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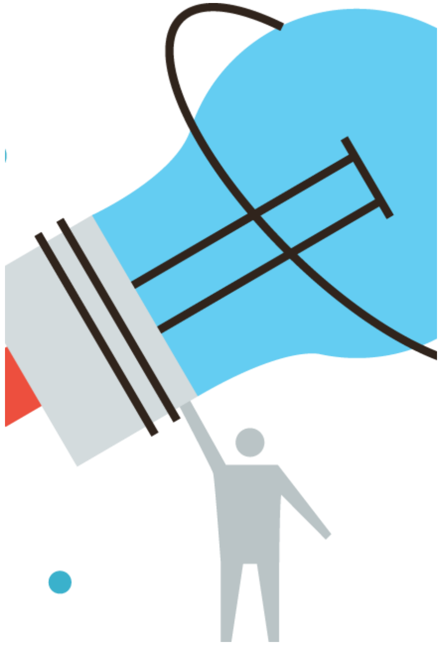

U.S. Credit Update – January 4, 2021

- Travel, Energy and Materials Dominated Q4 Excess Returns
- Credit, Equity Divergence in the Energy Sector
- The Automotive Industry Looks for a Fast Start to 2021
- Regional Banks in Focus
- Total Return & Issuance Recap

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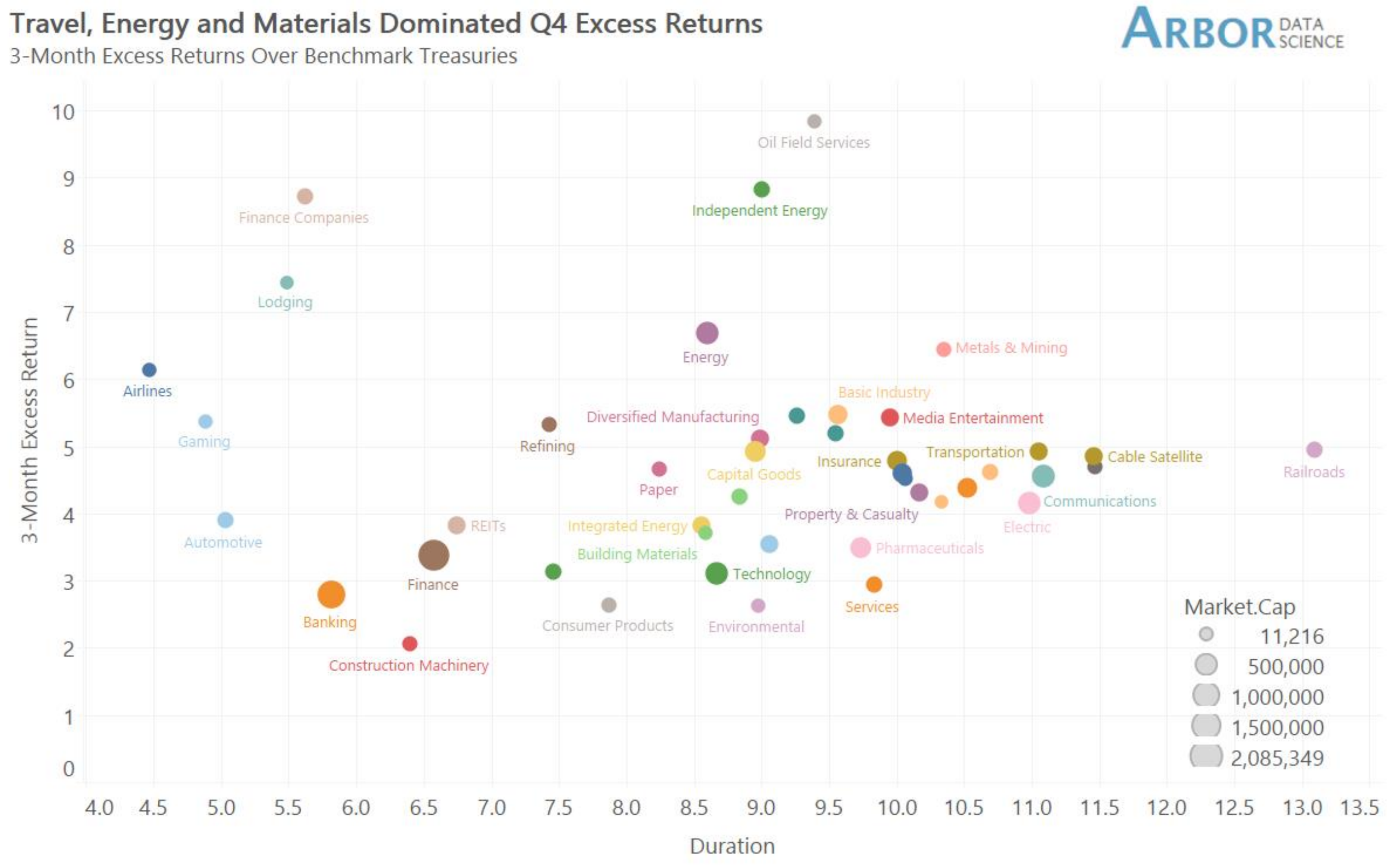
Travel, Energy and Materials Dominated Q4 Excess Returns

Some of the most distressed industries in the investment grade credit space posted the best performance in the fourth quarter.

The imminent return of more ambitious travel fueled the outperformance of airlines, lodging and finance companies (primarily aircraft leasing).

The hardest-hit industries in the energy sector, independent energy and oil field services, posted excess returns north of 8% for the quarter.

High-flyers aside, materials and manufacturing outshined similar-duration peers as the manufacturing economy reignited.



Data Source: Bloomberg Barclays, Bloomberg LP

 12-14-2020

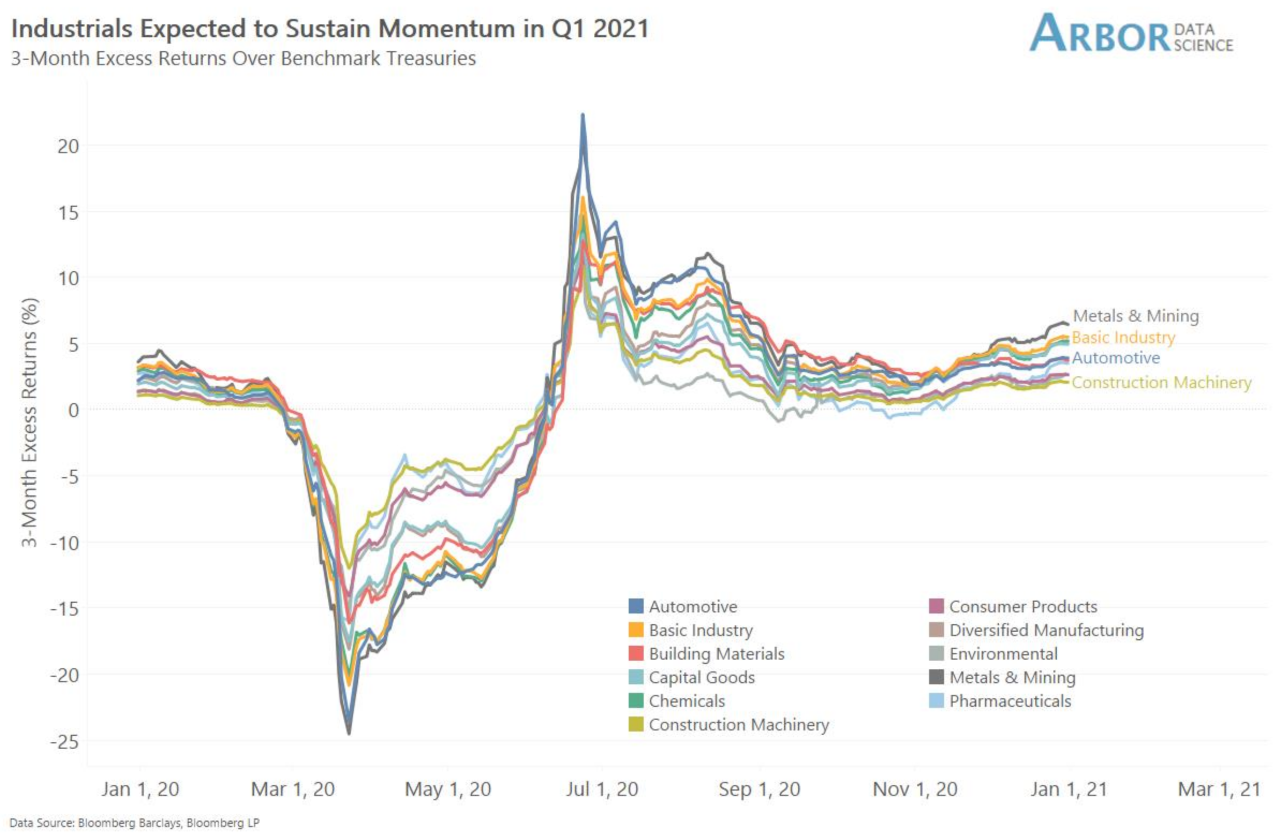
Travel, Energy and Materials Dominated Q4 Excess Returns

We still have concerns about the growth trajectory in the best performing industries in the energy sector. And there are new uncertainties in the outlook for travel. But we remain confident in the outlook for the industrial and manufacturing economy as a lower-beta bet on global economic momentum.

The chart shows 3-month excess returns over benchmark Treasuries for select industries. Metals & mining extended its margin of outperformance throughout December and should see tailwinds in the first quarter. For more, see our recent posts:

[Global Synchronized Growth on the Horizon]

[Industrial and Precious Metals are Still Heating Up]



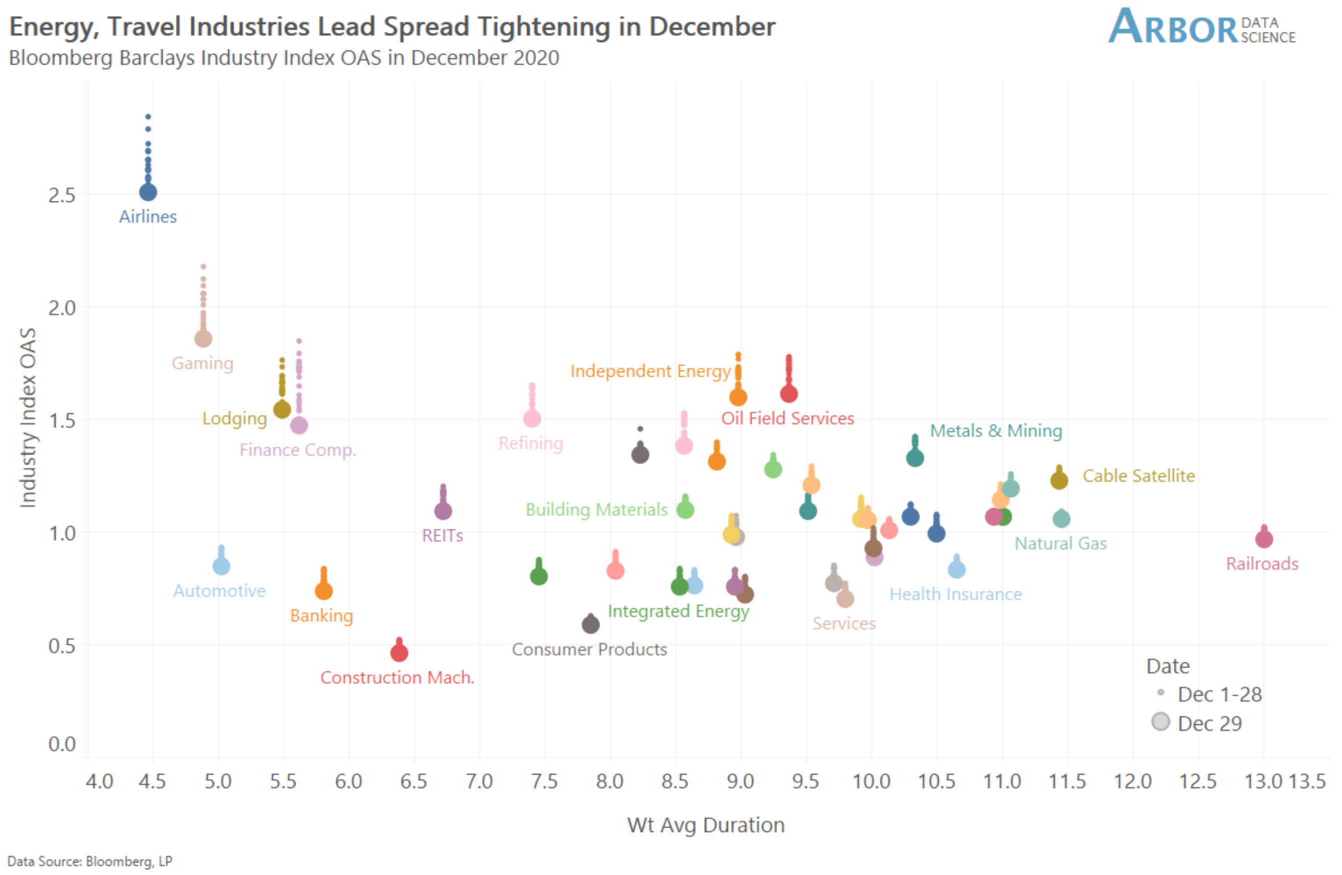
 12-14-2020

Credit, Equity Divergence in the Energy Sector

Last week's post noted that [while energy sector equities were falling away from earlier December highs, bonds are a different story](#).

Spread tightening in energy credits trailed only travel-related industries (airlines, gaming, and lodging). The chart shows index option-adjusted spreads (OAS) for our universe of Bloomberg Barclays investment grade indices. The largest dot is the latest point (December 29) with additional smaller marks for every other trading day this month.

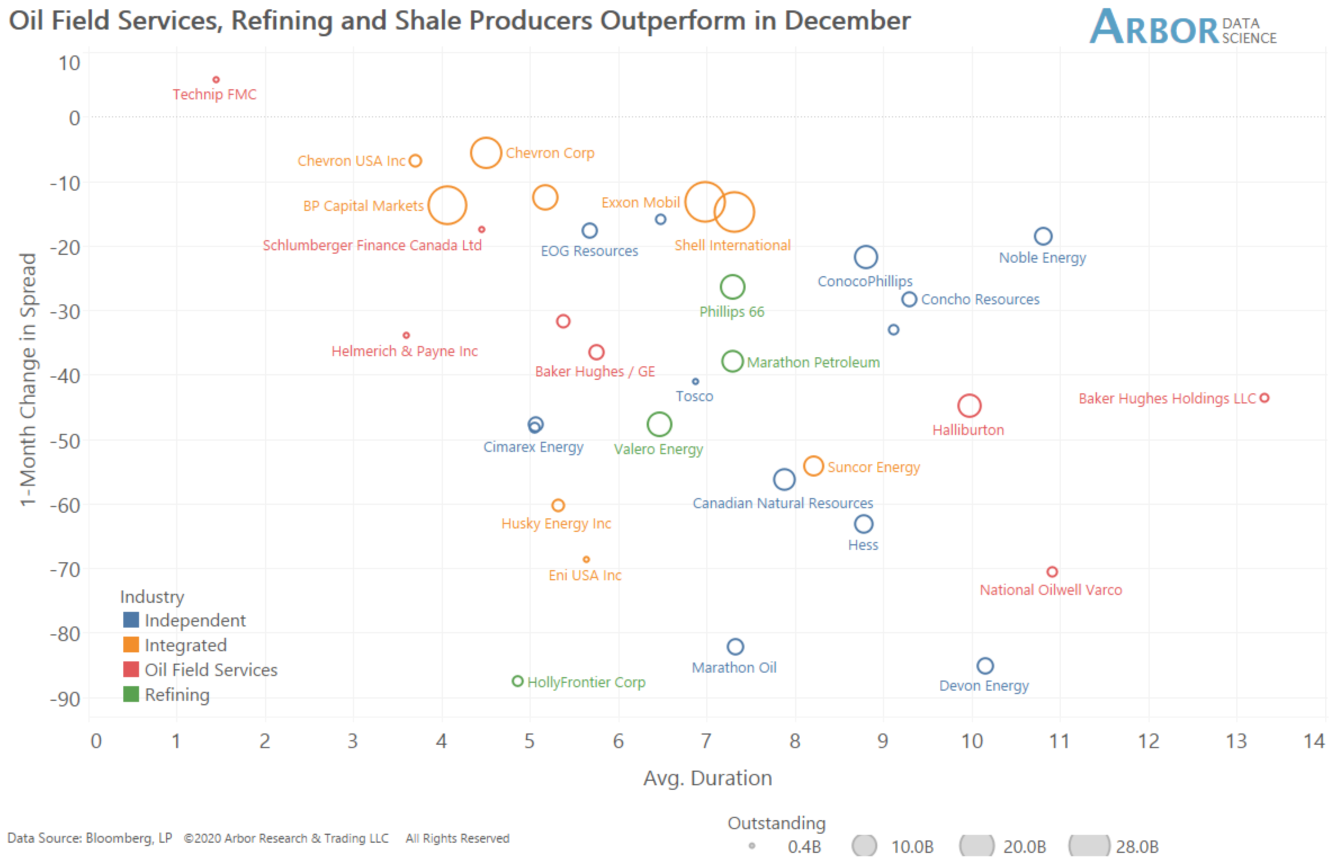
All industries saw spreads drift lower, those with the highest spreads to begin with performed best. Independent energy (shale producers), oil field services and refiners were among this group.



Credit, Equity Divergence in the Energy Sector

The next chart shows average one-month changes in spreads to benchmark Treasuries for each issuer in the investment grade energy index. Smaller shale producers, oil field services and Canadian oil sands producers posted an exceptional month with spreads narrower by 50+ bps in December.

Again, these were firms trading at wider spreads to start the month in most cases.

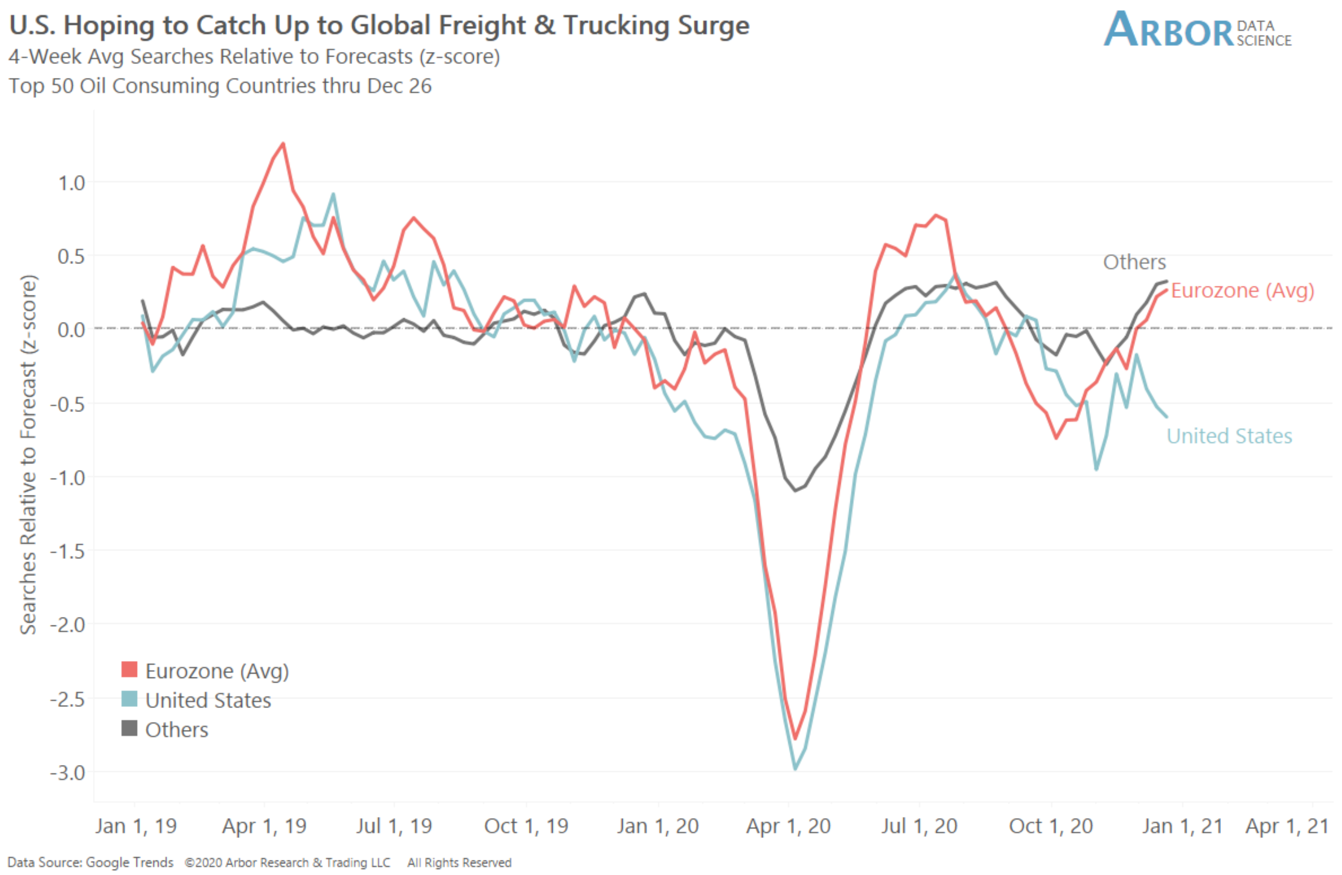


Credit, Equity Divergence in the Energy Sector

Continued uncertainty about OPEC+ production will remain elevated in the near term and holiday interference makes inferences from mobility data more challenging. Optimists can point abroad and argue that when the U.S. emerges from this latest wave, fuel demand for freight and transportation in other major economies will be humming.

The last chart shows Google search activity for freight & trucking relative to our forecasts. After stumbling early in its second wave, the eurozone has fallen back in sync with rising search activity across the rest of the group. The United States lags for now but will hope to benefit from the tailwinds for concerted global growth by spring.

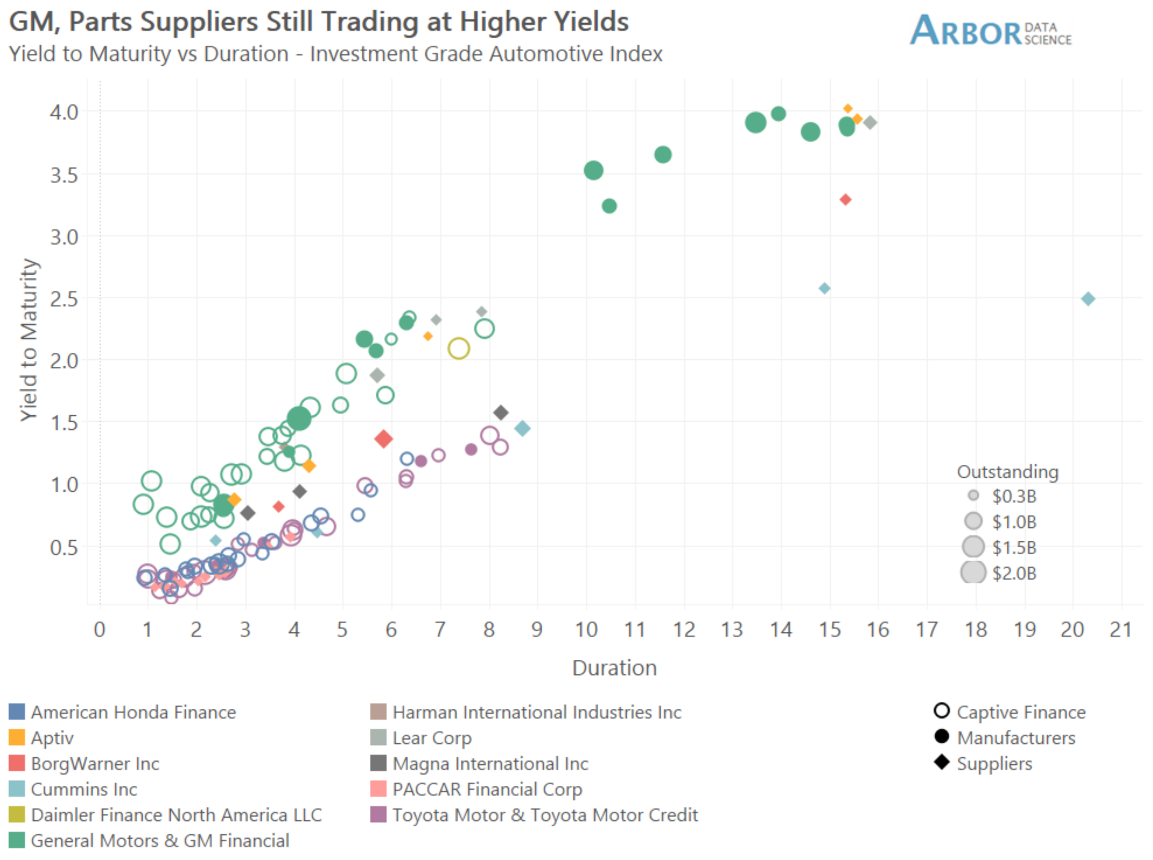
Full post: [Credit, Equity Divergence in the Energy Sector]



The Automotive Industry Looks for a Fast Start to 2021

A broad theme in investment grade credit in December was the outperformance of the highest-yielding industries including travel and energy. Automotive credits were another good example.

General Motors and some parts makers including Aptiv, BorgWarner and Lear Corp still offer a yield advantage compared to non-U.S. automakers despite outperforming on a spread basis.



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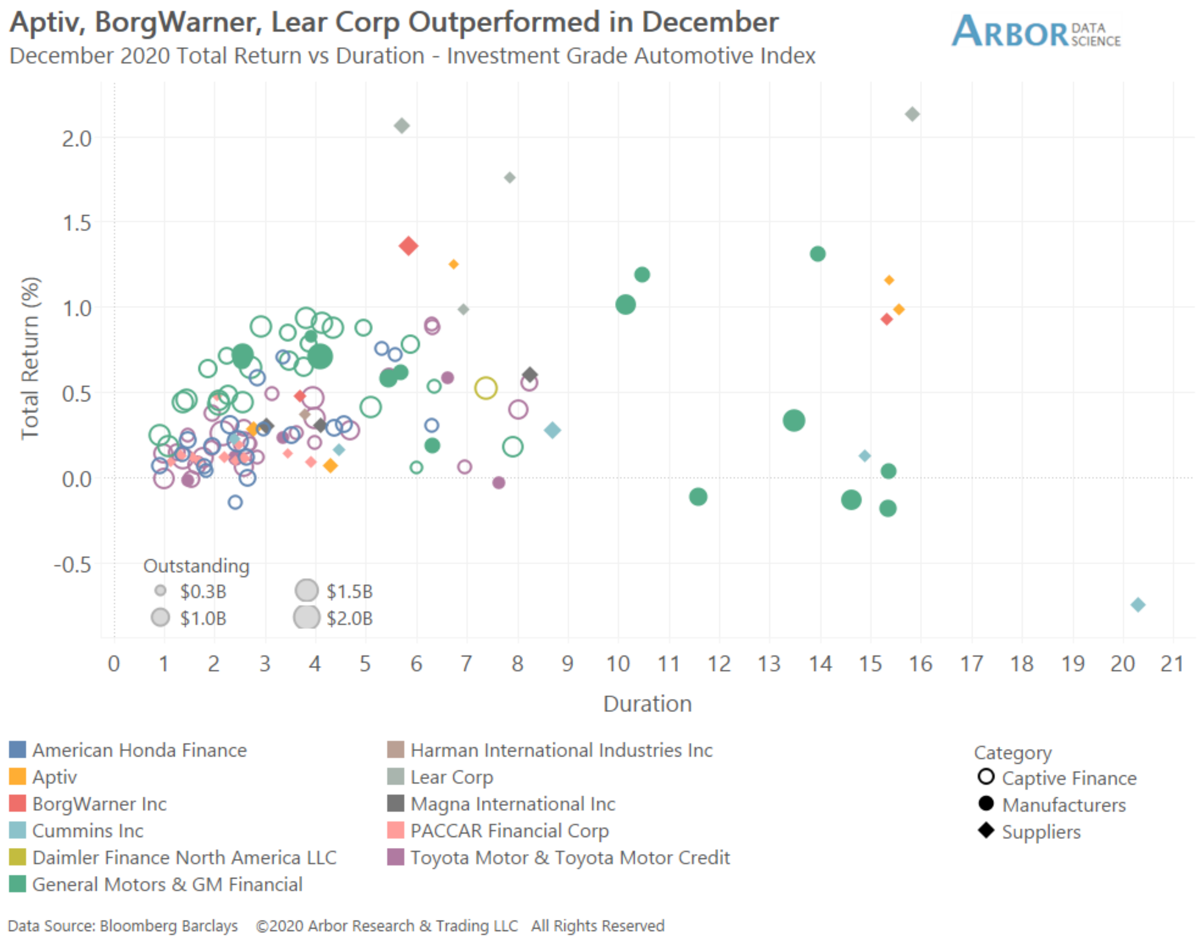
The Automotive Industry Looks for a Fast Start to 2021

Investors were rewarded for reaching out the risk curve in automotive credits in December. Higher yields and spread outperformance boosted those suppliers in particular. GM and GM financial paper outperformed at the short end of the curve.



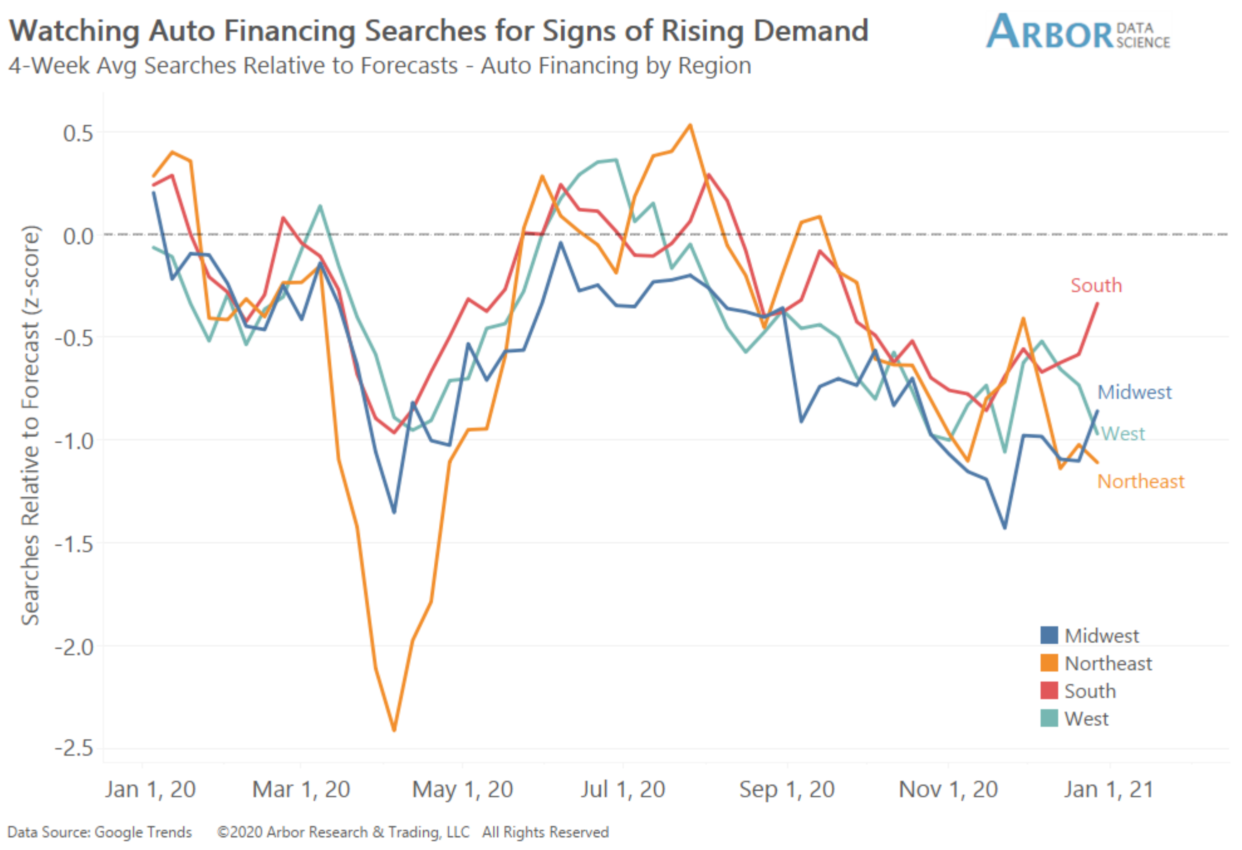
The Automotive Industry Looks for a Fast Start to 2021

The evidence here is supportive of robust demand outside the U.S., consistent with the [concerted global economic growth story](). Investors still need to assess whether the U.S. is on a similar path to recovering demand and how long that path will be.

State-level searches for auto financing are one indicator we'll be watching. This is another example of the pattern of Sun Belt states in the South seeing a quicker acceleration in activity across the economy. After bottoming in the first week of November, searches for auto loans in the South have risen steadily toward forecasts.

The most pressing concern is a deceleration in the Northeast. Seeing this turn higher will be an important piece of the puzzle.

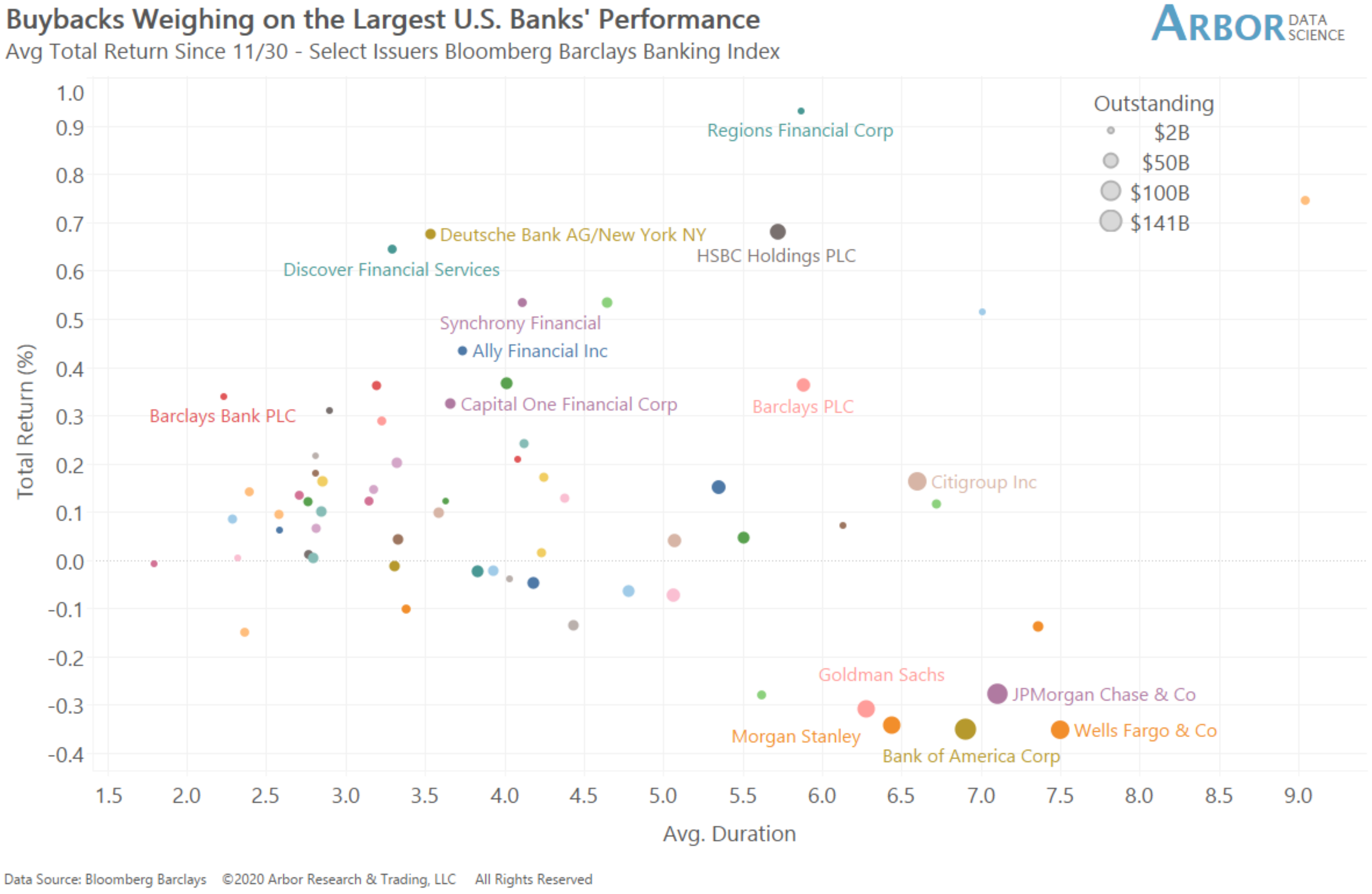
Full post: [The Automotive Industry Looks for a Fast Start to 2021]()



Regional Banks in Focus

Investor concern about renewed stock buybacks at the largest US banks is becoming clear in total return performance. The next chart shows the average total return against the average duration for issuers in the Bloomberg Barclays investment grade banking index. We selected only those issuers with at least $2 billion in debt outstanding.

Those six largest banks are conspicuously clustered at the bottom right. The outperformance at the front end of the curve boosted smaller banks with shorter duration profiles. A larger share of longer-dated bonds and the surprise change in capital structure weighed on the six largest. The net result was that five of the six posted total return losses for December on average.

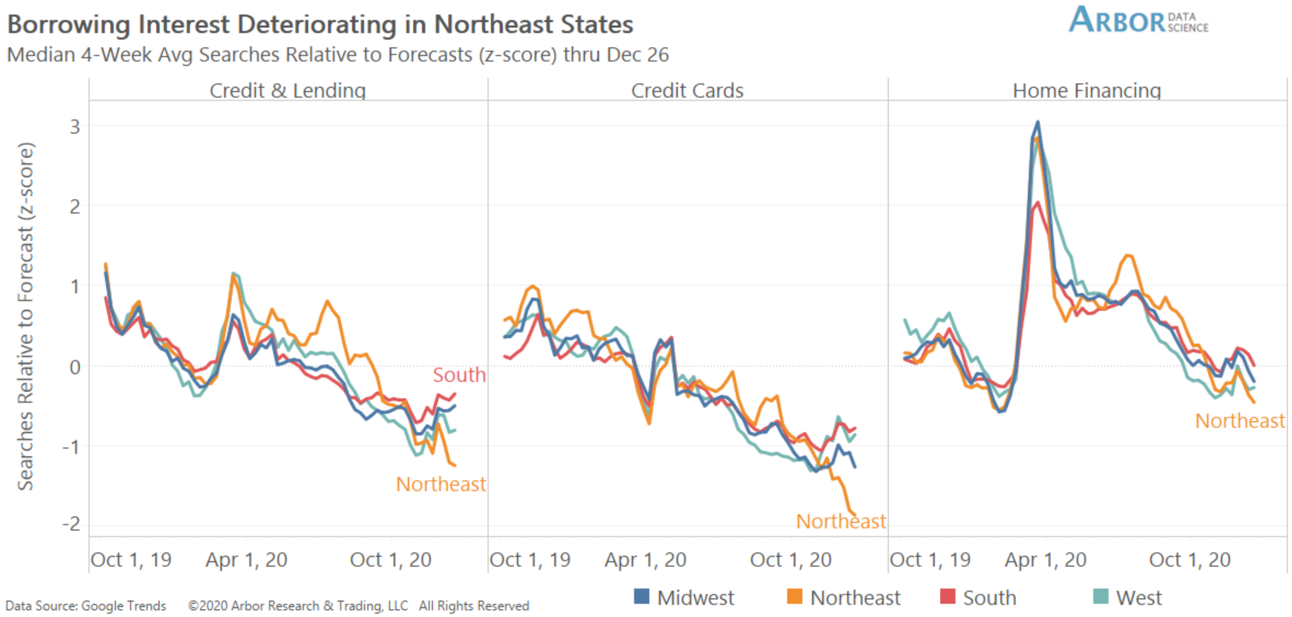


Regional Banks in Focus

While investors are doing their best to focus on the post-vaccine operating environment, the near-term outlook is flashing some warning signs. We track credit & lending search interest across the fifty states and DC and have seen a troubling deterioration in activity in the Northeast. The last chart shows the four-week average of searches relative to forecasts, aggregated by census region.

While Southern states have led a rebound in activity across most facets of the economy, large states in the Northeast are showing significant slowdowns. The abrupt decline is clearest in credit card interest but applies to home financing as well.

Full Post: [Regional Banks in Focus as Financials March On]



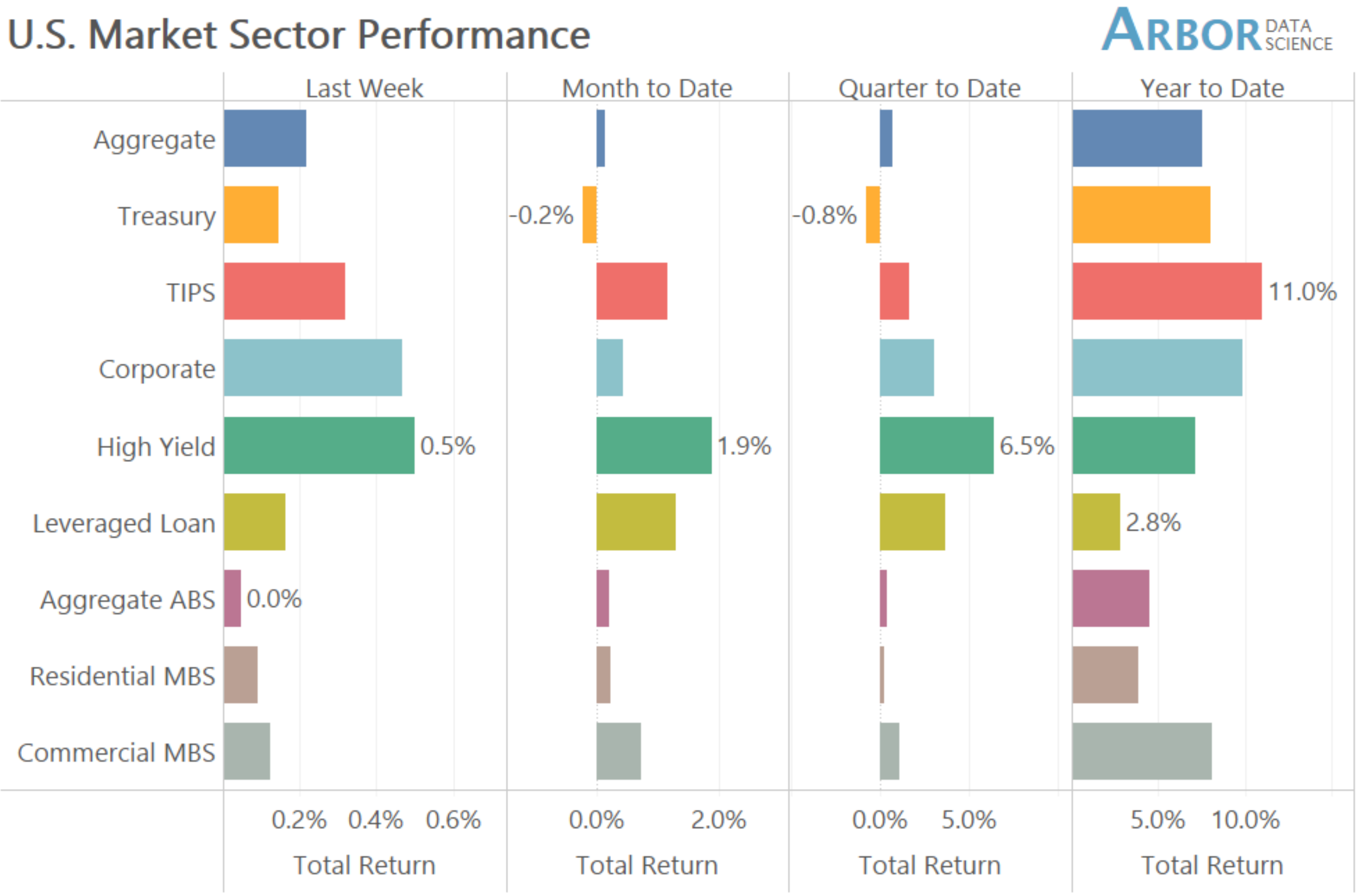
 12-14-2020

High Yield Posts a Strong Finish to 2020

High yield led the way as all market sectors posted positive total returns for the final week of 2020.

High yield gained 0.5%, extending its gain for December to +1.9% and for Q4 to +6.5%.

TIPS closed out a remarkable year for a total return of +11%, outpacing the Treasury index by 350 bps.



Data Source: Bloomberg Barclays Credit Suisse, Bloomberg LP

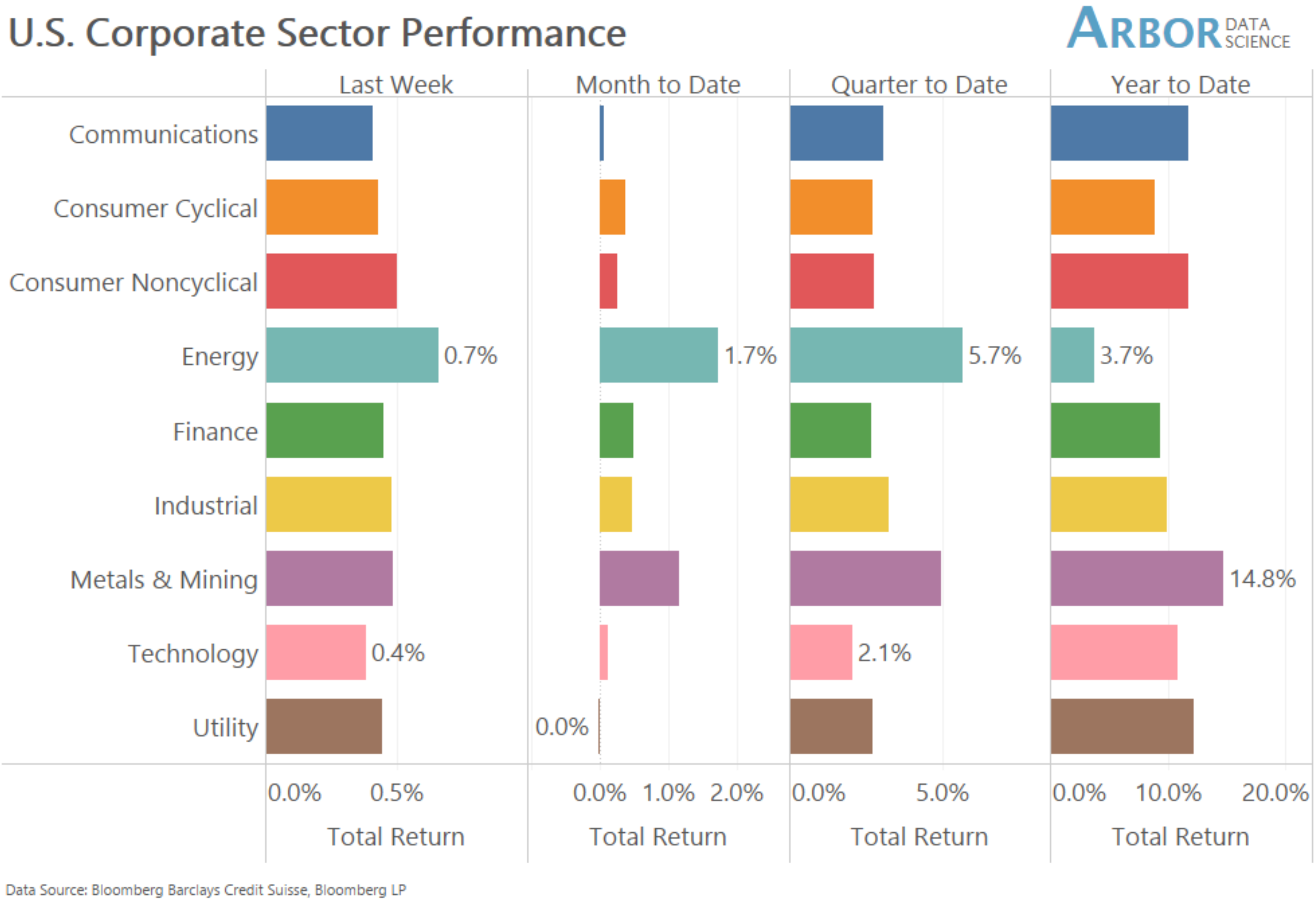
Sector Total Returns

Energy Credits March On

Investment grade corporates marched higher in unison to end the year.

The investment grade energy index continued to lead the way, posting an impressive gain of +1.7% in December. A total return of +3.7% for year was nearly inconceivable in April but is now a reality.

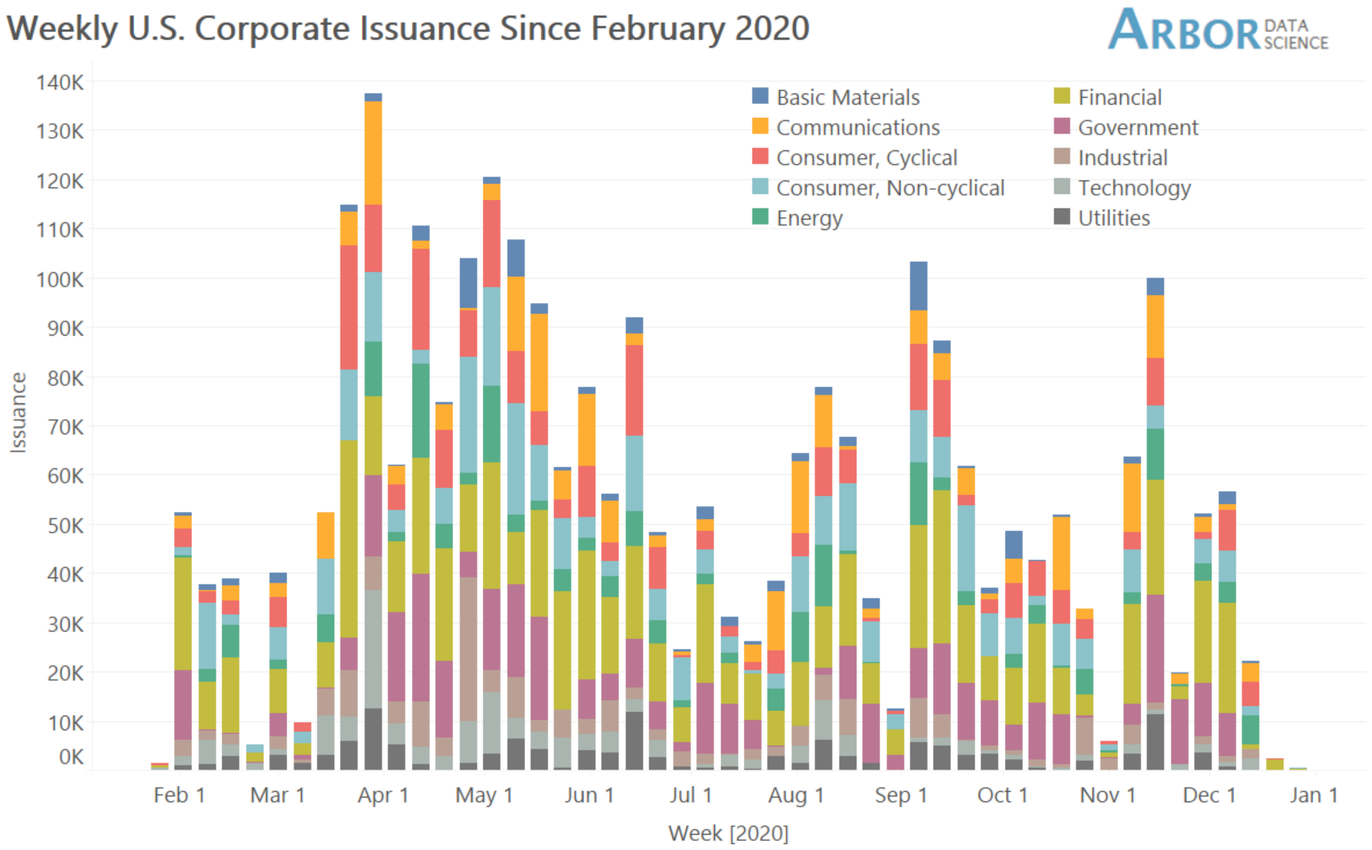
Metals & mining posted the strongest numbers for 2020 at +14.8%, riding a potent combination of industrial reopening and persistent precious metals demand.



Issuance Recap

New issuance was trivial in the final week of 2020 but is expected to ramp up quickly in the new year. Robust December issuance topped $81 billion, showing issuers remain opportunistic and investors hungry for corporate exposure.

Mid-December estimates for new issuance in the first week of January were near $40 billion with roughly $120 billion expected for the month, according to Bloomberg.



Data Source: Bloomberg Barclays Credit Suisse, Bloomberg LP

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