



Manager of the
TCW, MetWest,
and TCW Alternative
Fund Families

INSIGHT

MONTHLY COMMENTARY

May Credit Update

TAMMY KARP | JUNE 2, 2016

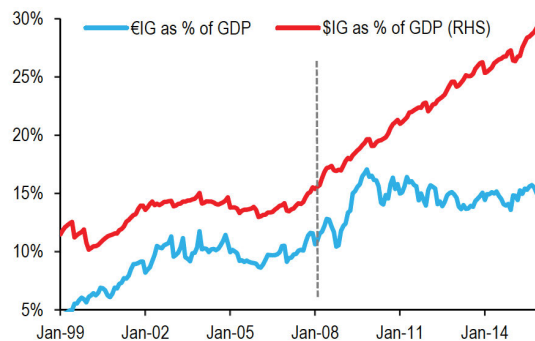
Spreads remained firm in May despite stretched valuations and record breaking new issue volumes. The credit index OAS ended the month at +141 basis point (bps) over Treasuries, only two basis points wider on the month. The intra-month range in spreads was 6 basis points (+138 - +144), thus we did not experience much volatility in May, certainly when compared to the previous four months. The main driver of the recent rally has been the global search for “yielding” assets in the face of an increasing pool of negative yielding debt. These forces have overshadowed tight valuations and worsening fundamentals. Demand for credit has been strong the last three months, as flows into IG credit from both domestic and foreign investors have accelerated. Corporations have responded by issuing record amounts of debt. Supply in May broke a new record, with \$176 billion printing, dominated by M&A related issuance. Supply was easily digested and new issue concession were de minimis. The ECB will start buying corporate bonds in June and expectations are for the ECB’s balance sheet to exceed the Fed’s \$4.5 trillion balance sheet by early 2017. This will likely encourage more debt issuance and extend the re-leveraging cycle. Whether or not the ECB’s underwriting of credit risk translates into real economic growth is yet to be seen.



Tammy Karp
Managing Director
U.S. Fixed Income

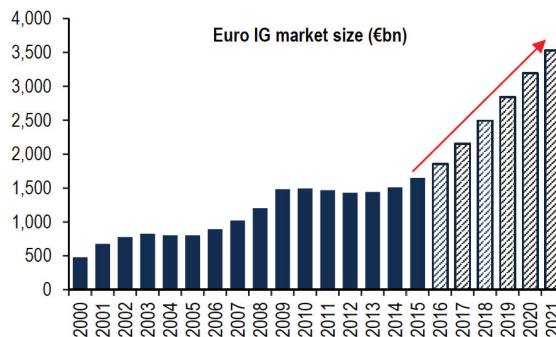
Ms. Karp is a Managing Director in the U.S. Fixed Income group where she trades investment grade and cross over securities. Ms. Karp joined TCW in 2009 during the acquisition of Metropolitan West Asset Management LLC (MetWest). Prior to joining MetWest in 1997, she was with the fixed income department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

Debt Growth In U.S. and European Market



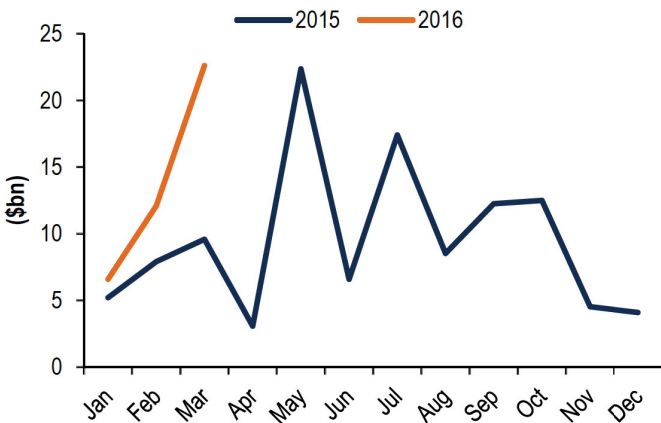
Source: BofA Merrill Lynch Global Research. IG credit market face values as a % of domestic GDP. EROO and COAO, Bloomberg.

Euro IG Market Size With Proportions



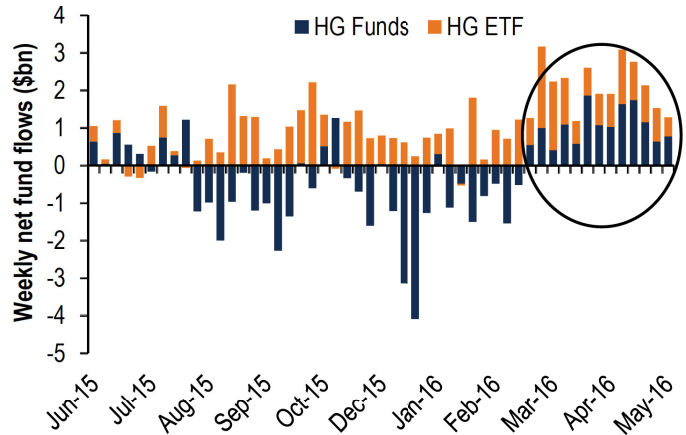
Source: BofA Merrill Lynch Global Research. IG credit market face values as a % of domestic GDP. EROO and COAO, Bloomberg.

Foreign Net Buying of U.S. Corporates



Source: U.S. Treasury, BofA Merrill Lynch Global Research

IG Fund Flows



Source: U.S. Treasury, BofA Merrill Lynch Global Research, EPFR Global

Credit Index performance: Credit spreads were quite resilient in the face of record M&A driven supply volumes. Technicals have been strong over the last few months as investors chase yield. Stronger economic data in May, particularly in housing (new home sales at eight year highs) and higher oil prices have also supported credit spreads. Treasury yields were stable in the face of stronger economic data and a more hawkish Fed, and oil prices rallied despite the dollar strength (thanks to supply disruptions in Nigeria, Venezuela and Canada). The credit index OAS of +141 basis points over Treasuries was 2 bps wider on the month. Spreads are now 14 bps tighter on the year and returns are strong at 5.14% (total return) and 1.46% (excess return). The YTD spread range is 62 bps (+138 to +200), which compares to a range of 44 bps for all of 2015. The increased volatility is a reflection of several factors, including the reduced liquidity in the market which exacerbates moves in both directions. Valuations have gotten stretched again, as central bank intervention has interfered with the markets ability to appropriately price risk. From a sector standpoint, industrials underperformed in May as record M&A related issuance and commodity weakness

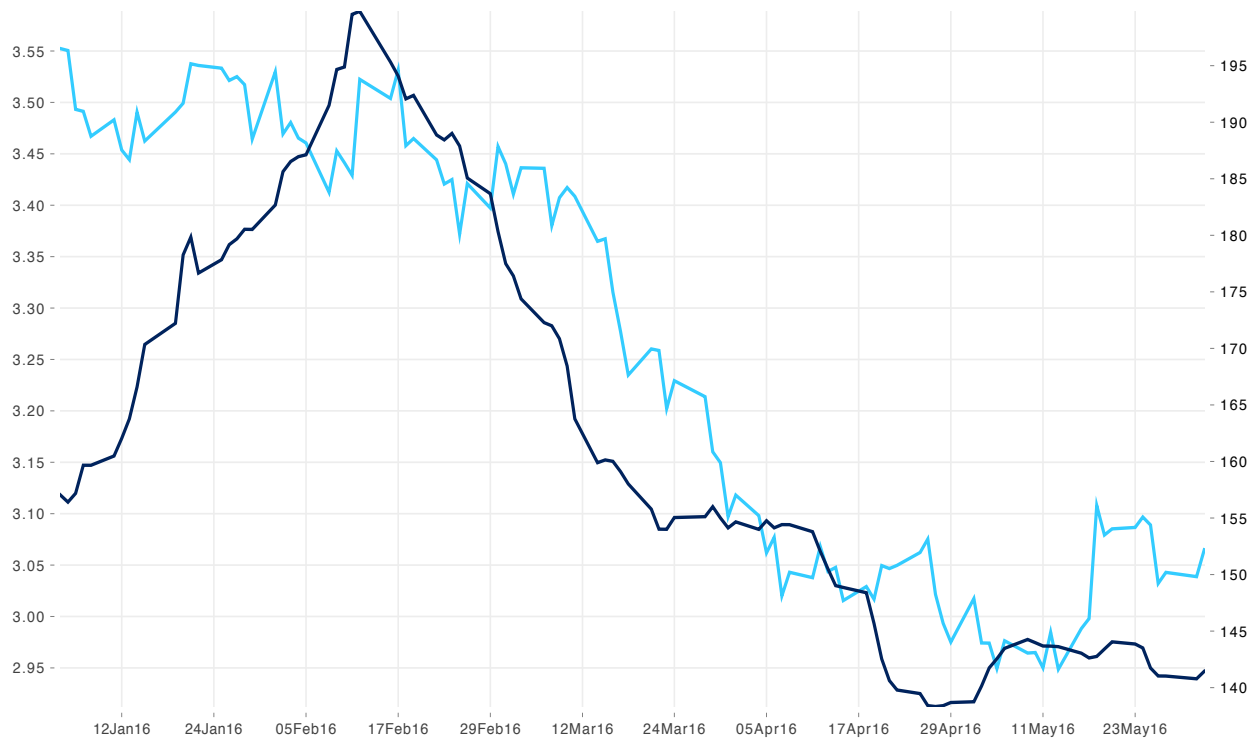
(outside of oil) weighed on the space. Worst performing sectors were refiners (-2.21% excess return) metals (-2.11 excess return), cable (-1.1%), and pharma (-0.89%). Refiner margins are negatively impacted by rising crude prices and narrowing basis differentials. Additionally, the refining sector has historically been a volatile and cyclical sector so we are starting to see some spread widening after peak profitability and spread outperformance. Cable sector underperformance came mainly from TWC bonds that encountered some forced selling after the merger with Charter closed, resulting in the expected Moody's downgrade to Ba1. Pharma spreads widened 13 bps on the heels of increased M&A and debt related M&A issuance. Pharmaceutical companies have been engaging in M&A in order to diversify their revenue base and "buy" growth to offset patent expirations and pricing pressures. Two large M&A related deals priced this month: Abbvie (to fund Stemcentryx) and Mylan (to fund Meda). Best performing sectors were Munis (+1.65% excess return), airlines/EETCS (+.82 bps excess return), and utilities (+.6% excess return).

May Credit Update

May 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	-.11%	-.04%	141	+2
Industrials	-.39%	-.29%	155	+7
Financials	.13%	.12%	141	-1
Utilities	.60%	.85%	133	-9
Municipals	1.65%	2.00%	156	-14
Sovereigns	-.84%	-.70%	192	+9

Credit Index Yields and Spreads



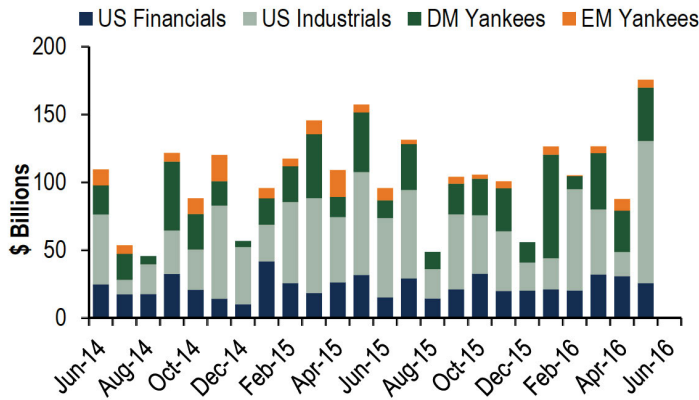
Key	Axis	Name	Last	Minimum	Maximum
	Right	U.S. Credit - OAS	140.782	138.329 04/27/2016	199.808 02/12/2016
	Left	U.S. Credit - Yield to Worst	3.039	2.949 05/13/2016	3.552 01/04/2016

Source: Barclays

May Credit Update

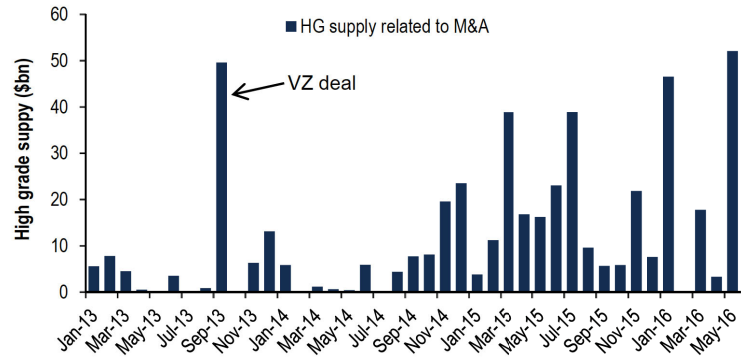
May IG supply: Another record month with \$176 bn of new issue volumes. M&A related new issuance accounted for \$52 bn, also a new record. Demand was strong and issue concessions were de minimis. Several new issues actually priced inside of secondaries (WBA for example). Biggest deals of the month included Dell secured (\$20 bn multi tranching deal to fund EMC merger), WBA (\$6 bn to fund Rite Aid), \$7.8 bn Abbvie deal (to fund Stemcentryx), \$8.5 bn Southern Co deal to finance AGL acquisition and \$6.5 bn Mylan deal to fund Meda acquisition.

IG Monthly Supply



Source: BofA Merrill Lynch Global Research

M&A Related Supply



Source: BofA Merrill Lynch Global Research

This material is for general information purposes only and does not constitute an offer to sell, or a solicitation of an offer to buy, any security. TCW, its officers, directors, employees or clients may have positions in securities or investments mentioned in this publication, which positions may change at any time, without notice. While the information and statistical data contained herein are based on sources believed to be reliable, we do not represent that it is accurate and should not be relied on as such or be the basis for an investment decision. The information contained herein may include preliminary information and/or "forward-looking statements." Due to numerous factors, actual events may differ substantially from those presented. TCW assumes no duty to update any forward-looking statements or opinions in this document. Any opinions expressed herein are current only as of the time made and are subject to change without notice. Past performance is no guarantee of future results. © 2016 TCW