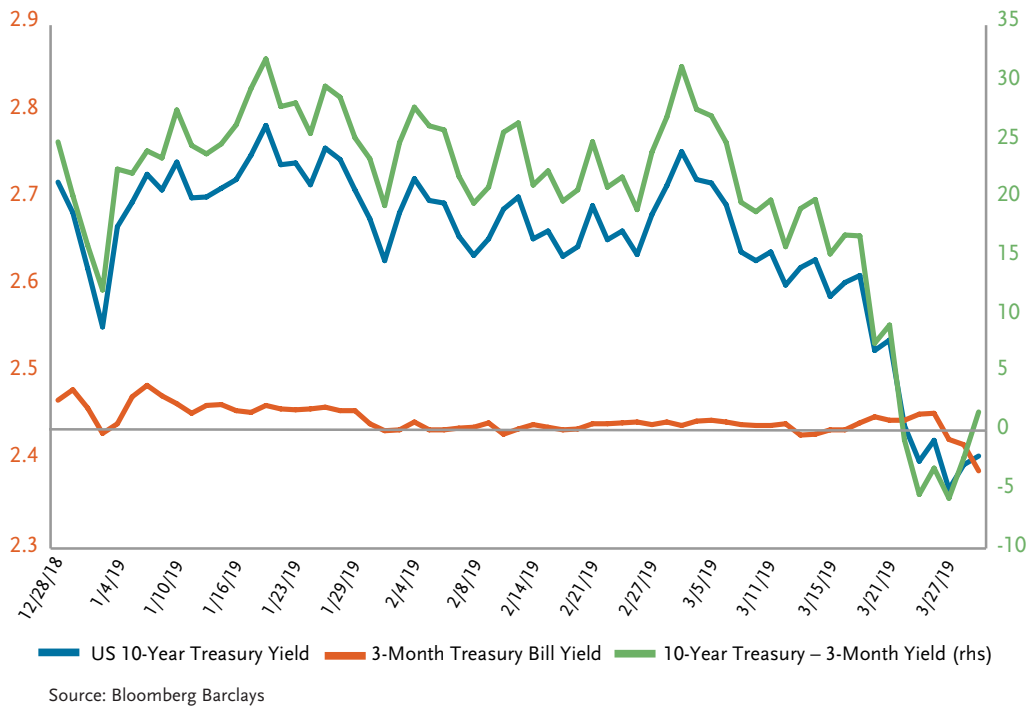
Ms. Karp is a Managing Director in the Fixed Income group where she trades investment grade and cross over securities. Ms. Karp joined TCW in 2009 during the acquisition of Metropolitan West Asset Management LLC (MetWest). Prior to joining MetWest in 1997, she was with the fixed income department at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

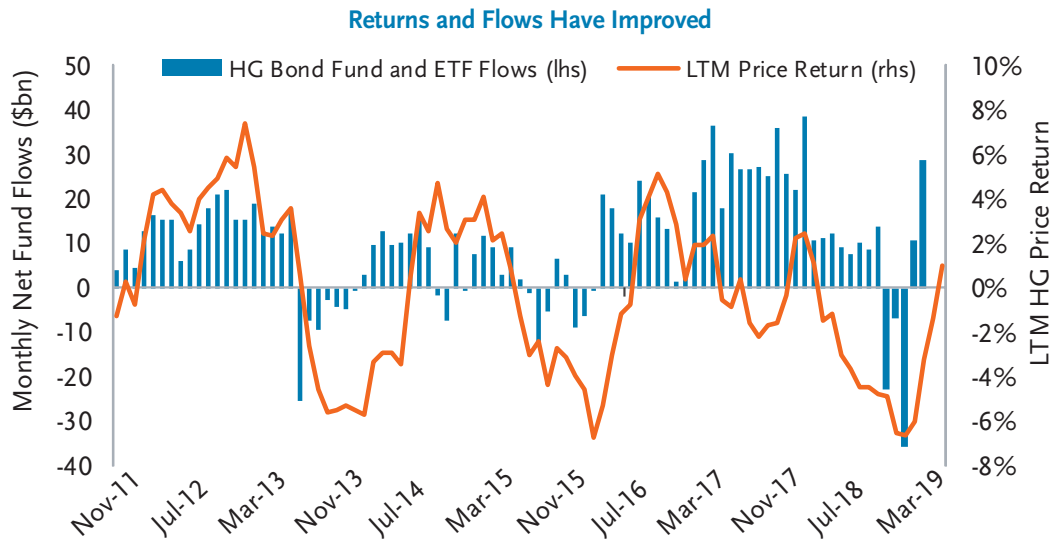


March Total Returns for Various Fixed Income Classes



3-Month – 10-Year Treasury Curve Inverted in March





### Index Performance

The credit index OAS of +113 bps over Treasuries was marginally tighter in March (-1 bps), bringing the YTD spread move to -30 bps. The reach for yield, beta compression theme continued as lower rated, higher yielding credits outperformed, including sectors that have recently engaged in leveraging M&A transactions – like tobacco and food and beverage. Two notable underperformers were CVS and Bayer. CVS spreads widened 7 bps in March (10yrs @ +168, 30yrs @ +218) on the heels of the Centene/Wellcare merger announcement. The concern specifically relates to Centene’s potential internalization of Wellcare’s PBM business which is currently contracted with CVS through 2020. While CVS does not disclose terms of its contract with Wellcare, the estimated EBITDA impact is \$450 mln, or 2.6% of estimated 2019 CVS EBITDA. Bayer spreads widened 5 bps in March (and 50 wider since the Bayer/Monsanto merger closed) after a San Francisco jury awarded \$80mm to a plaintiff in another Roundup trial. This is the second trial (both in California) where the jury decided in favor of the plaintiff though both cases are being appealed by Bayer. The standard for determining causation in a California jury trial is low which means that an appeal to a panel of judges is more likely to be decided based on the underlying science, which has not supported a connection between glyphosate use (the main ingredient in Roundup) and cancer. Most sell side estimates have the liabilities from Roundup at \$5 - \$6 bln, which assumes 15,000 cases at an average liability of \$500,000 discounted back to today.

**BBB/A Basis:** The BBB vs. A basis is currently 67 bps, which was 4 bps tighter in March and 12 bps tighter YTD. The cycle range in the BBB/A basis is 30 bps at the tight to 169 bps at the wides (128 bp wides if we exclude 2009) so the relative value of the lower rated segment of the IG market, as a whole, is not compelling. At the same time, a record number (233 bln) of fallen A’s in 2018 widened 120 bps on average. That compares to 73 bps of widening for the entire BBB universe last year, highlighting the risk of paying up for ratings without properly assessing event risk.

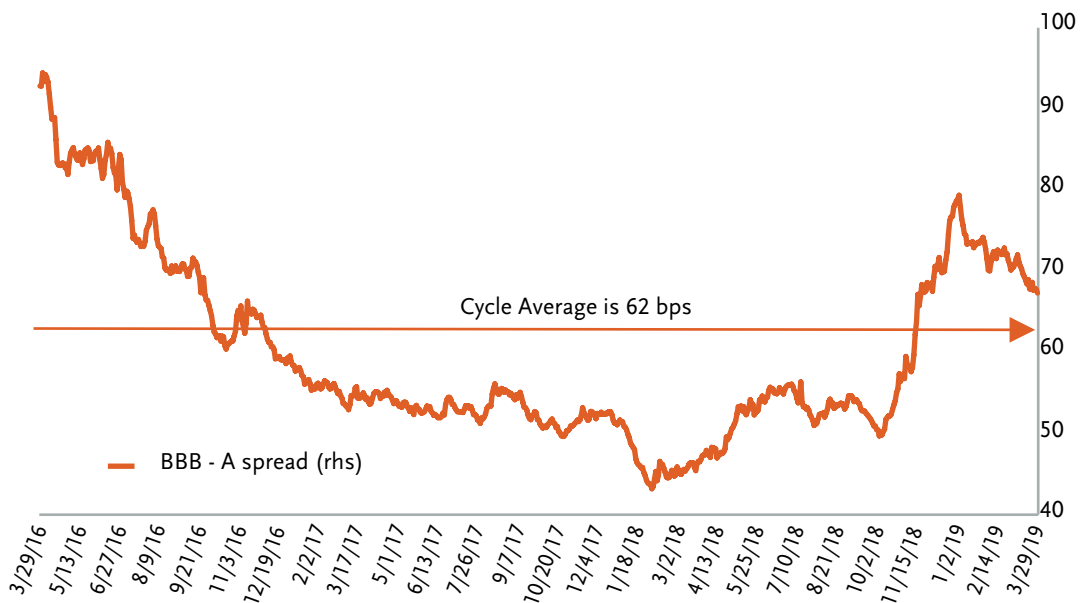
# March Credit Update

## March Index Returns

	March Excess Return	March Total Return	3/28/19 OAS	Monthly OAS Change
Credit Index	0.24%	2.44%	113	-1
Industrials	0.30%	2.73%	125	-2
Financials	0.12%	1.92%	109	-1
Utilities	0.25%	3.27%	116	-2
Municipals	0.71%	4.02%	124	-7
Sovereigns	0.13%	2.86%	127	-2
AA	0.15%	2.17%	62	0
A	0.07%	2.33%	90	0
BBB	0.42%	2.75%	157	-4

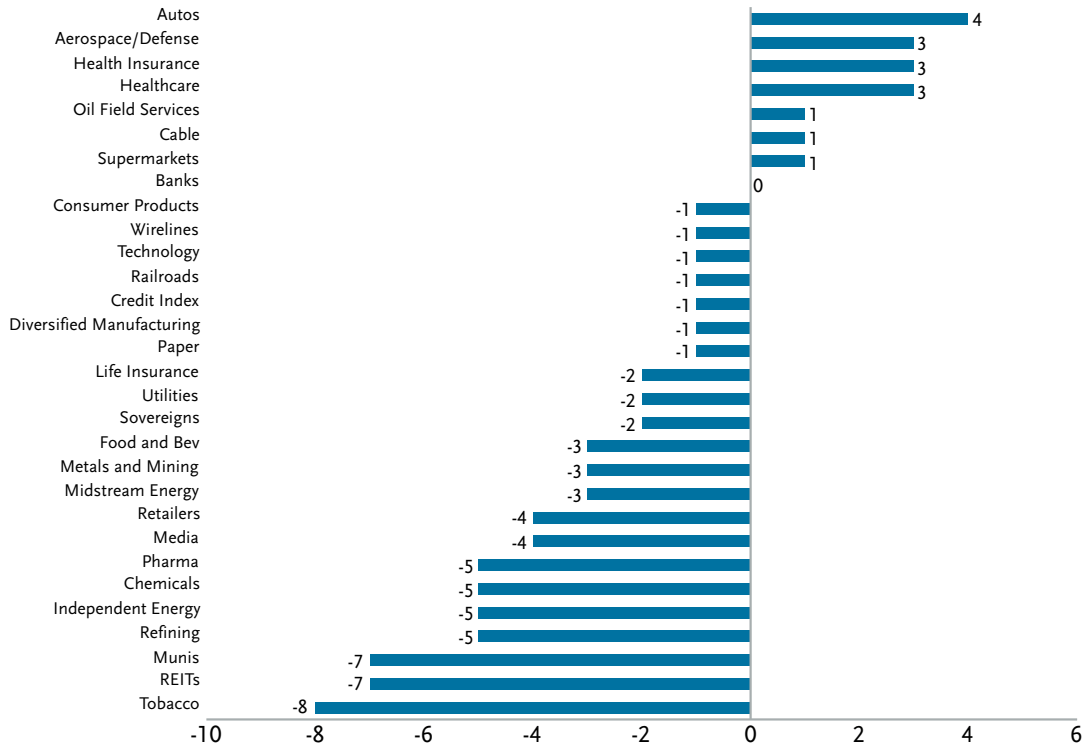
Source: Bloomberg Barclays

## BBB vs. A Spread at 67 bps is Near the Cycle Mean



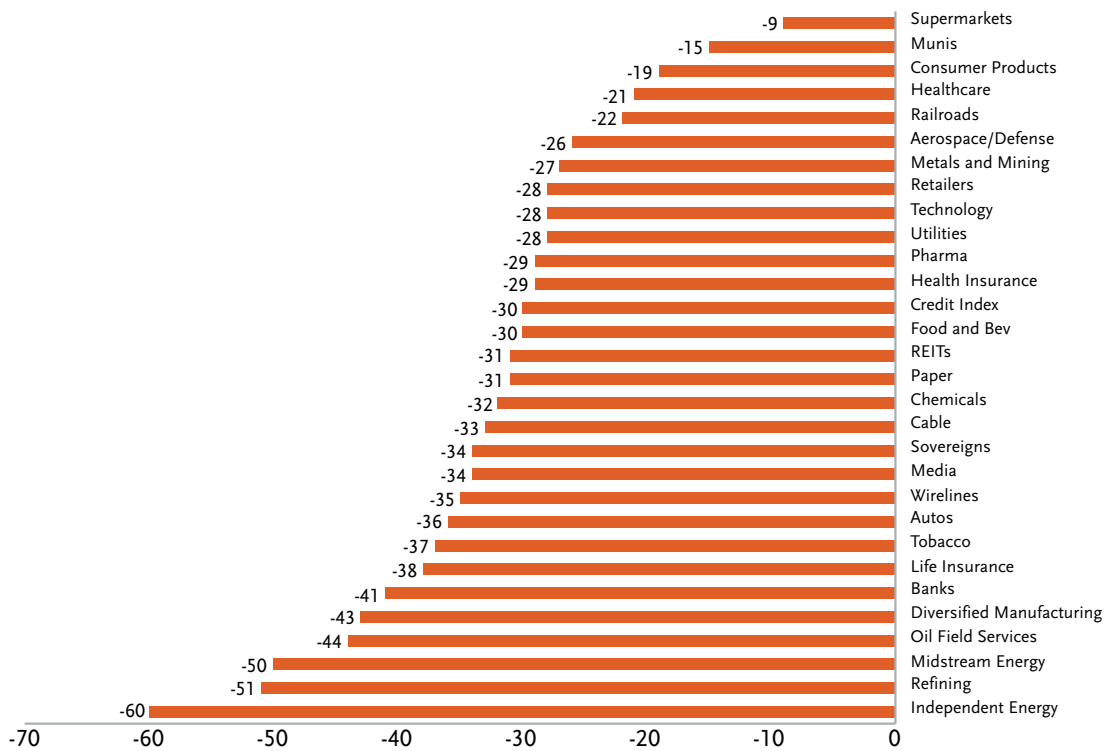
Source: Bloomberg Barclays

March Sector OAS Changes

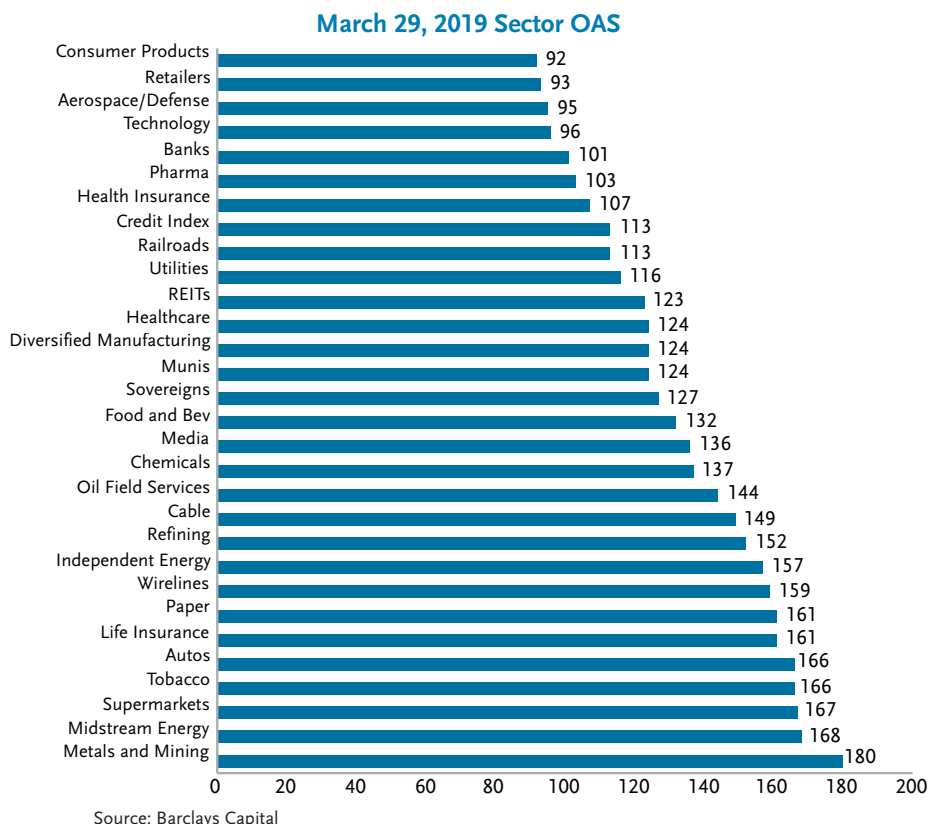


Source: Barclays Capital

YTD Sector OAS Changes



Source: Barclays Capital



### March Investment Grade Supply

March supply volumes were \$121 bln, bringing the YTD total to \$346.6 bln, down modestly (-2.8%) from the same period last year. M&A related supply was \$21 bln in March, bringing the YTD total to \$53.4 bln. The largest M&A related deal in March came from AVGO (Broadcom), issuing \$11 bln across 5 tranches to fund the CA acquisition (5yrs priced at +155, 10yrs @ +240). The current pipeline of pending M&A related bond issuance is \$100 bln, which is relatively modest compared to the past four years – though that can certainly change if M&A activity picks up. The largest pending deals are BMY/CELO, Sprint/T-Mobile (deal probability low), and IBM/Red Hat.

### Largest Pending M&A Deals With Potential Funding Needs

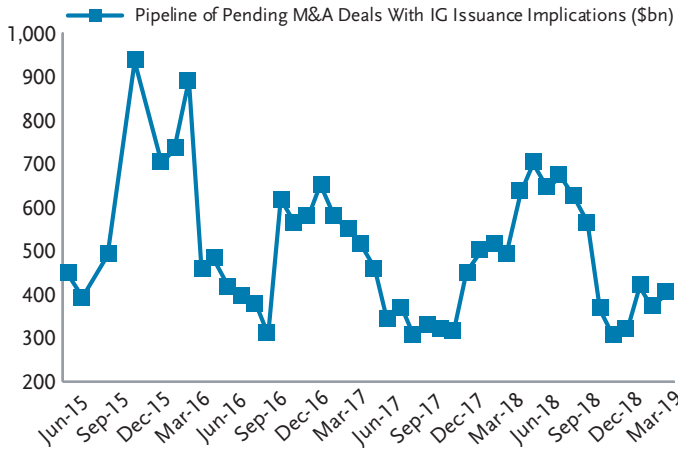
Deal Announce Date	Acquirer Ticker	Acquirer Name	Target Name	Expected Completion Date	Announced Deal Enterprise Value (\$bn)	Deal Probability	Likely Size of Bond Deal (\$bn)
1/3/19	BMY US	Bristol-Meyers Squibb Co	Celgene Corp	9/30/19	88.8	71%	10-15
4/29/18	TMUS US	T-Mobile US Inc	Sprint Corp	6/30/19	57.8	38%	30
3/18/19	FIS US	Fidelity National Information	Worldpay Inc	12/31/19	41.0	82%	11
10/28/18	IBM US	International Business Machine	Red Hat Inc	12/31/19	31.8	88%	25
4/30/18	MPC US	Marathon Petroleum Corp	Andeavor	10/1/18	29.0	100%	3.5
2/25/19	DHR US	Danaher Corp	BioPharma Business/GE	12/31/19	21.4	40%	15
7/27/18	BP/LN	BP PLC	Petrohawk Energy Corp	10/31/18	10.5	100%	5-10

Note: We show Bloomberg's calculation for deal probabilities: Bloomberg uses the deal terms and the current market price of the target company to calculate the deal probability that the market is pricing in:  $(\text{current price less pre-offer price}) / (\text{target price less pre-offer price})$ . Deal sizes are BofAML estimates based on public information.

Source: BofA Merrill Lynch Global Research, Bloomberg

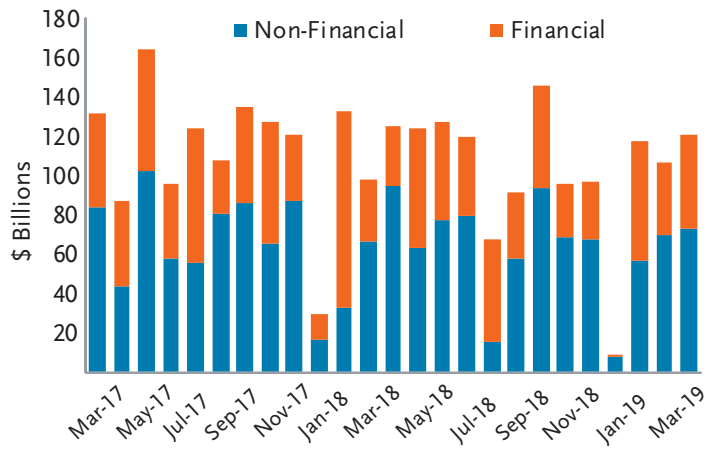
# March Credit Update

## Current Pipeline of M&A Deals (Total Enterprise Value)



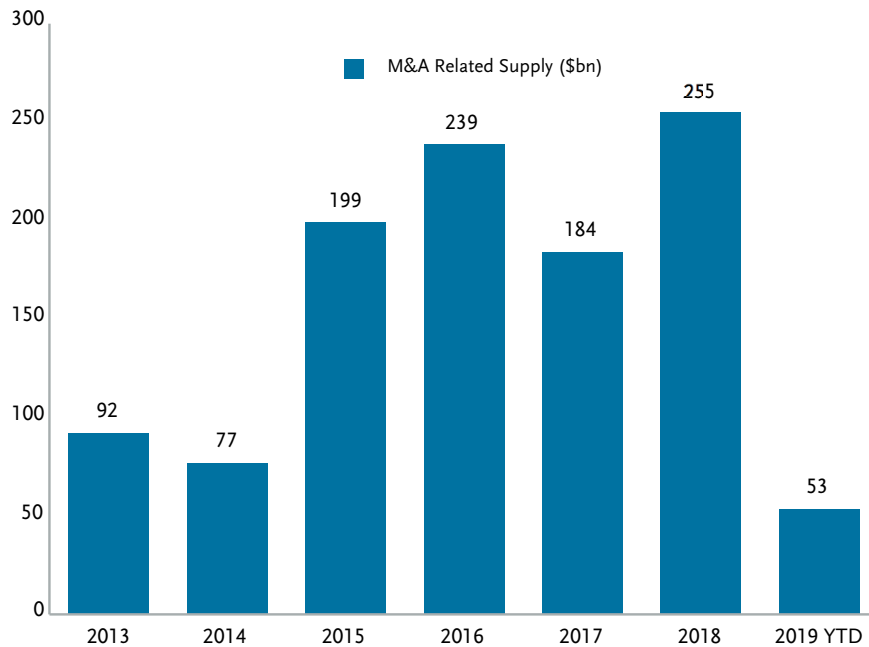
Source: BofA Merrill Lynch Global Research

## Monthly Supply Data



Source: BofA Merrill Lynch Global Research

## YTD M&A Related Supply is Tracking Lower Than 2015, 2016 and 2018



Source: BofA Merrill Lynch Global Research, Bloomberg

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