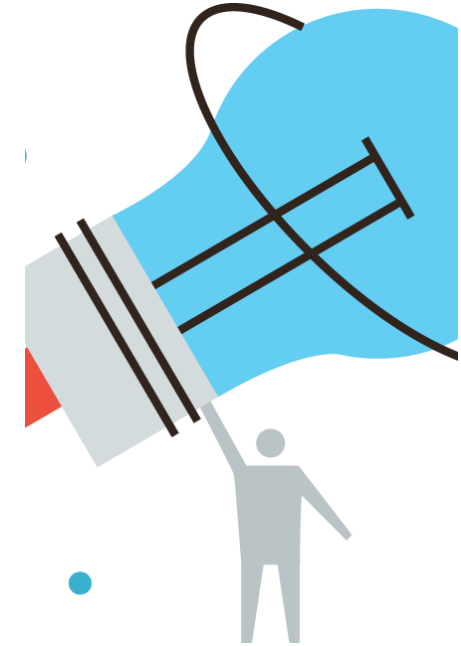# ARBOR DATA SCIENCE

U.S. Credit Update – February 8, 2021

- Industrials Starting to Lose Their Edge
- Auto Demand Takes a Step Back
- The Rent Narrative May Get Messy
- Bank Loans, Munis and TIPS on the March
- Total Return & Issuance Recap

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Benjamin Breitholtz and Peter Forbes
datascience.arborresearch.com

The standout industries in the investment grade credit space over the past three months have largely fit into one of three themes.

The hardest hit energy industries, refining, oil field services and independent shale producers, stormed ahead of the pack.

Travel industries including airlines, gaming and lodging dominated among industries with shorter-duration profiles.

The third theme has been manufacturing and materials, especially those tied to housing. There are signs that theme may be running out of gas.

The chart shows three-month excess returns versus weighted-average duration for each industry index.

3-Month Excess Returns Over Benchmark Treasuries
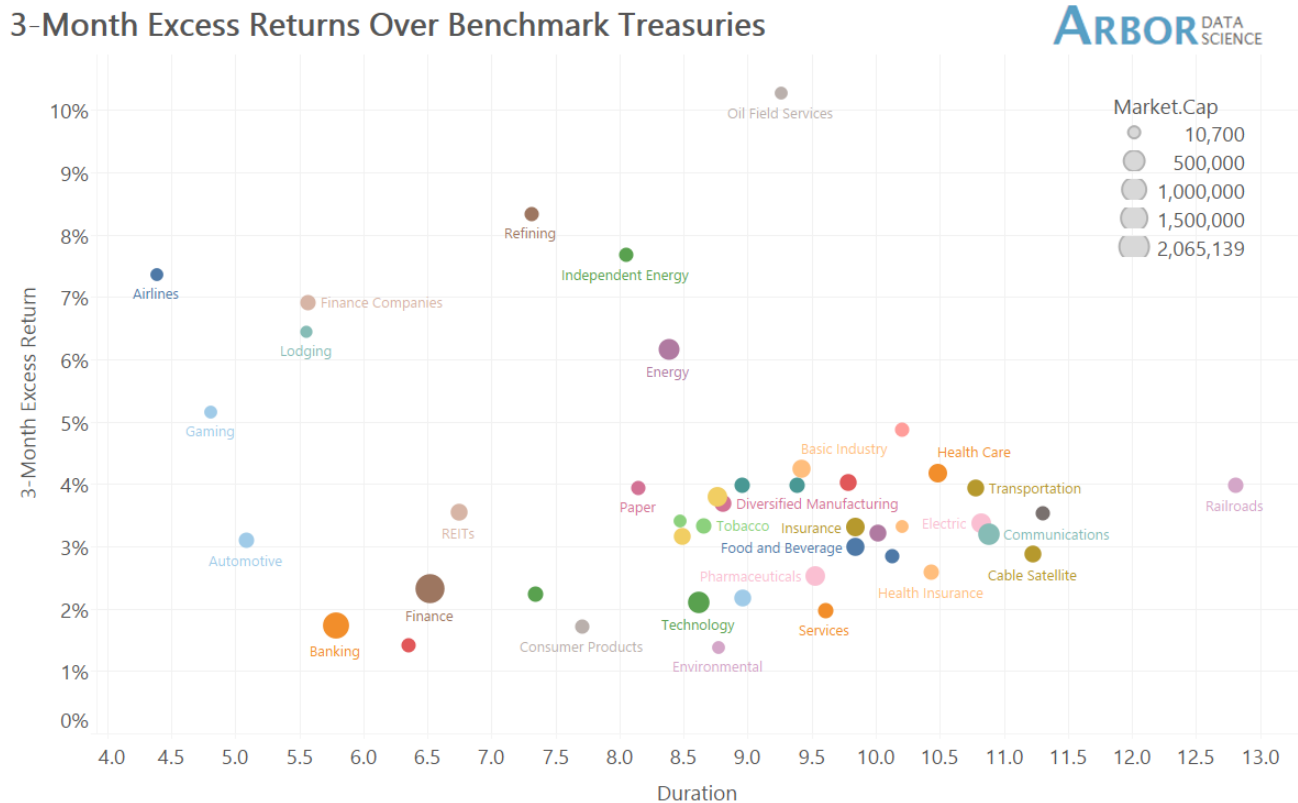
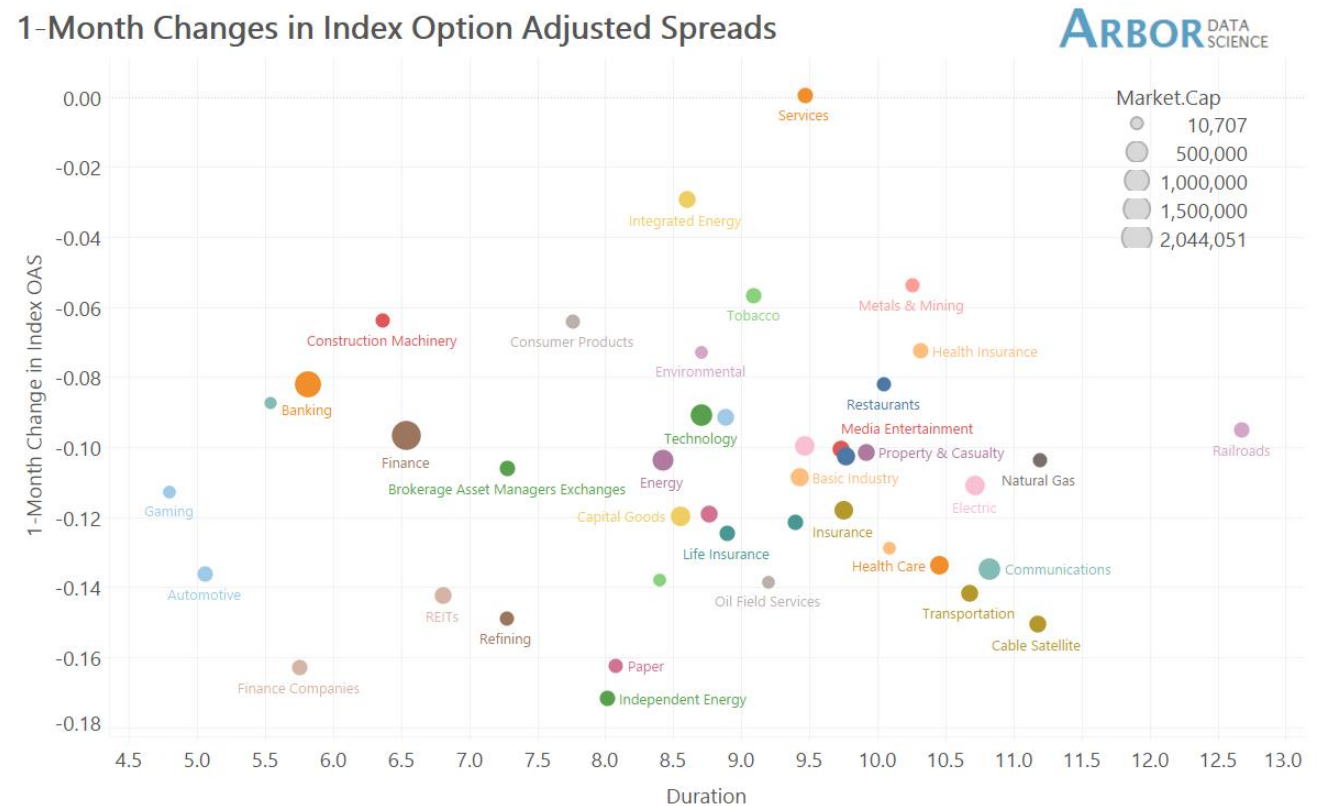Data Source: Bloomberg Barclays, Bloomberg LP

Spread performance over the past month has seen sustained outperformance in energy. But a new mix of industries is beginning to overtake materials and manufacturing.

Real estate, paper, transportation, health care, communications and insurance were among the top performers on a spread basis.

The chart one-month change in index option adjusted spread versus weighted-average duration for each industry index.

1-Month Changes in Index Option Adjusted Spreads

Data Source: Bloomberg Barclays, Bloomberg LP

As far as reported economic data, manufacturing and housing remain the two pillars of economic momentum in the US.

Retail has lost considerable momentum with consumer goods demand much more muted that during the spring lockdown.

The latest Google search activity is pointing to some bumps in the road ahead for industrial activity, however.

The chart shows our Economic Strength Indices, which measure income incoming data relative to one-year averages for each category of economic data.

Housing and Manufacturing Driving US Momentum
ESIs Measure Incoming Data Relative to 1-year Averages

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Legend:
- Confidence
- Housing
- Industrial
- Retail

Economic Strength Index
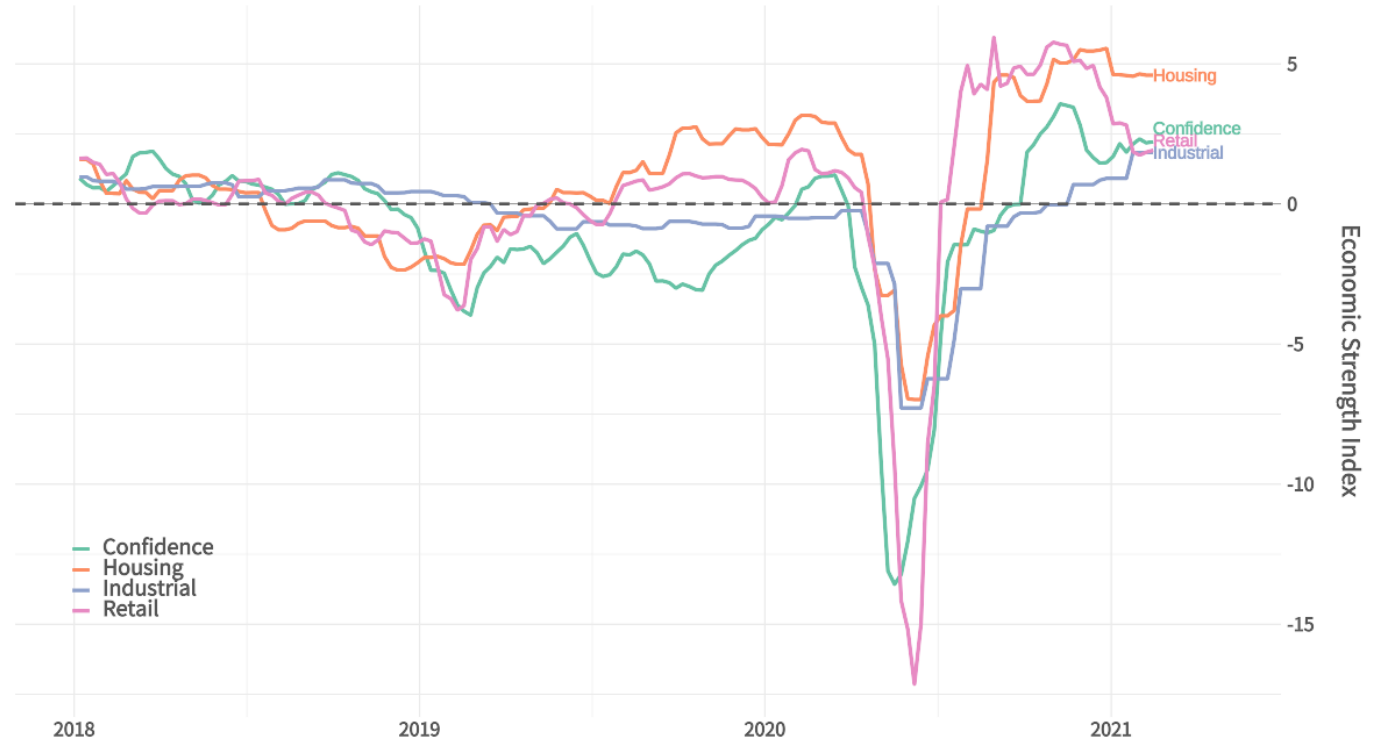
Data Source: Bloomberg, LP datascience.arborresearch.com

Industrials Starting to Lose Their Edge

Google search activity in both industrial and services categories turned sharply lower relative to forecasts over the past two weeks.
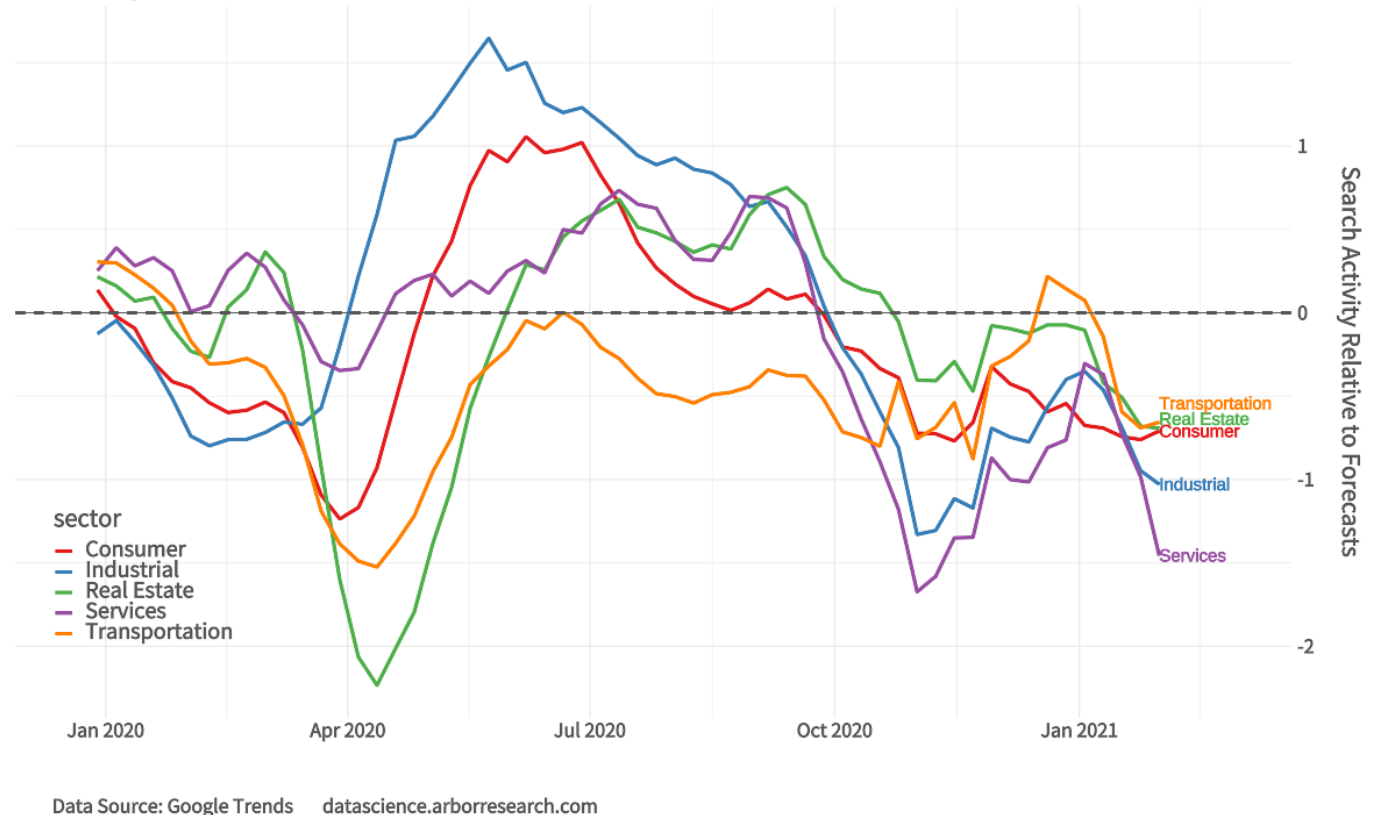
Search activity is failing to keep up with expectations as the US economy tries to power through to the post-vaccine era.

Monday's post and subsequent posts this week will dive into the details of the slowdown and the implications for markets. Stay tuned!

The chart aggregates Google searches across several dozen categories, showing the four-week average of search activity relative to forecasts in five key sectors.

Concerning Drop in Momentum for US Search Activity
4-Week Avg Searches vs. Forecasts - US thru Feb 6

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sector
— Consumer
— Industrial
— Real Estate
— Services
— Transportation

Data Source: Google Trends   datascience.arborresearch.com

Auto Demand Takes a Step Back

We track Google search activity for a range of auto shopping categories in the world's largest 25 auto markets. Only a month ago, auto shopping searches were holding steady or improving in most major developed markets. Search activity has failed to keep pace with the usual seasonal pickup in activity and fallen further below forecasts in the US, Canada, and the largest eurozone auto markets.
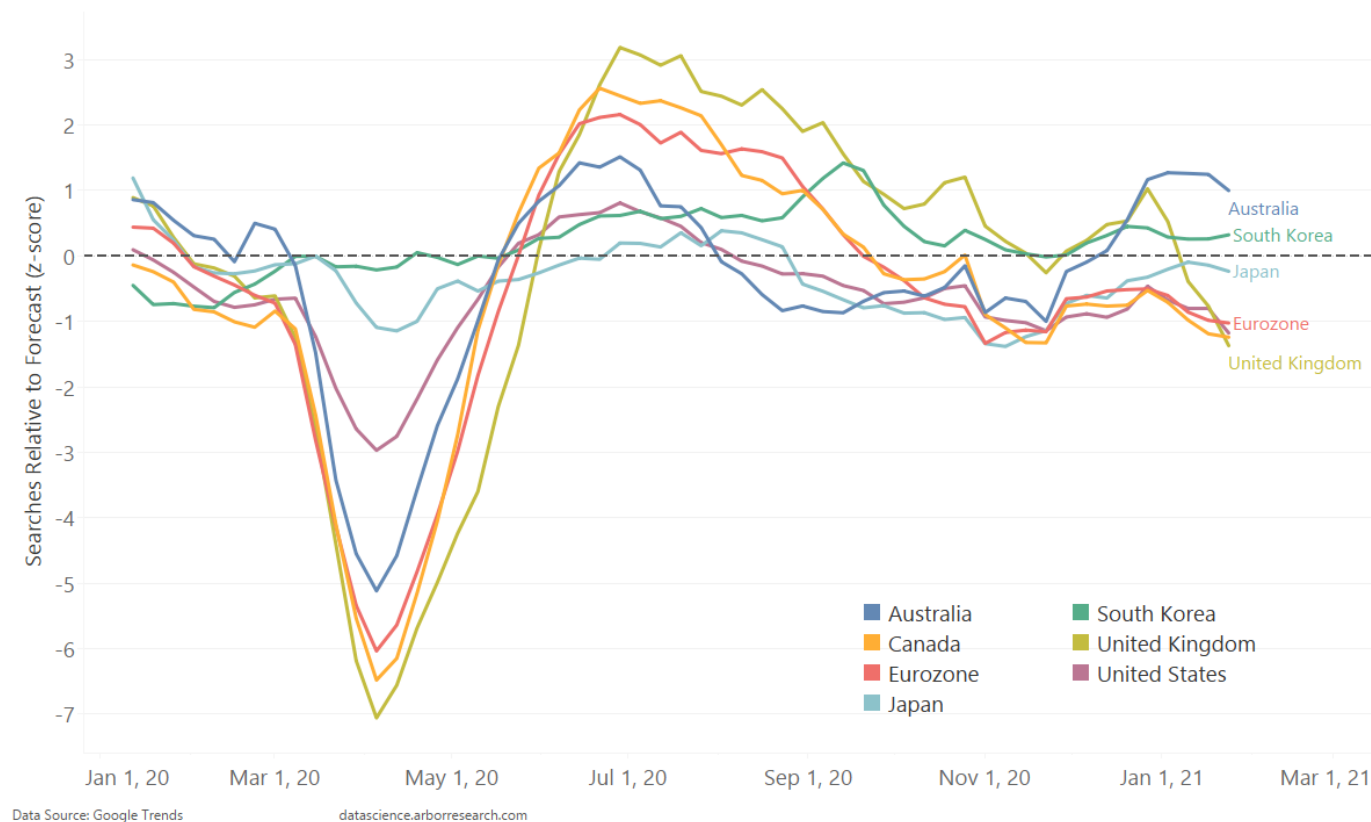
We highlighted the particularly bleak downturn in auto & vehicle searches in eurozone economies as part of a broader retreat by consumers.

The next series of charts shows four-week moving averages of search activity relative to our three-month forecasts.

Auto Searches Beginning to Fall Off the Pace in Developed Markets
4-Week Avg Auto & Vehicle Searches vs Forecast - Select Countries thru Jan 30 2021

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Data Source: Google Trends   datascience.arborresearch.com

Legend:
- Australia
- Canada
- Eurozone
- Japan
- South Korea
- United Kingdom
- United States
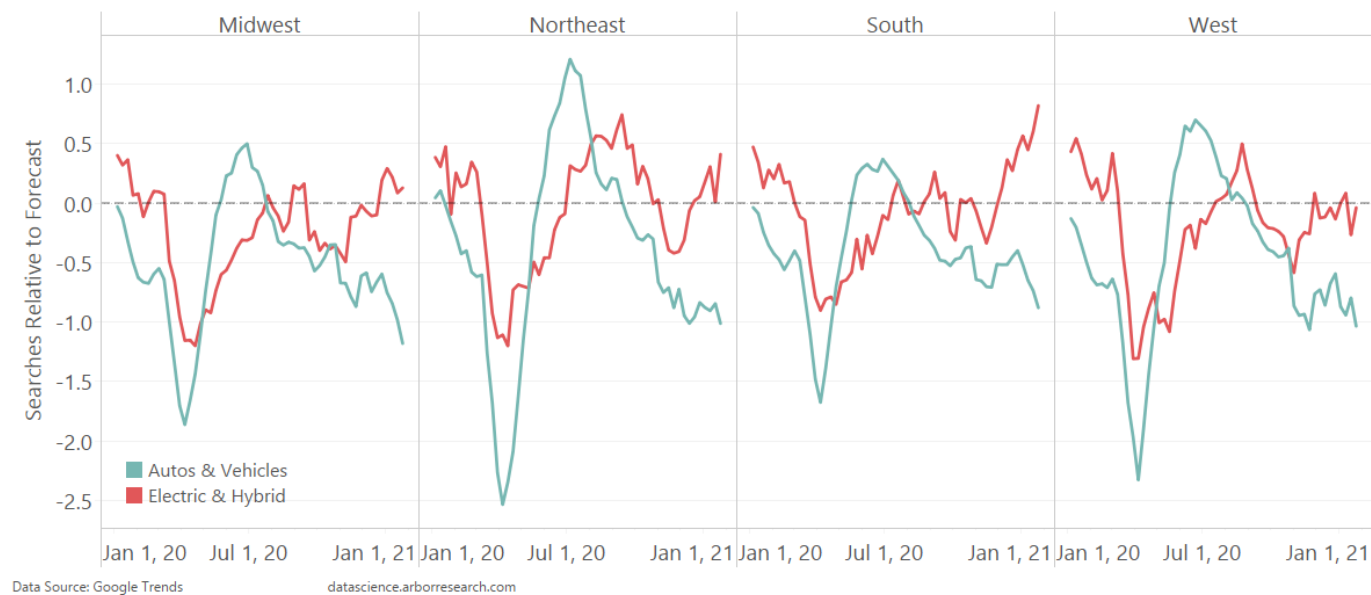
Auto Demand Takes a Step Back

There is a widening gap between growing enthusiasm for hybrid & electric vehicles and the deteriorating search activity for autos & vehicles more broadly. Looking across US states by census region, all four are seeing searches tied to hybrid and electric vehicles strengthen. Critical markets in the South and Northeast are seeing search activity rise above forecasts.

GM made headlines with a [long-term target for an all-electric fleet by 2035](#). Consumer interests may spur a faster transition still. A nimble transition away from ICE and toward lower-emission vehicles looks increasingly critical to automakers near term future. The backdrop of a [global boom in renewable energy](#) may be another accelerant.

Widening Gap Between EV & Hybrid and Broader Auto Searches
4-Week Average Searches Relative to Forecasts thru Jan 30 2021

Data Source: Google Trends   datascience.arborresearch.com

Auto Demand Takes a Step Back

Past credit updates regularly highlighted autos as one of the industries outperforming in the investment grade space.

A blend of short duration resilience and strong spread performance for longer-dated GM and Aptiv paper helped the index deliver a strong first month of 2021.

Aptiv, GM, Stellantis Outperformed Auto Index Peers in January
December 2020 Total Return vs Duration - Investment Grade Automotive Index

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Legend:
- American Honda Finance
- Aptiv
- BorgWarner Inc
- Cummins Inc
- Daimler Finance North America LLC
- General Motors & GM Financial
- Harman International Industries Inc
- Lear Corp
- Magna International Inc
- PACCAR Financial Corp
- Stellantis NV
- Toyota Motor & Toyota Motor Credit

Category:
- Captive Finance
- Manufacturers
- Suppliers

Outstanding: $0.3B, $1.0B, $1.5B, $2.0B

Data Source: Bloomberg Barclays   ©2020 Arbor Research & Trading LLC   All Rights Reserved

Auto Demand Takes a Step Back

We ended the [January update](#) with an eye on auto financing search activity. The optimistic case at the time was that rising activity in the South would be followed by similar strength in other regions. That scenario has not unfolded.

Instead, we've seen auto financing searches converge further below forecasts. Sharp weakness in the Northeast has moderated. Demand looks to have taken a step back after the hot start to the year.

For more on auto and parts manufacturing on the equity side, [see last week's post](#).

Auto Financing Search Activity Weakened in January
4-Week Avg Searches Relative to Forecasts - Auto Financing by Region

Data Source: Google Trends   datascience.arborresearch.com
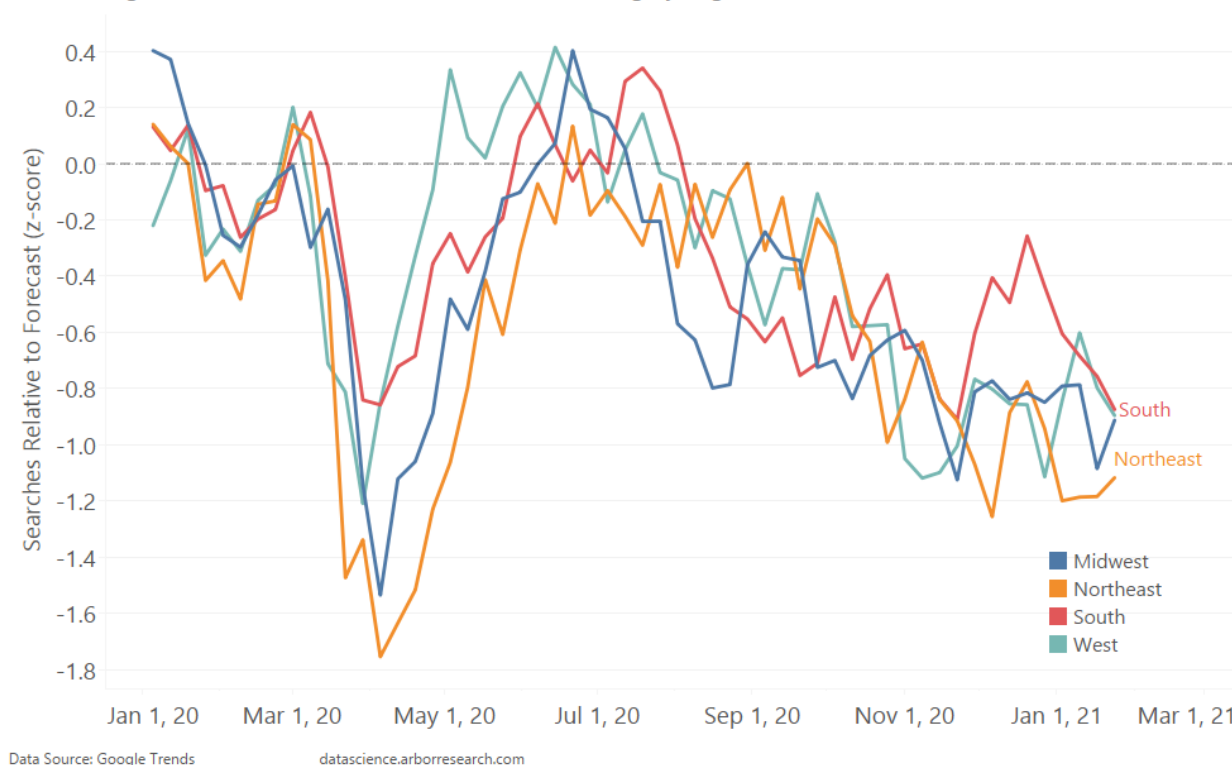
Investors and potential tenants could be forgiven for getting lost in the swirling narratives about rents, zoom towns are the latest hot take on the future of work from home. The reality on the ground is a divergence between a handful of large, highly visible cities and most of the rest of the country.
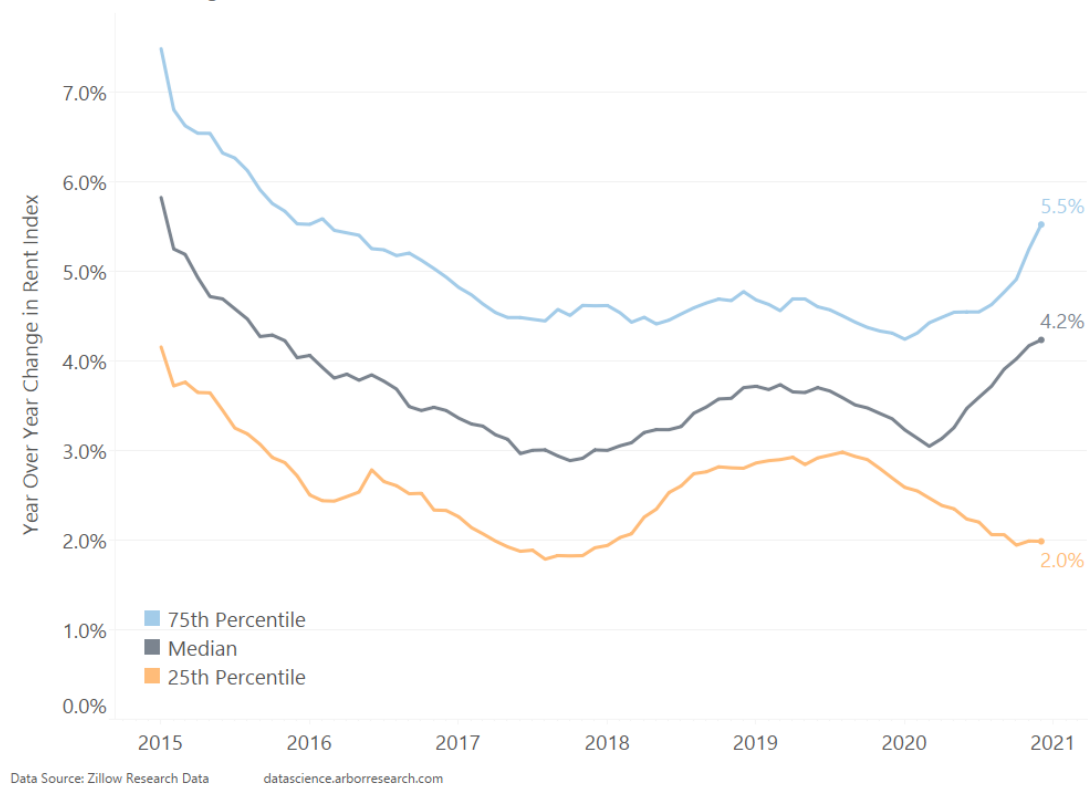
The latest data from Zillow's Observed Rent Index across the top 100 metros in the US reflect this and even show rents accelerating into the end of 2020.

The chart shows the median along with 25th and 75th percentiles for the year-over-year change in Zillow's Observed Rent Index (ORI) for each city.

The median recovered nearly linearly from a March 2020 low to end the year at +4.2%. The top 25% of metros saw their ORI increase by 5.5% or more. Yet the bottom 25% of metros have seen year-over-year rent growth continue to wane.

Zillow's Observed Rent Index Accelerated in Many Metros
Year-Over-Year Change in Zillow Observed Rent Index - US Metros

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- 75th Percentile
- Median
- 25th Percentile

5.5%
4.2%
2.0%

Data Source: Zillow Research Data   datascience.arborresearch.com

The list of highly visible cities with lower ORIs compared to December 2019 is short. New York, San Francisco, Boston, San Jose, Seattle, Austin, Chicago and Washington DC are the only metros with materially negative YoY changes.

More than three-quarters of these metros are still seeing positive YoY rent growth. This runs the spectrum from larger metros including Atlanta, Phoenix, Dallas Fort Worth and even Detroit. It also includes so-called zoom towns including Memphis, Providence, Tucson and Boise City.

Declining Rents Concentrated in Large Metros
Zillow Observed Rent Index - % Change YoY

Data Source: Zillow Research Data

datascience.arborresearch.com
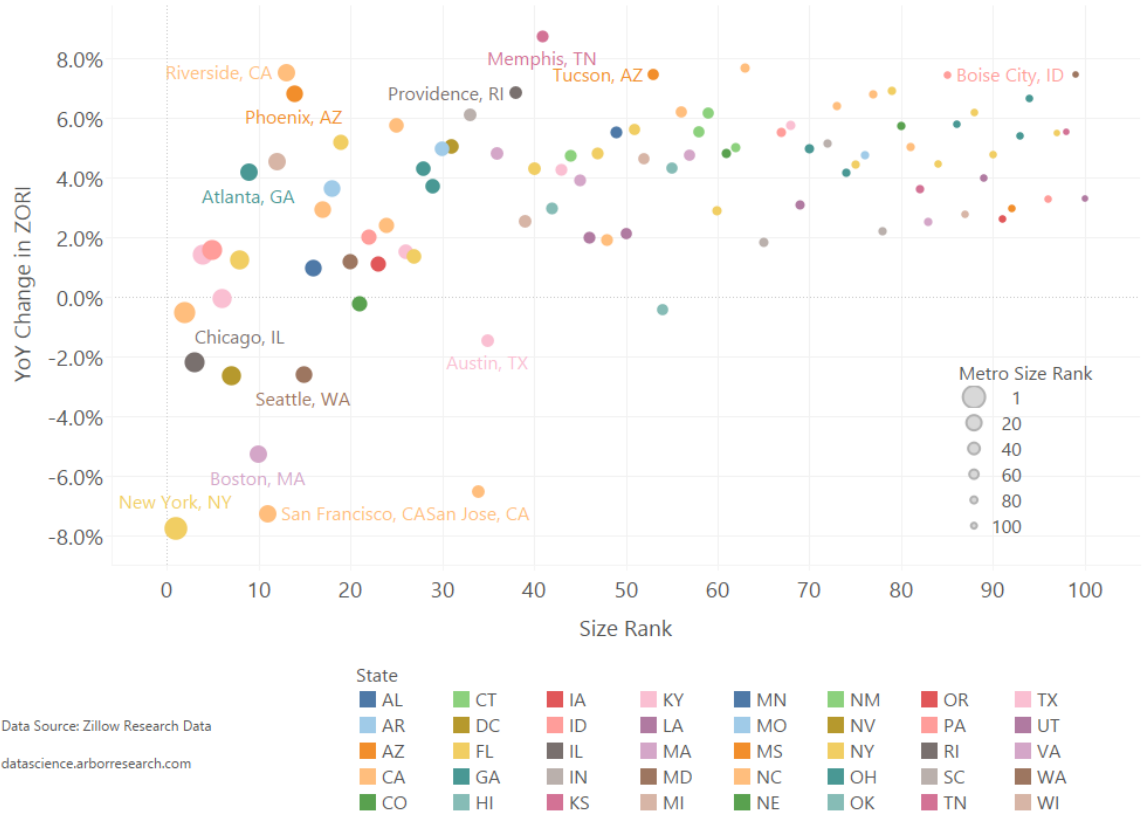
Whether that narrative sounds compelling probably has a lot to do with the stage of life, age of children, current school circumstances and how the pandemic has affected local public goods broadly in each instance. Even if it sounds compelling, there is some evidence that potential tenants are not yet acting on the opportunity.

Nationwide, Google search activity for apartments & residential rentals is falling sharply relative to our three-month forecasts. The week ending January 30th saw apartment searches fall to their lowest relative to forecasts since the reopening. Real estate searches broadly have also deteriorated.

For a deeper dive into the regional search activity around apartment rentals, as well as the implications for inflation via OER, see last week's post.

Apartment Search Activity Falling Further Below Forecasts
4 Week Avg Searches Relative to Forecasts - US thru January 30

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Data Source: Google Trends   datascience.arborresearch.com
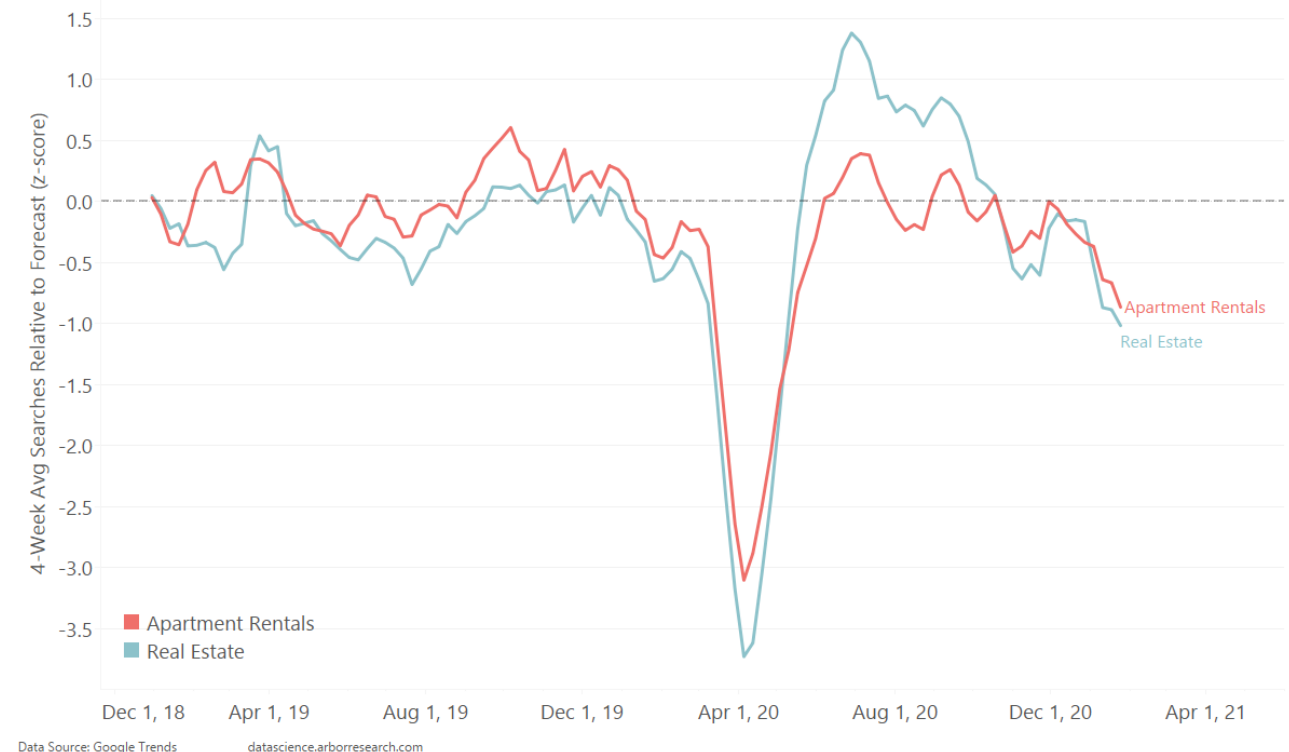
Bank Loans, Munis and TIPS on the March

We continue to watch a divergence in risk-adjusted return performance across fixed income sectors in the US. Leveraged loan funds remain in the spotlight as long end yields head higher and expectations of rising rates firm up.

Three-month reward/risk ratios for munis, TIPS and leveraged loans are still on the rise.

Mortgage backed securities ETFs delivered their best 3-month risk adjusted return since July.

Corporate bond ETF performance improved.

The chart shows average three-month reward/risk ratios for US domiciled fixed-income ETFs by strategy.

Bank Loans, Munis and TIPS Leading in Risk Adjusted Returns
Avg 3-Month Reward/Risk Ratios for U.S. Fixed Income ETFs by Strategy

ARBOR DATA SCIENCE

Data Source: Bloomberg, LP   datascience.arborresearch.com

02-08-2021
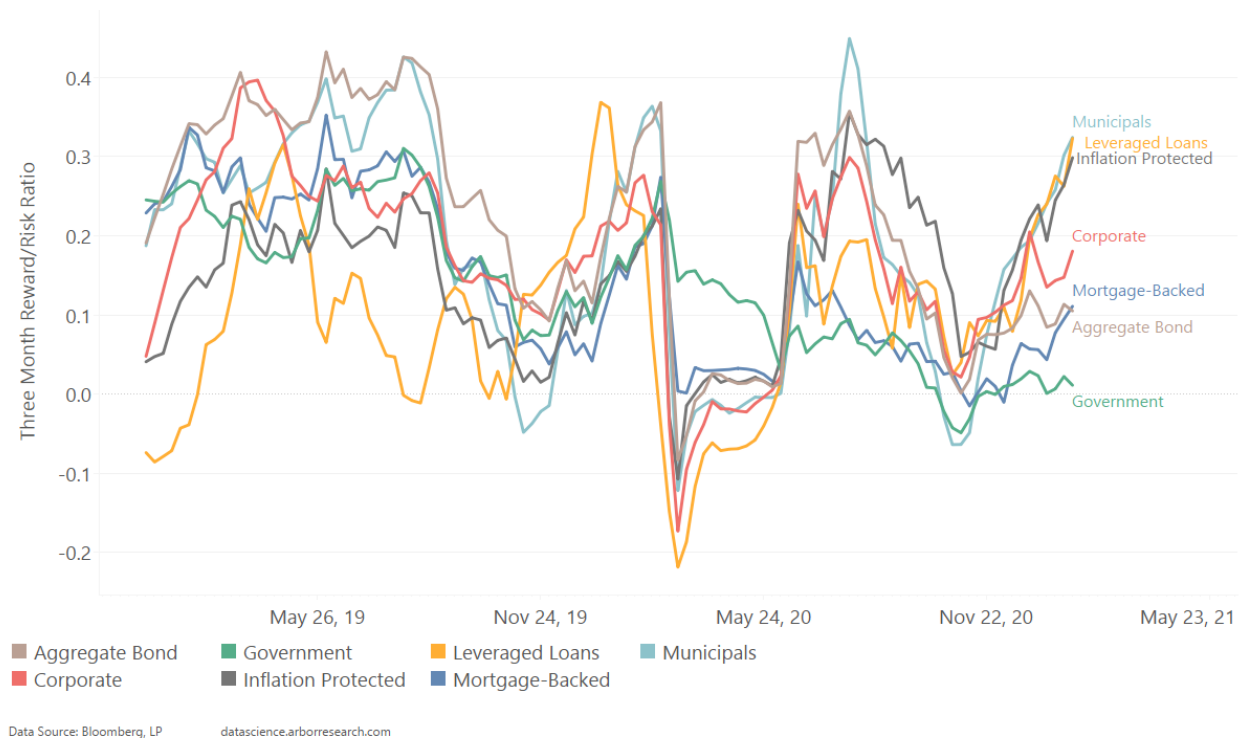
Net inflows continue to follow performance in the three best performing categories (Leveraged Loans, TIPS, Munis).

Rolling monthly net flows for bank loan funds set a new high above $500 million.

TIPS funds saw net monthly inflows dip to $242 million.

For a comprehensive break down of US fixed income ETF flows, see our latest update.

Investors Boosting Exposure to Bank Loans, TIPS, Munis
Net One-Month Flows for U.S. Domiciled ETFs

ARBOR DATA SCIENCE
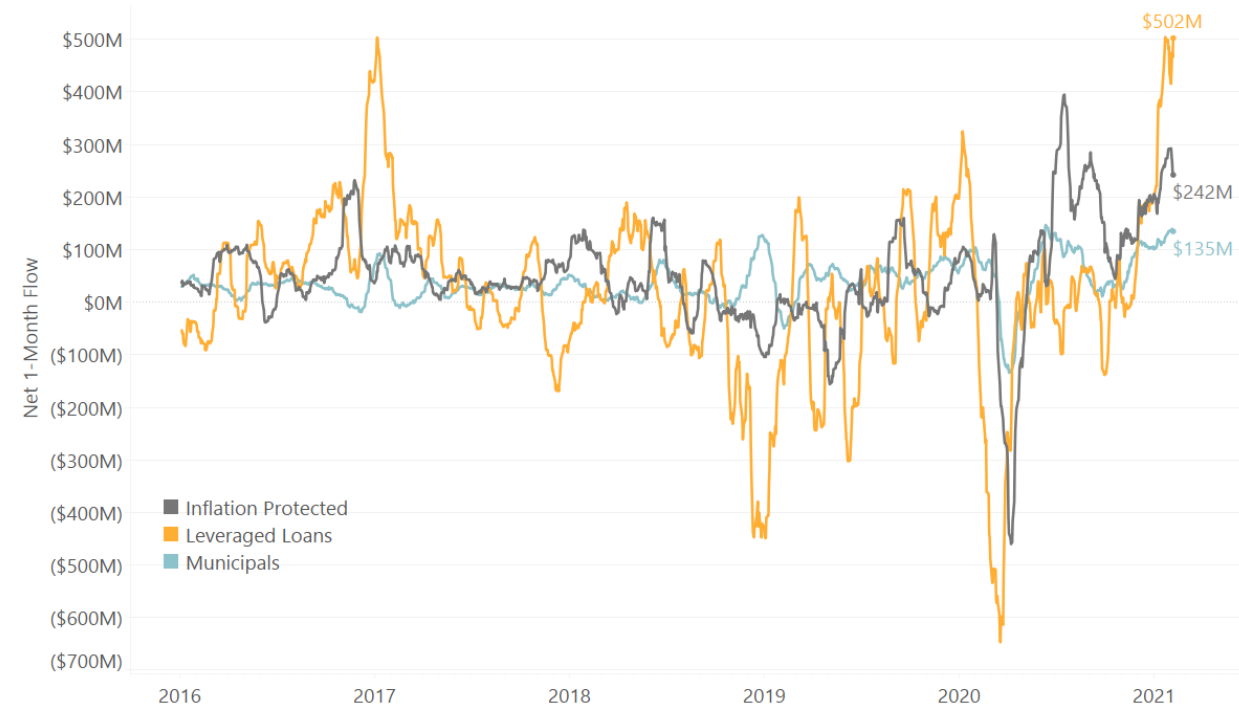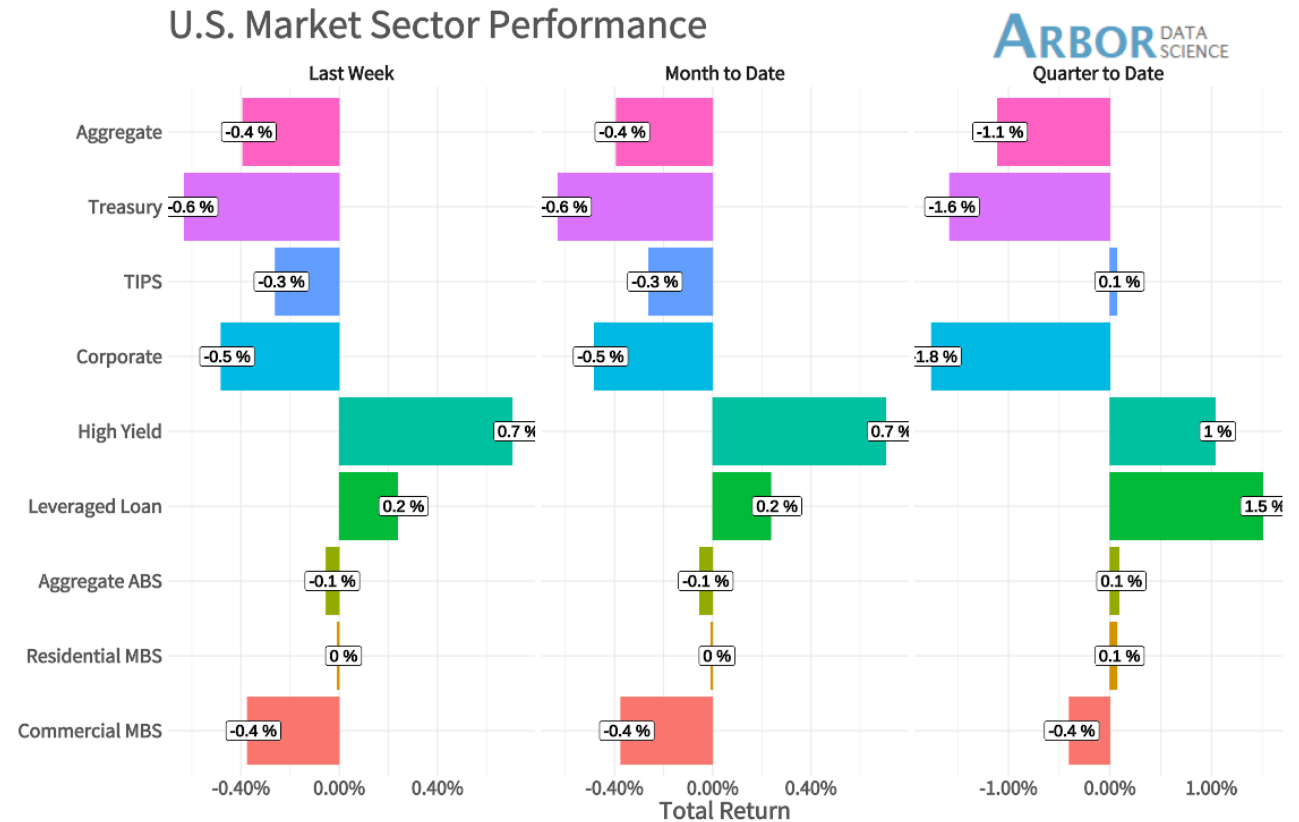

Data Source: Bloomberg, LP

Risk On Flows Fueling High Yield, Leveraged Loans

Safe assets underperformed and the riskier sectors of the US fixed income markets extended gains.

High yield gained 0.7% on the week, extending its Q1 return to +1%. Leveraged loans inched higher by 0.2% and continue to lead for Q1 at +1.5%.

The Treasury index lost 60 bps, extending the Q1 loss to -1.6%. TIPS continue to outperform but did slide 30 bps on the week and are clinging to a positive Q1 return of +0.1%.

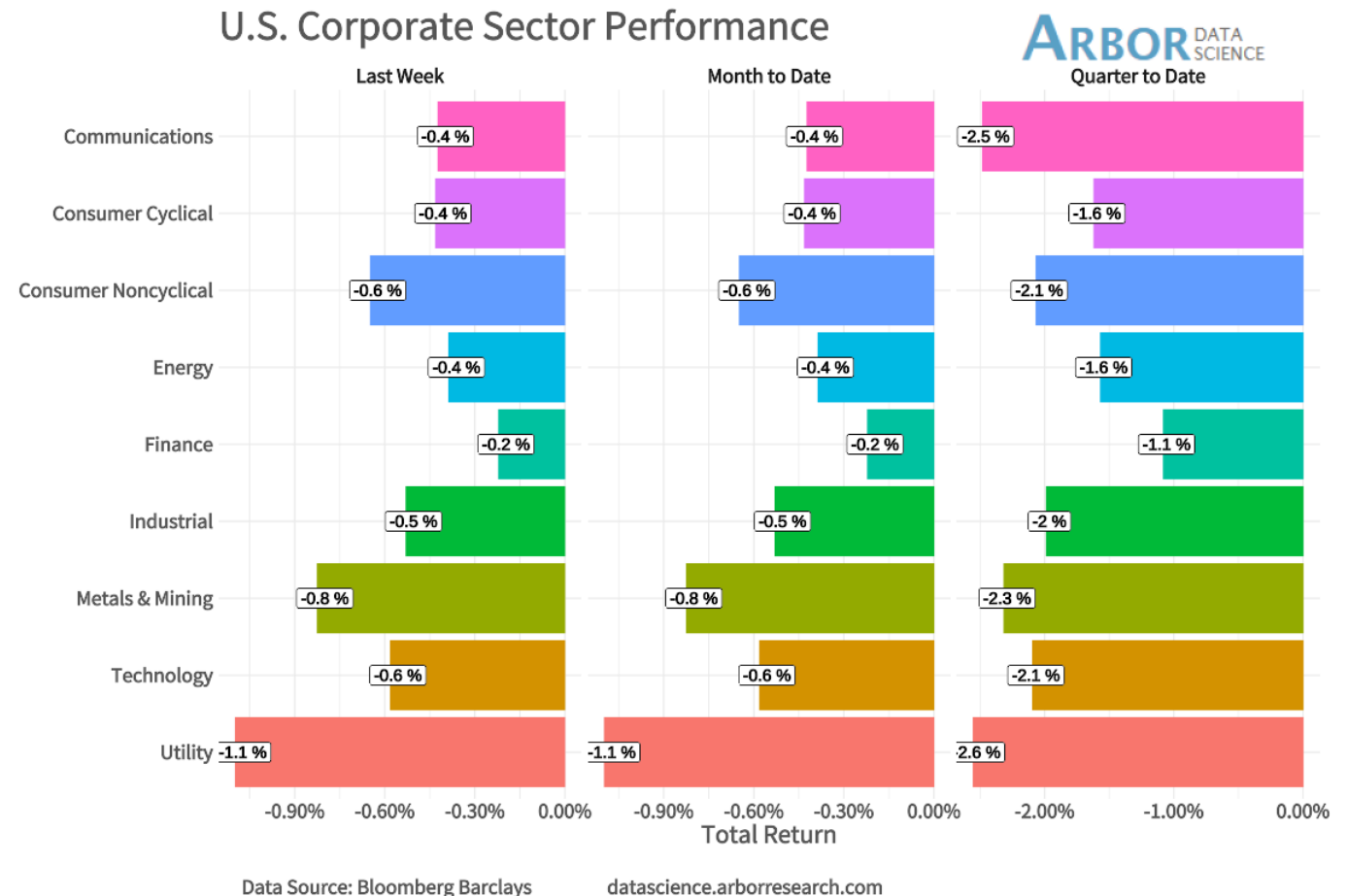U.S. Market Sector Performance

Data Source: Bloomberg Barclays, Credit Suisse   datascience.arborresearch.com

Investment Grade Retreat Persists

Rising yields dominated modest spread tightening on the week in the investment grade space. All sectors lost ground with longer-duration utilities faring worst. Utilities were -1.1% on the week and now -2.6% for Q1.

Shorter duration financials were spared some of the pain from higher yields. The financial index lost 0.2% and leads for the quarter at -1.1%.
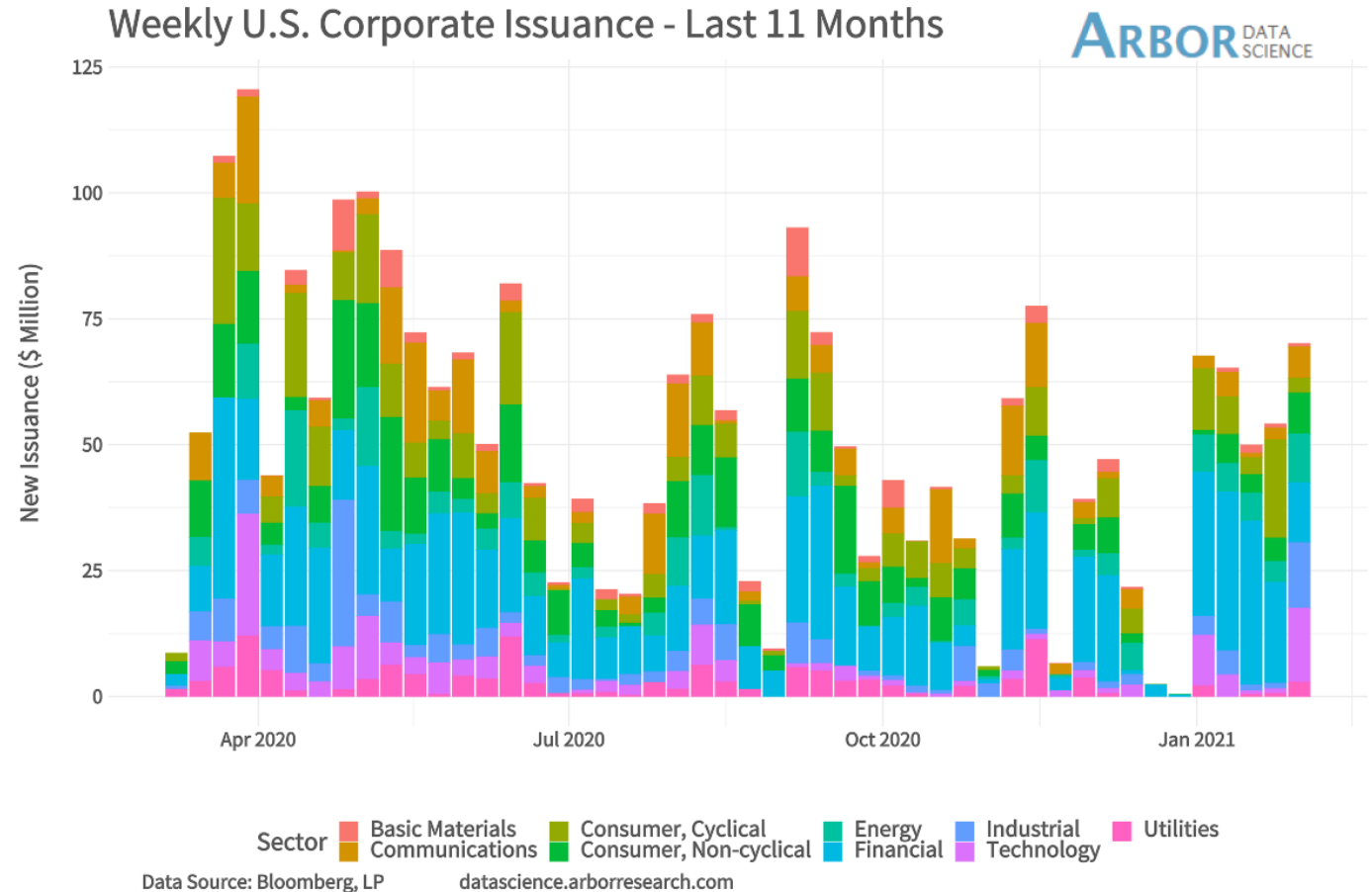
U.S. Corporate Sector Performance

	Last Week	Month to Date	Quarter to Date
Communications	-0.4 %	-0.4 %	-2.5 %
Consumer Cyclical	-0.4 %	-0.4 %	-1.6 %
Consumer Noncyclical	-0.6 %	-0.6 %	-2.1 %
Energy	-0.4 %	-0.4 %	-1.6 %
Finance	-0.2 %	-0.2 %	-1.1 %
Industrial	-0.5 %	-0.5 %	-2 %
Metals & Mining	-0.8 %	-0.8 %	-2.3 %
Technology	-0.6 %	-0.6 %	-2.1 %
Utility	-1.1 %	-1.1 %	-2.6 %

Total Return

Data Source: Bloomberg Barclays   datascience.arborresearch.com

Primary market activity remains robust. Last week's dose of new supply was the largest so far in 2021, approaching $75 billion.

Still-low rates, tight spreads and increasing confidence about both fiscal stimulus and a vaccine-driven recovery all continue to fuel investors' risk appetites.

We expect issuers to remain active as they prepare for the surge of economic activity later in the year.
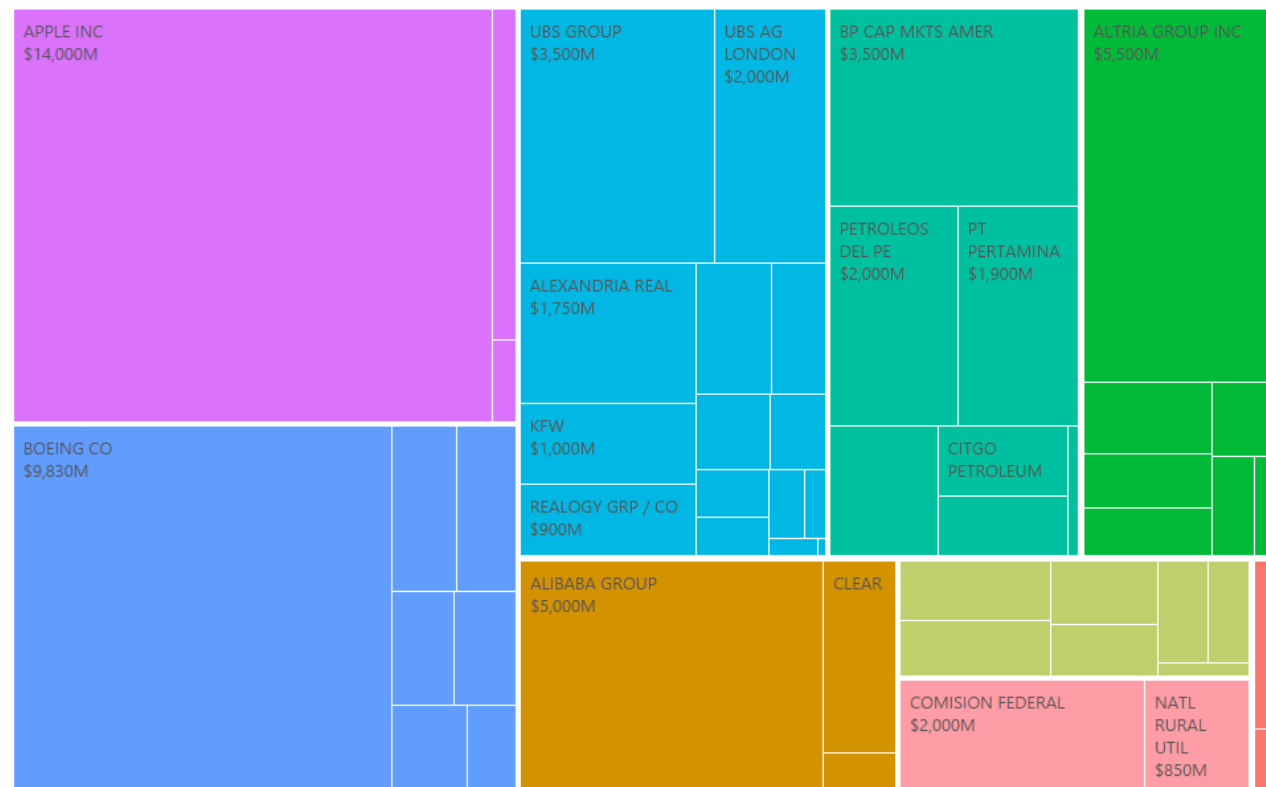

Weekly U.S. Corporate Issuance - Last 11 Months

Data Source: Bloomberg, LP   datascience.arborresearch.com

Issuance Recap

A series of large deals dominated new issuance in the first week of February. Apple ($14 billion), Boeing ($9.8 billion), Alibaba ($5 billion) and Altria Group ($5.5 billion) all combined for almost $35 billion.

The wave of new supply may have contributed to pressure on Treasury yields. Swaption volatility is beginning to show more anxiety over rising long-end yields. That may prove to be a catalyst for more opportunistic issuance in the weeks ahead.

New U.S. Corporate Issuance by Sector

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APPLE INC $14,000M
UBS GROUP $3,500M
UBS AG LONDON $2,000M
BP CAP MKTS AMER $3,500M
ALTRIA GROUP INC $5,500M
ALEXANDRIA REAL $1,750M
PETROLEOS DEL PE $2,000M
PT PERTAMINA $1,900M
BOEING CO $9,830M
KFW $1,000M
CITGO PETROLEUM
REALOGY GRP / CO $900M
ALIBABA GROUP $5,000M
CLEAR
COMISION FEDERAL $2,000M
NATL RURAL UTIL $850M

Data Source: Bloomberg Barclays Credit Suisse, Bloomberg LP

Legend:
- Basic Materials
- Communications
- Consumer, Cyclical
- Consumer, Non-cyclical
- Energy
- Financial
- Industrial
- Technology
- Utilities

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