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Navigating credit markets

Global Credit Outlook

Fixed Income Boutique

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Navigating credit markets: our list of worries and opportunities

Macroeconomics

1. Lower economic growth
2. Inflation high and sticky
3. Hawkish central banks but visibility should improve

Microeconomics

4. Strong and resilient credit metrics
5. Corporate cash balances slightly declining

Technical factors

6. Lower bond issuance
7. Cost of debt up substantially

Valuation

8. Spreads and yields at multi-year highs
9. Record amount of low cash price bonds
10. How to benefit from this environment

Our monthly scorecard evaluates the four main driving factors for global credit: Macroeconomics (economic trend and monetary policy), Microeconomics (corporate fundamentals), Technical factors (flows, new issues, etc.) and Valuation. Our market outlook follows this structure.

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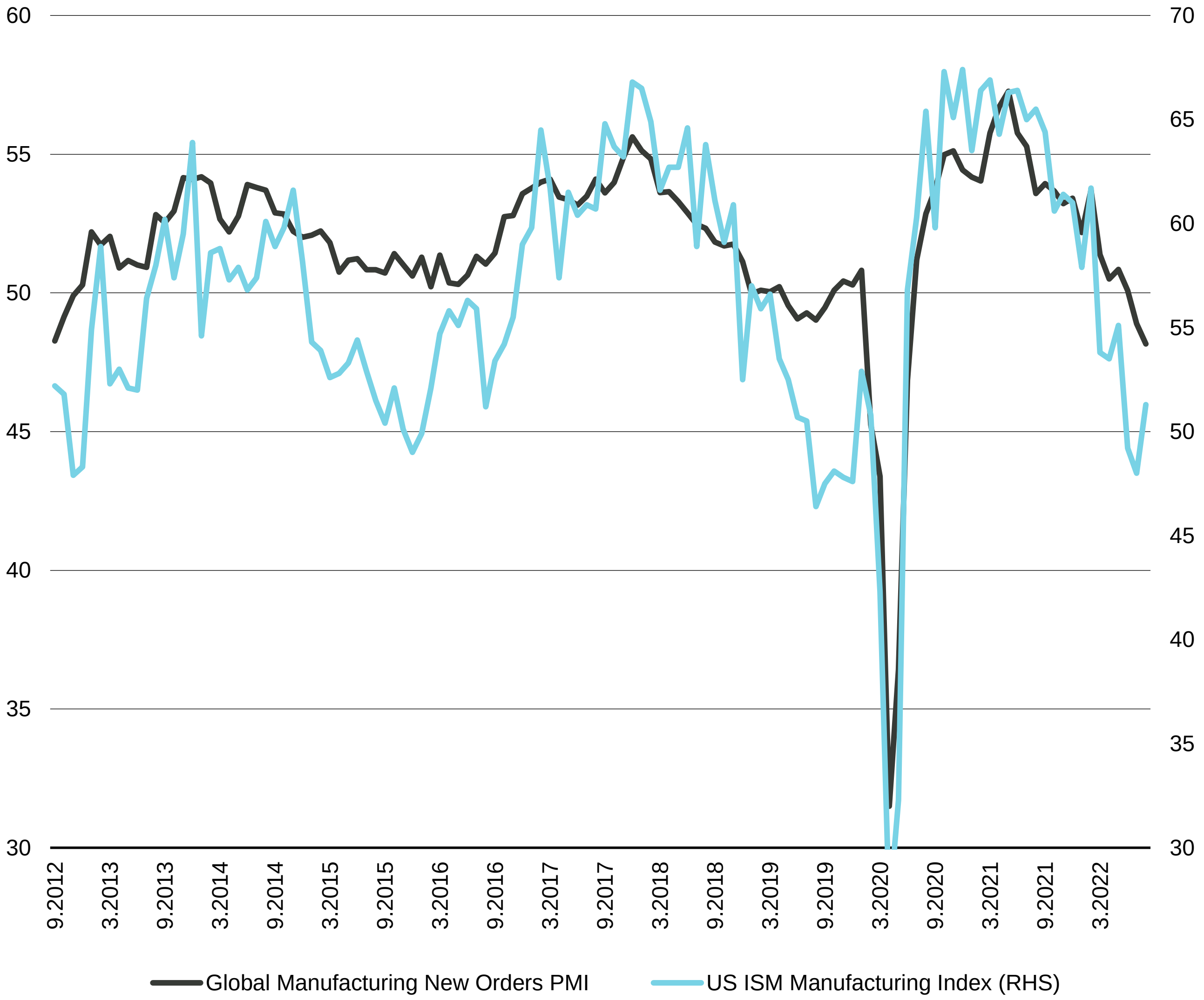
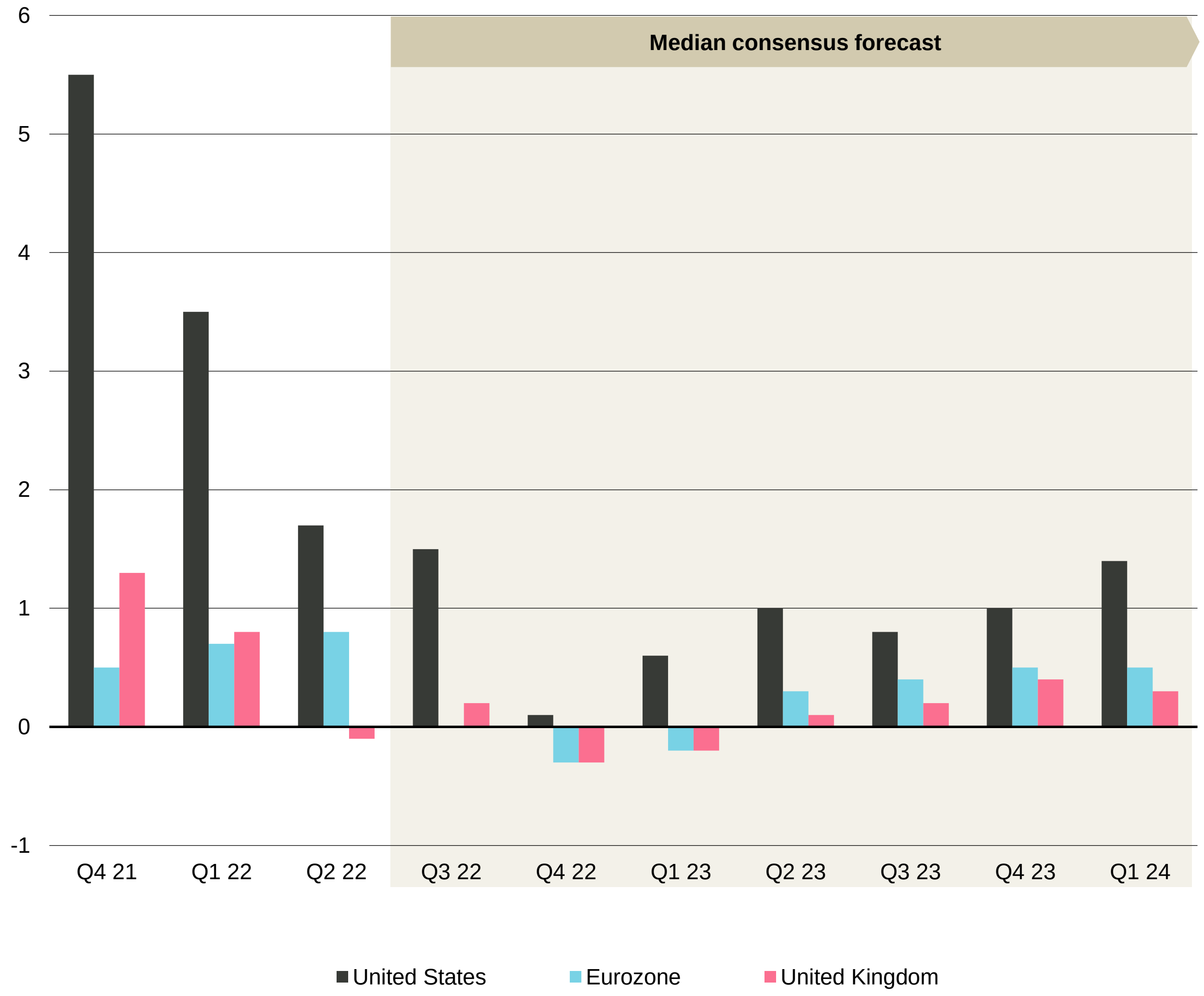
#1. Global growth expected to slow down further.

Macro

Global & US leading indicator (PMI) moved below 50



GDP expected to slow down further



Source: Bloomberg, Vontobel, September 2022.

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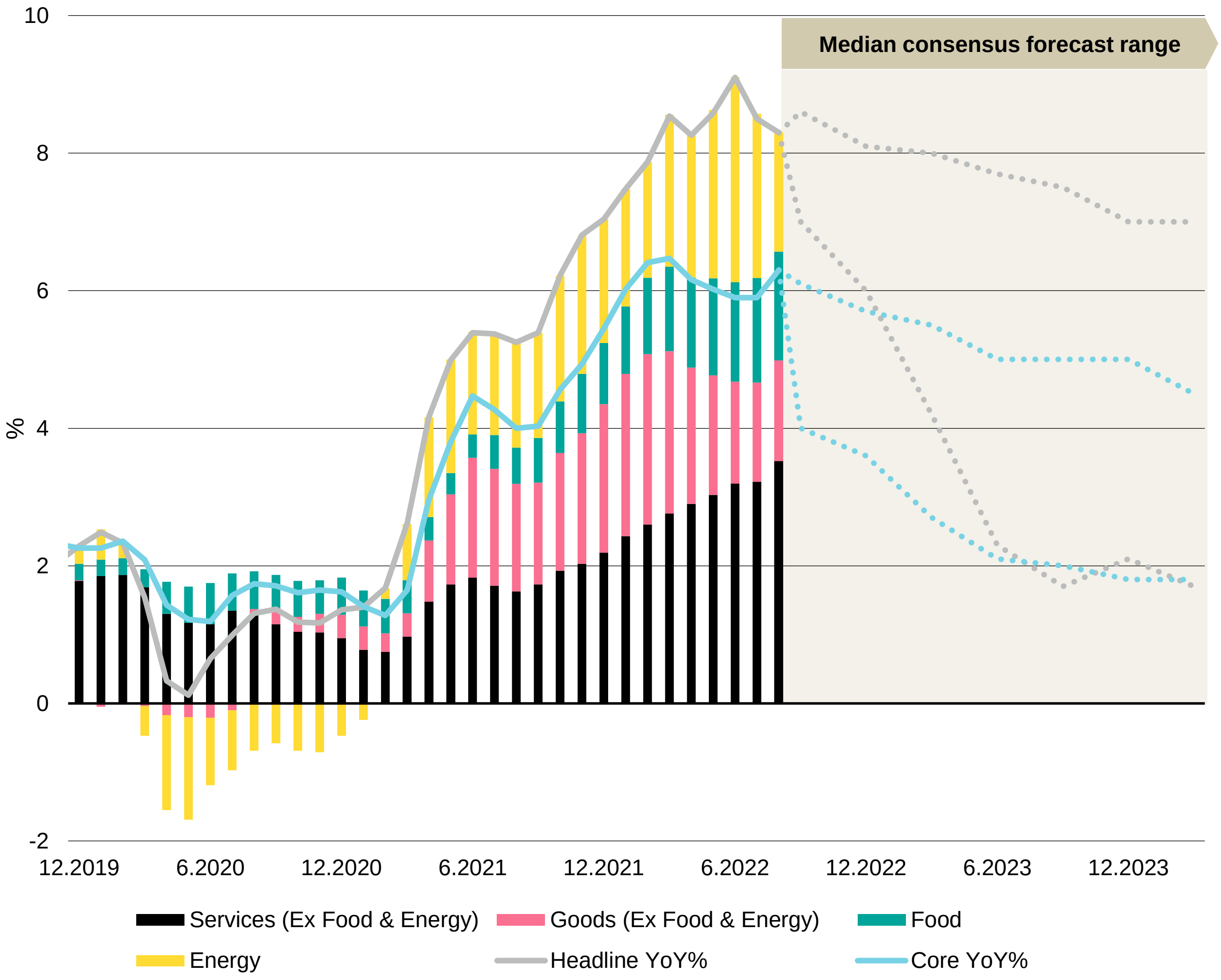
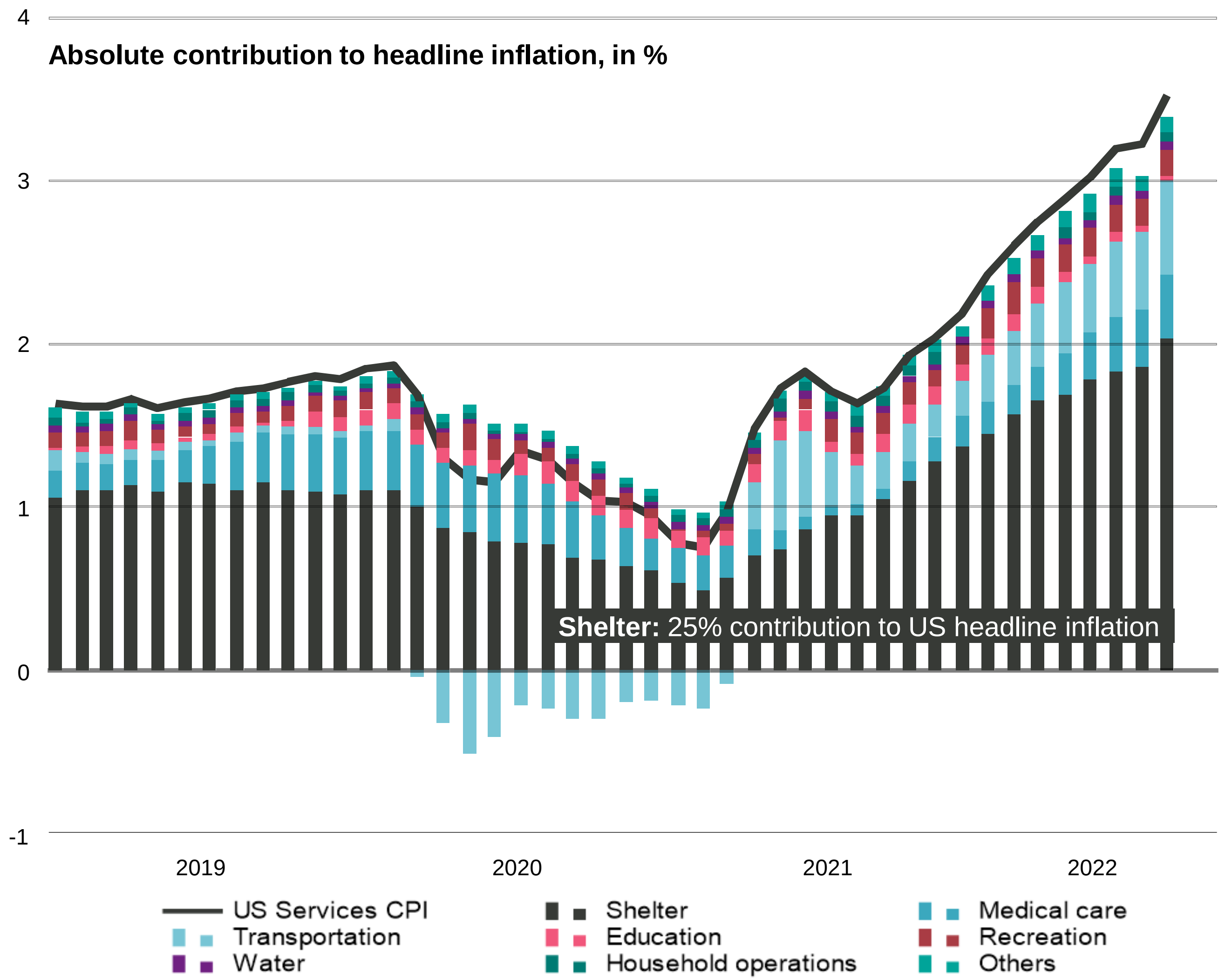
#2. Inflation remains high and core inflation sticky…

Macro

US inflation: different drivers and a wide range of forecasts



Core inflation remains sticky



Source: Refinitiv Datastream, Bloomberg, Vontobel, September 2022

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…but there are good arguments for peak inflation soon.

Macro

10 arguments why US inflation should come down from here

Demand-pull inflation

1. The **global economy** is slowing down
2. The **strong US-Dollar** makes imports cheaper
3. US central bank has returned to a **restrictive monetary policy**
4. **Inflation expectations** remain well anchored

Cost-push inflation

5. **Energy prices** have peaked on demand concerns
6. **Food prices** have recently collapsed
7. Global **supply chains** are normalizing
8. Corporate **profit margins** started to decline
9. Goods prices heading south as **Covid-19-induced shortage eases**
10. **Rent inflation** capped by weaker housing activity

Demand-pull inflation takes place when the demand in an economy outpaces the supply, thereby pulling up prices. Cost-push inflation, on the other hand, arises when demand remains the same while the supply of goods or services is – in one way or the other – limited, thereby pushing up prices. Source: Vontobel.

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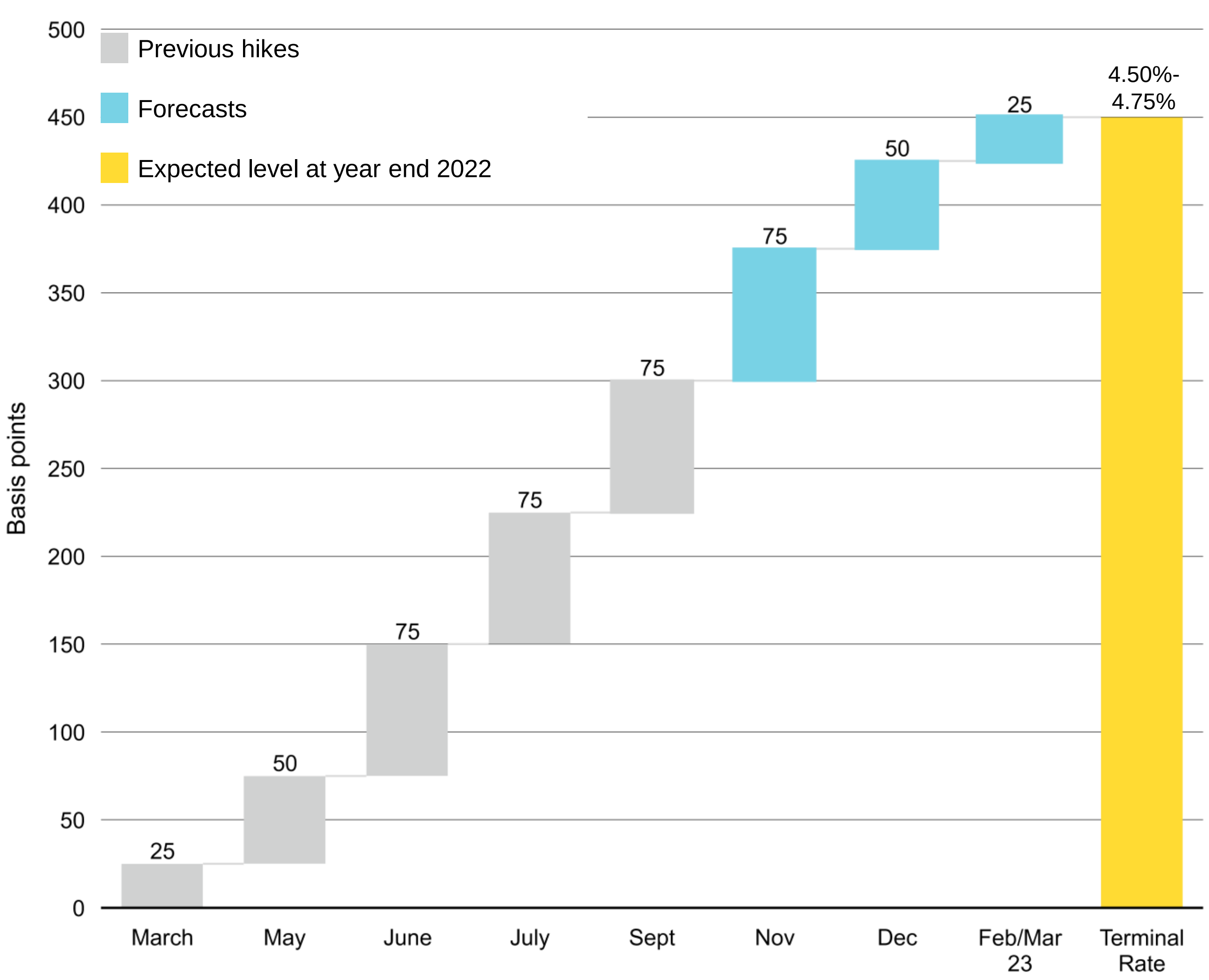
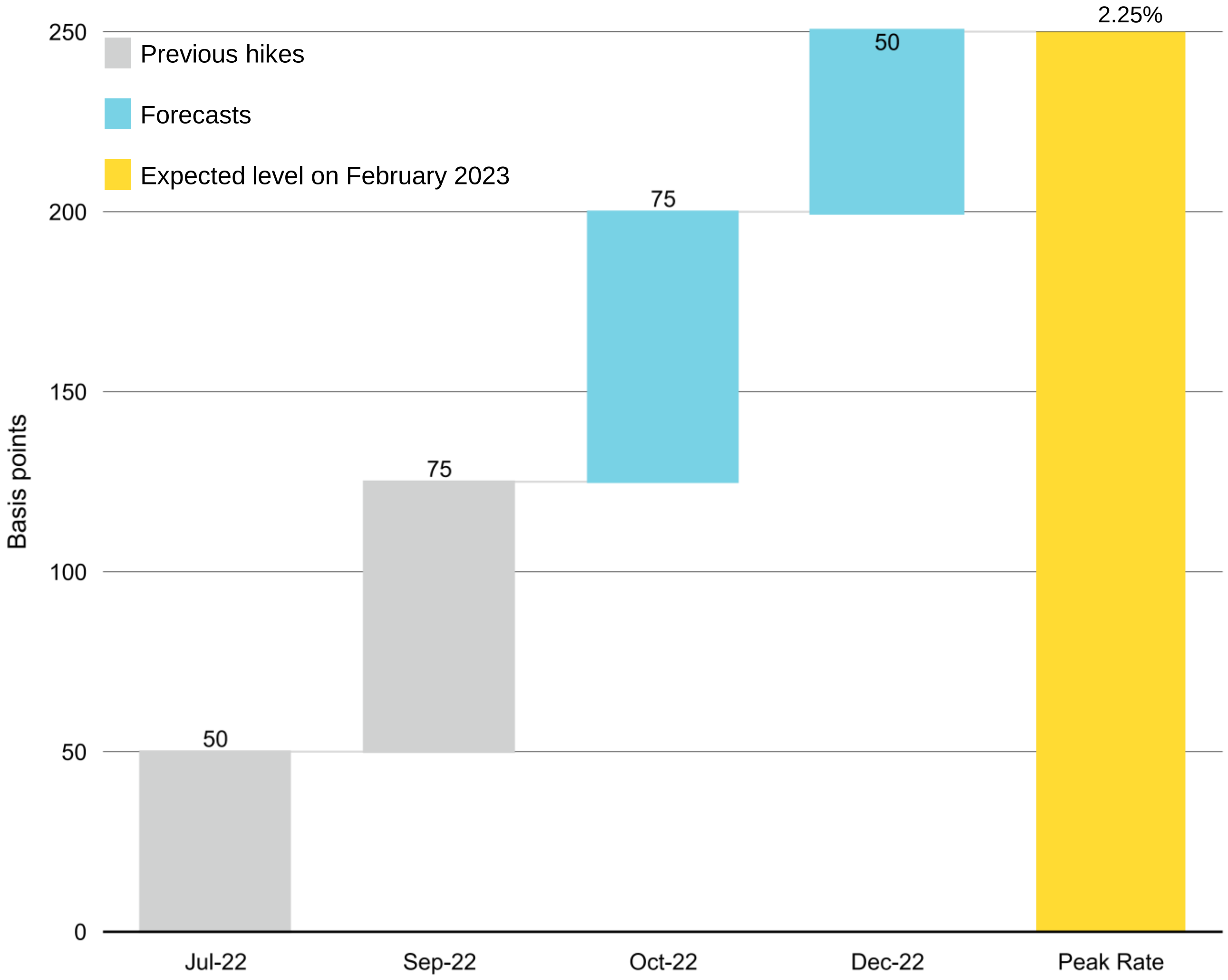
#3. Hawkish central banks but visibility should increase towards year end.

Macro

Fed: accelerated rate hikes to fight inflation



ECB: progressive start but speeding up



Source: Fed: Median hike forecast of the Fed fund rate from Goldman Sachs, BAML, JP Morgan, Citi and Barclays. ECB: Median hike forecast of the ECB deposit rate from Goldman Sachs, JP Morgan, Citi, Deutsche Bank and Barclays, September 2022.

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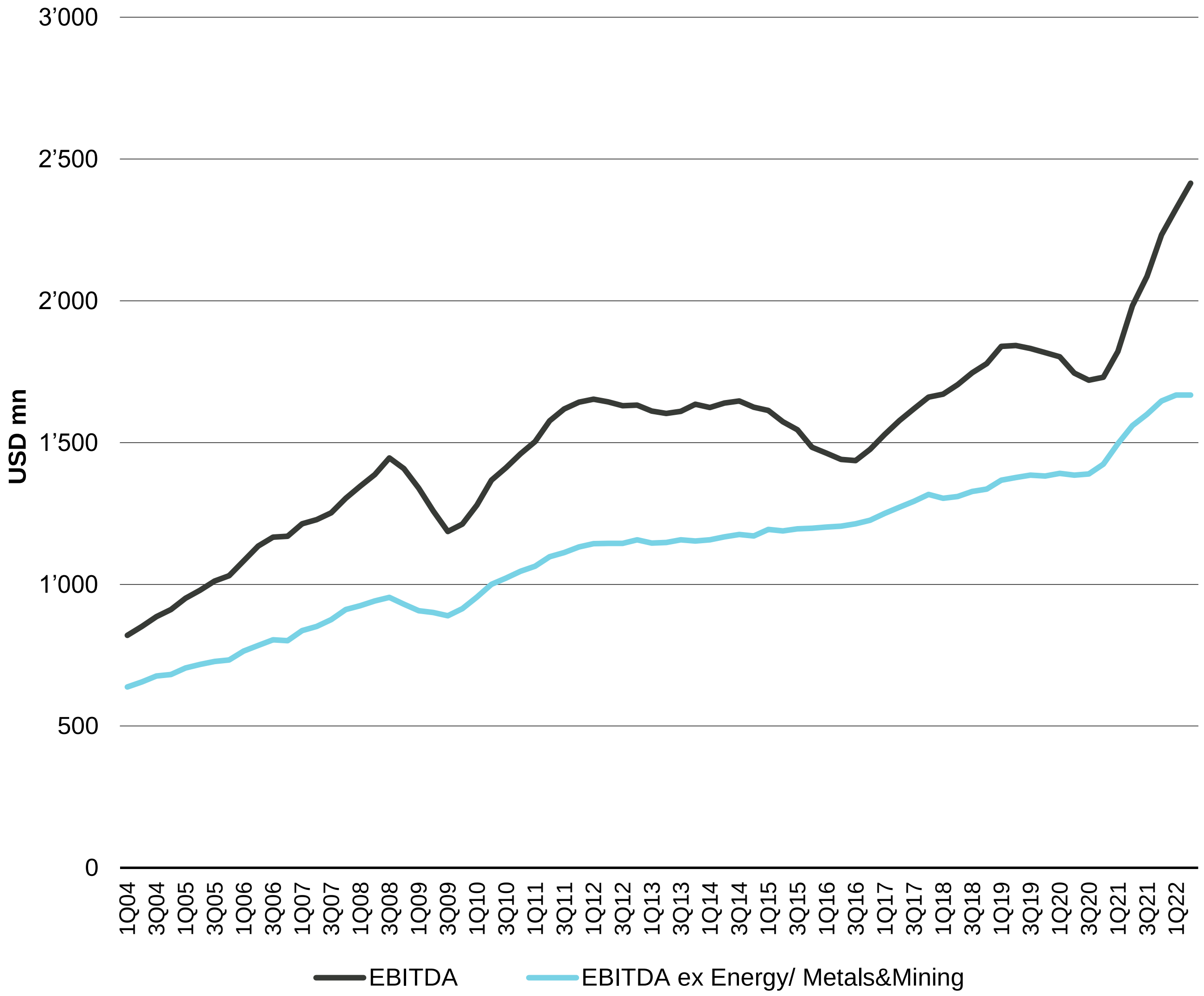
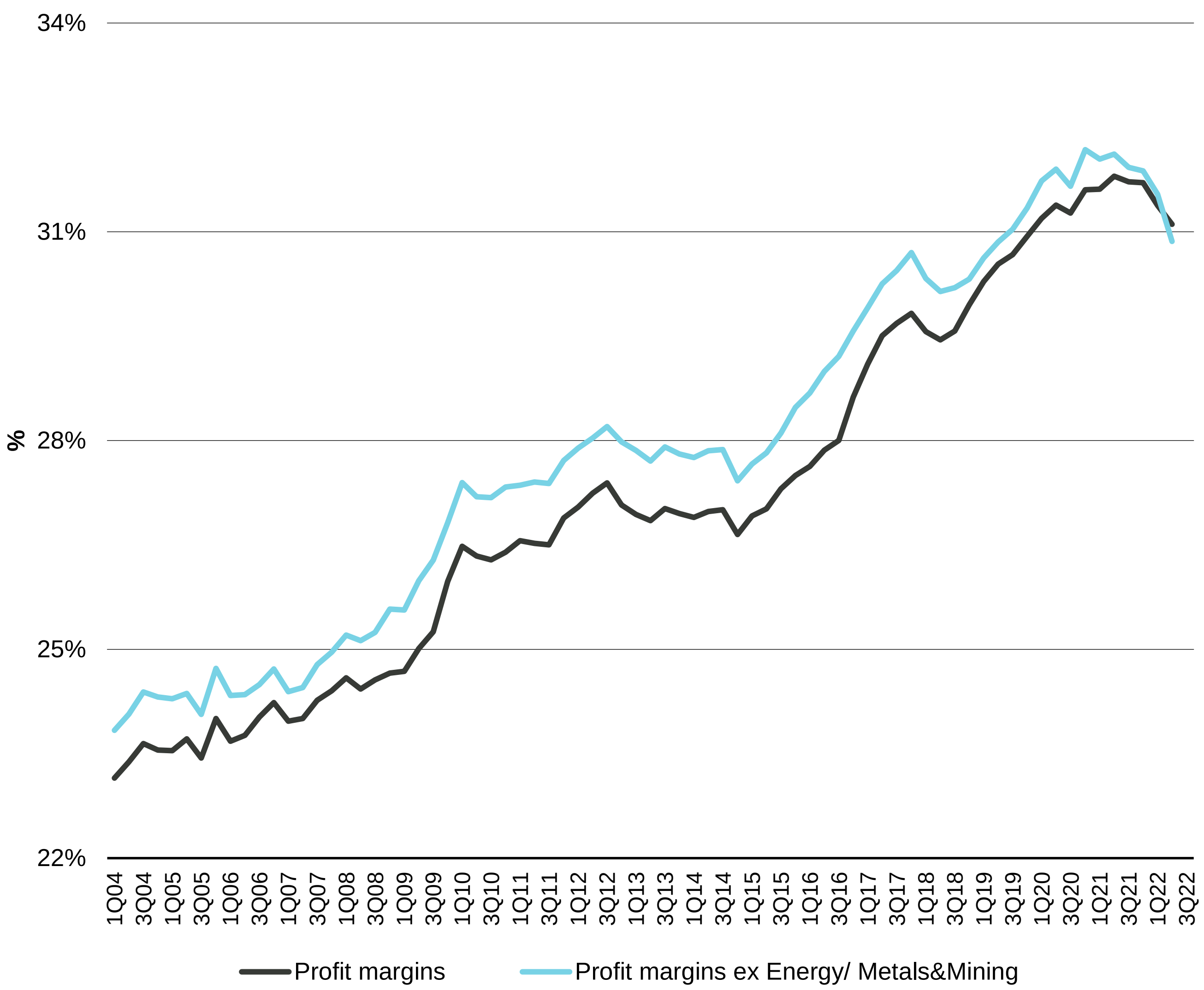
#4. Resilient company earnings but margins trending lower…

Micro

Earnings continue to improve



Margins lower but still at high levels



Including Q2 2022 results of US Investment Grade Non-Financial issuers. Source: JPM, as of September 2022.

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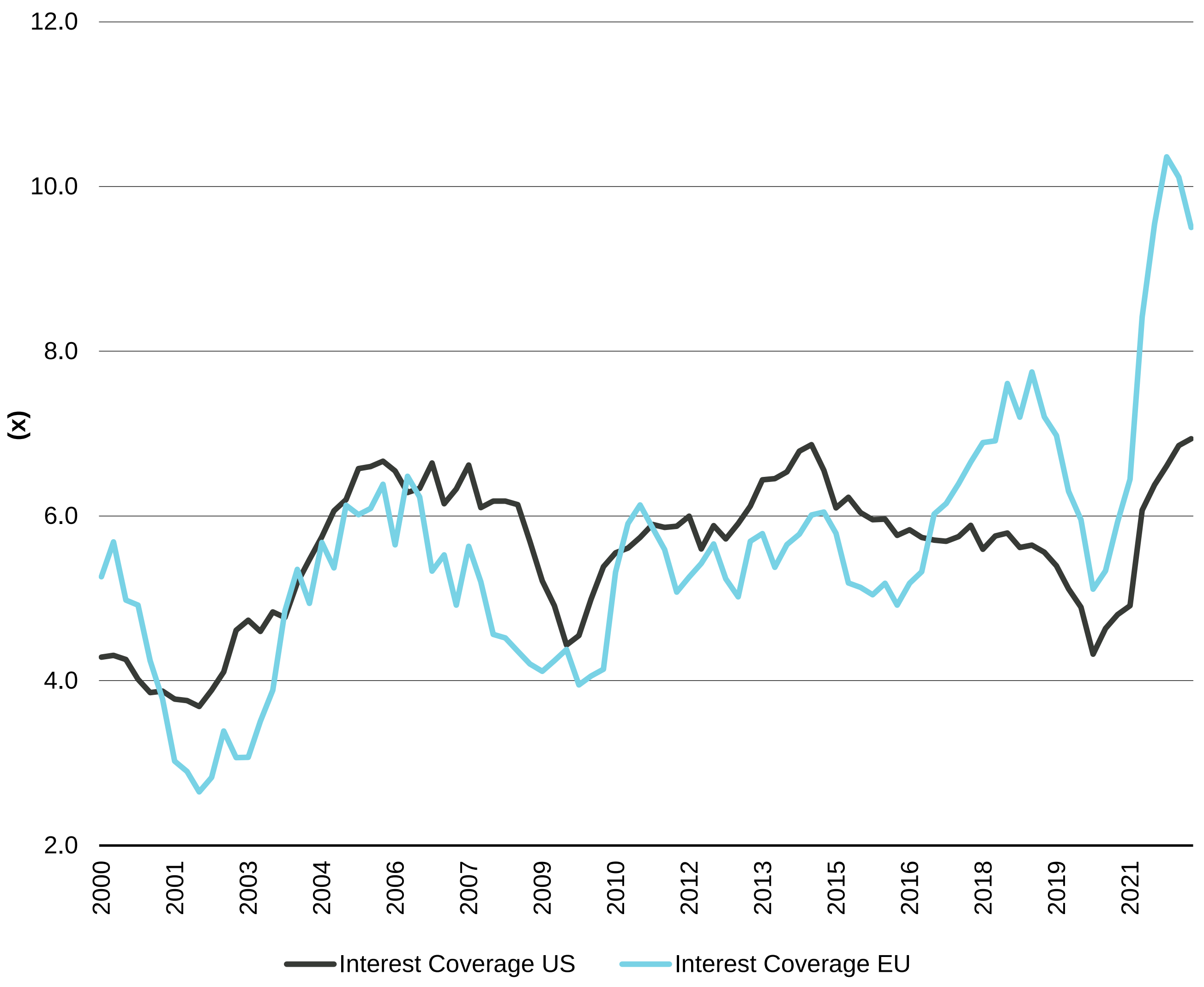
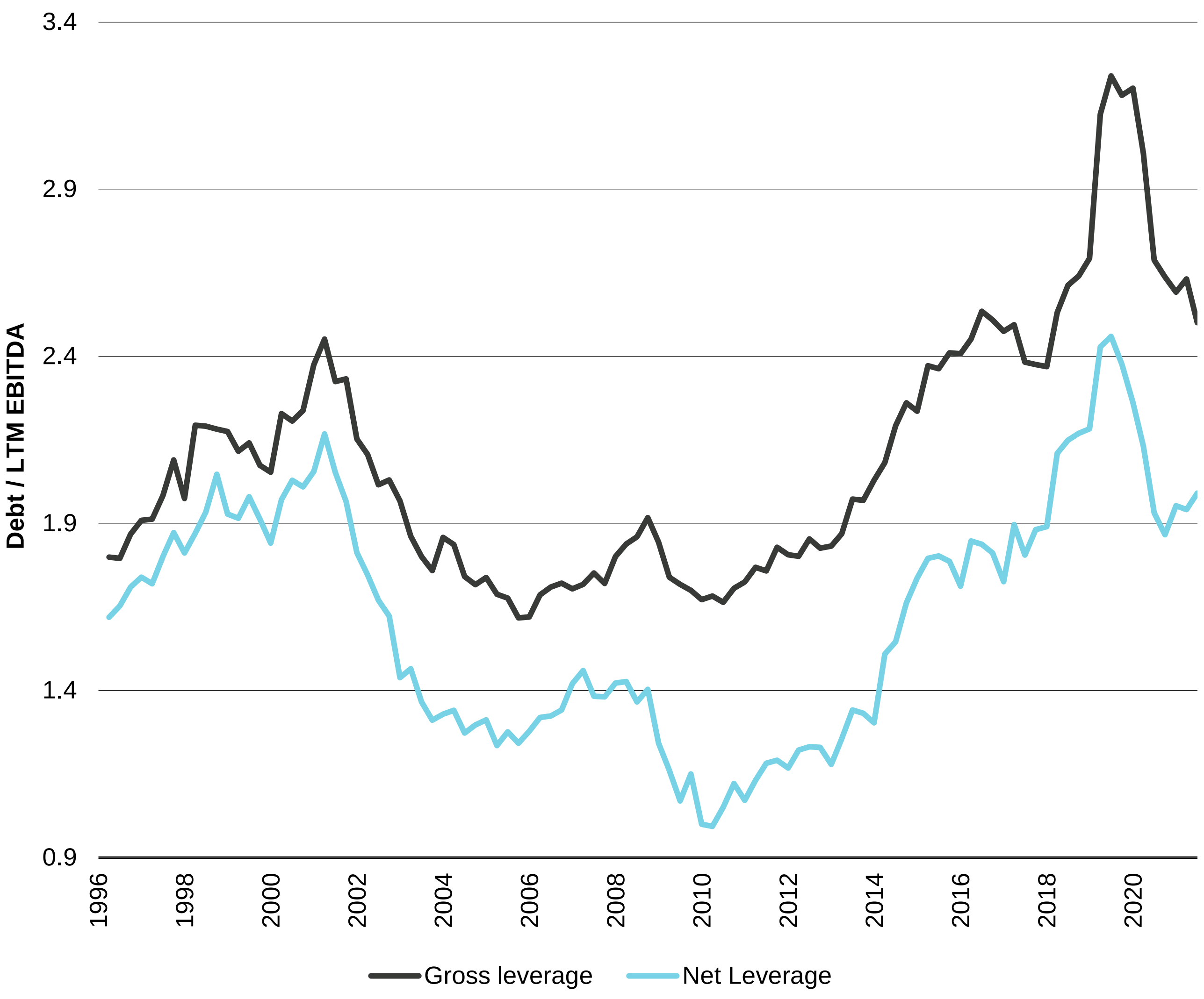
…while credit metrics continued to improve.

Micro

Interest coverage ratio up at record levels



Gross leverage down



Including Q2 2022 results of US and EU Investment Grade Non-Financial issuers (left); results of US Investment Grade Non-Financial issuers (right). Net Leverage = Net Debt / LTM EBITDA. Net debt is gross debt minus cash and marketable securities. Source: Goldman Sachs, BAML, Vontobel as of September 2022.

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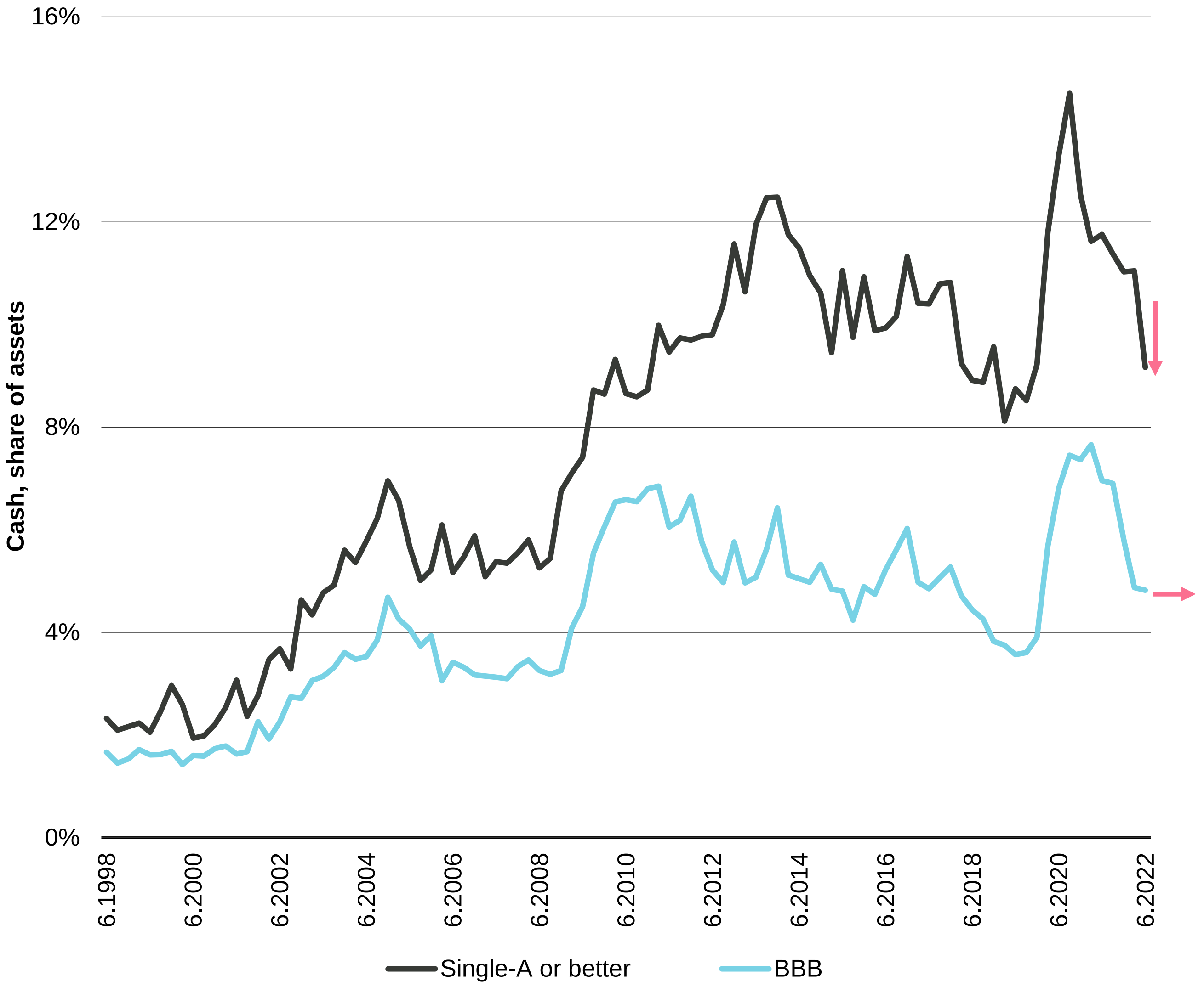
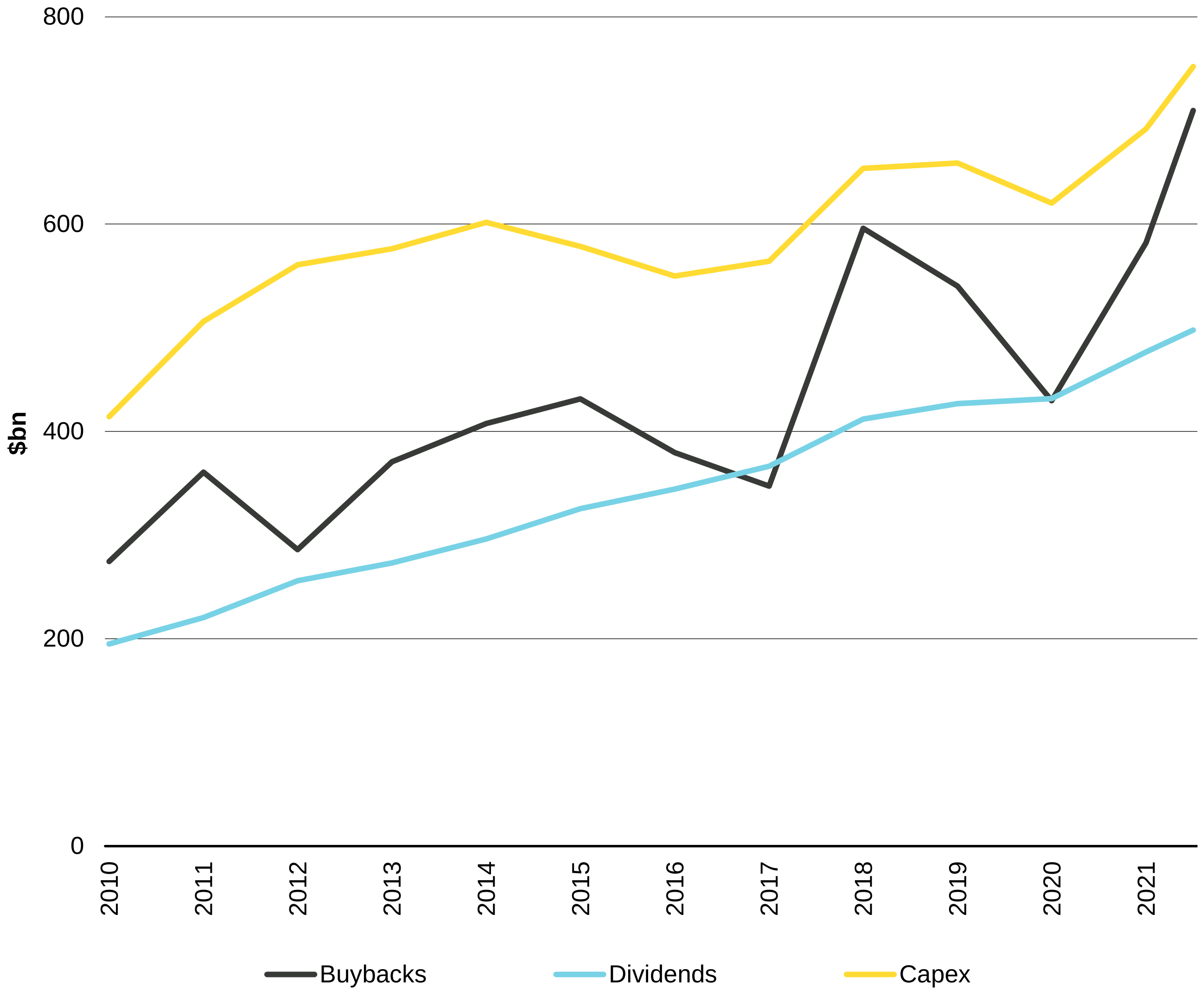
#5. The large cash pile is slightly down, but some companies can afford it.

Micro

Cash decline driven by higher rated firms



Some cash spent on capex and shareholders



Including Q2 2022 results of US Investment Grade Non-Financial issuers. Source: BAML, Morgan Stanley, Vontobel as of September 2022.

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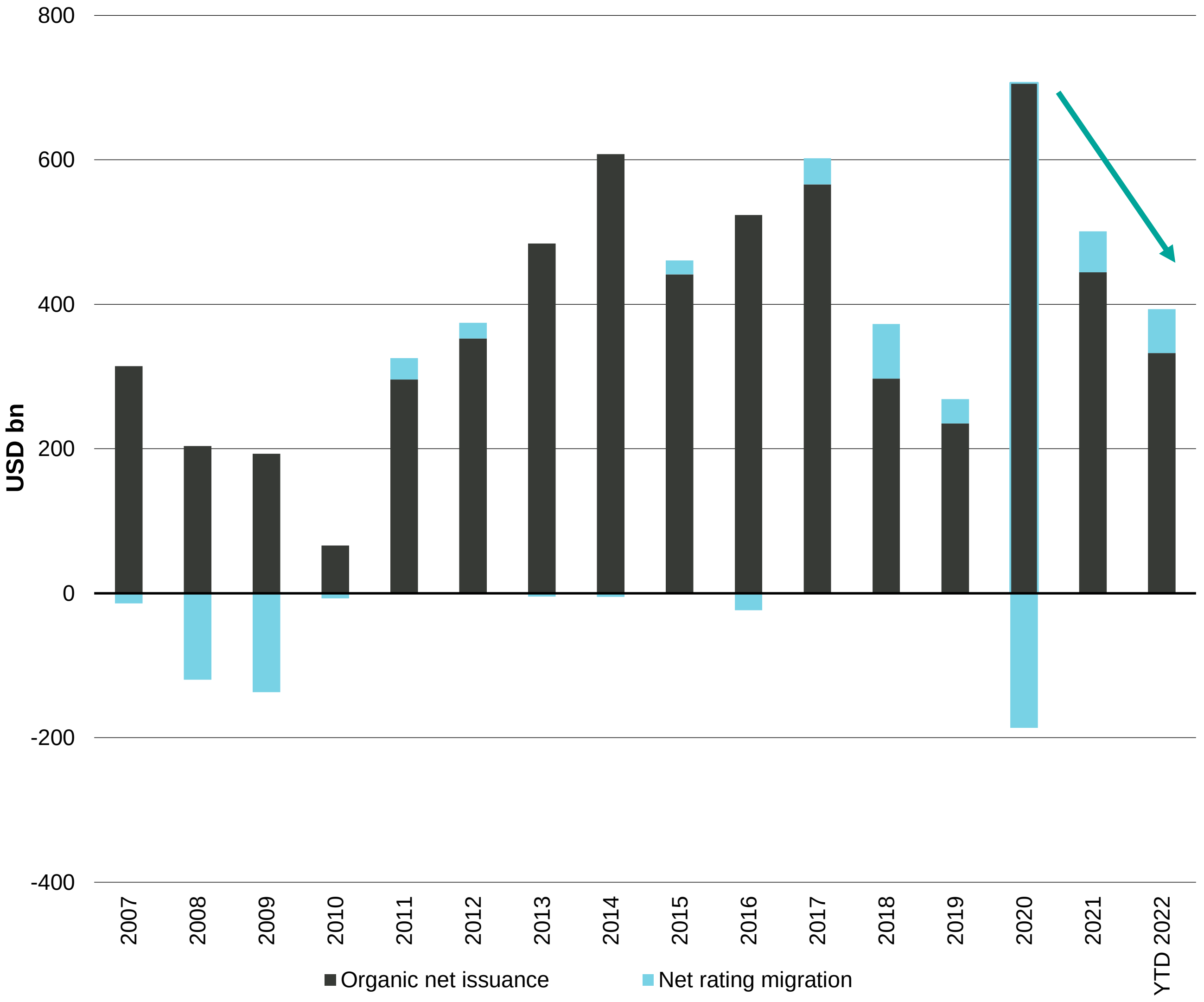
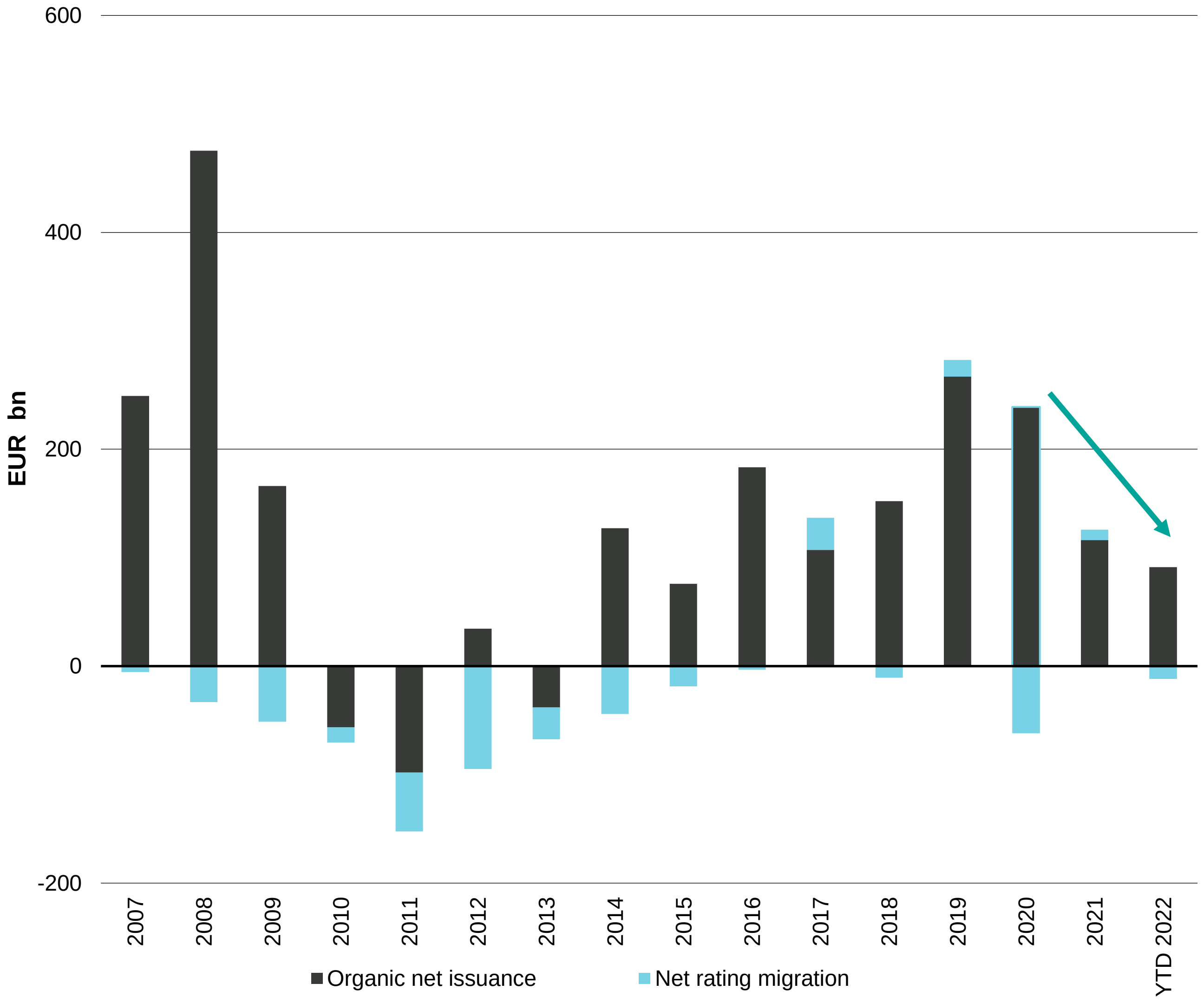
#6. Bond issuance declining globally, as…

Technicals

USD IG corporate bond net issuance



EUR IG corporate bond net issuance



Source: Goldman Sachs, Vontobel, as of September 2022.

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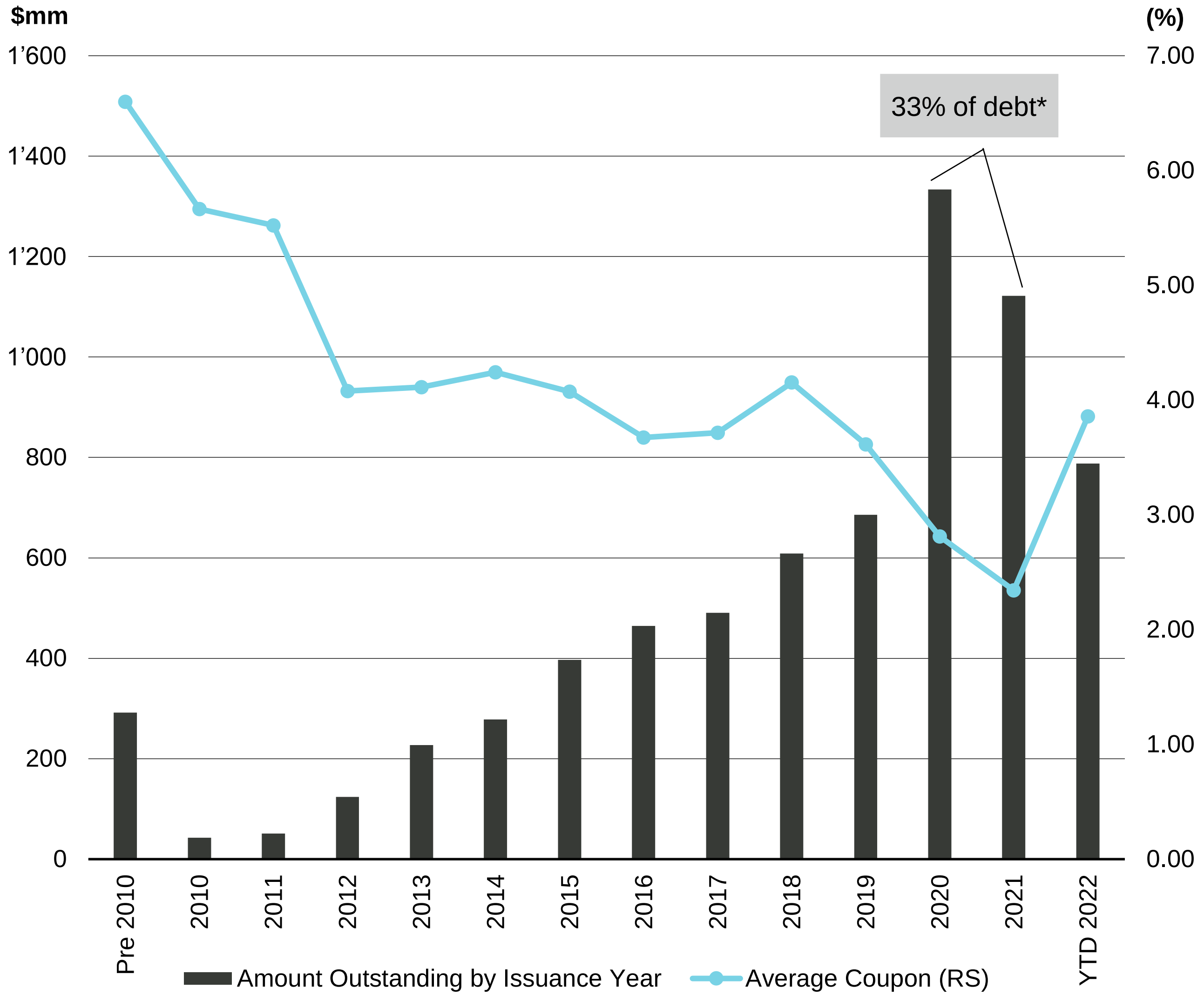
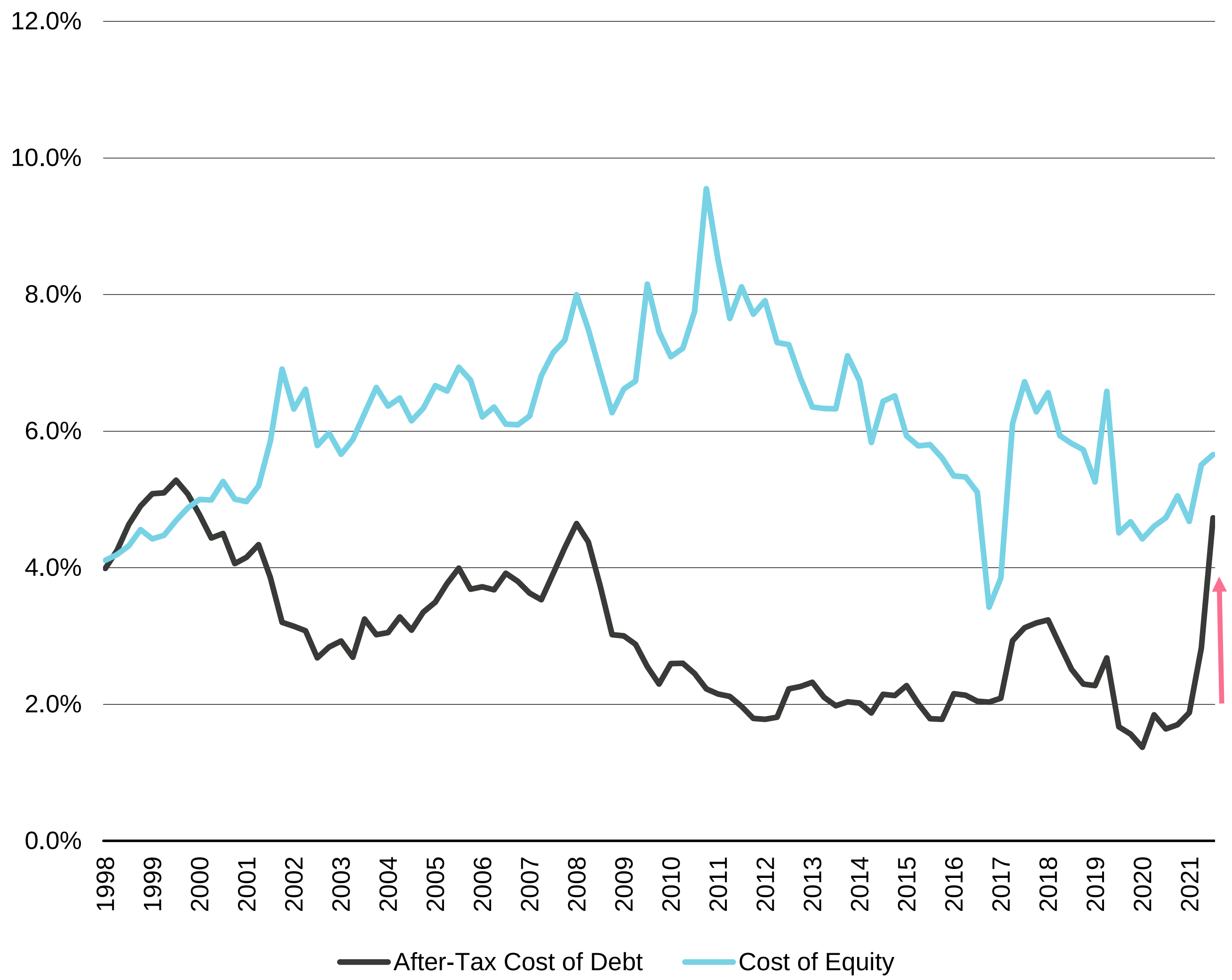
Technicals

#7. …companies refinanced at benign conditions, while now the cost of debt is up substantially.

Record issuance with the lowest coupon



Cost of debt close to cost of equity



*US Investment Grade Bonds. Source: Bloomberg, Morgan Stanley, Vontobel as of September 2022.

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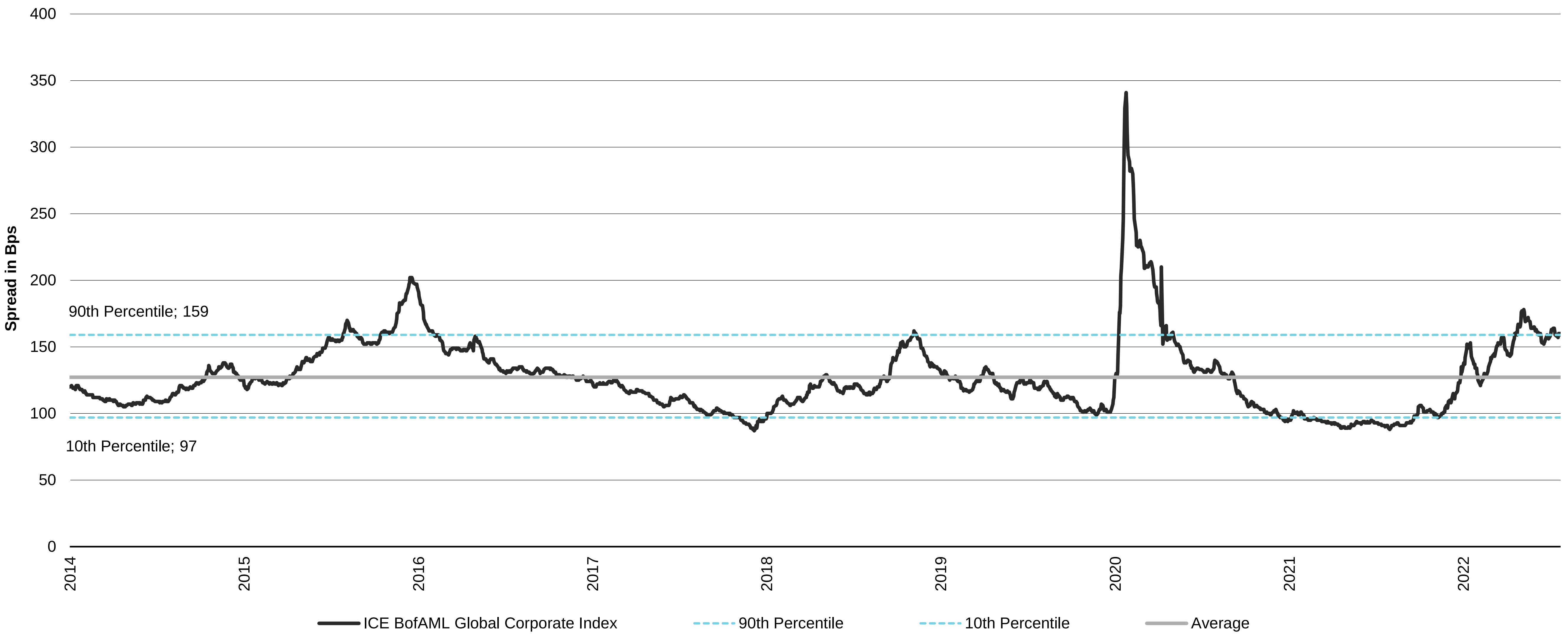
#8. Spreads near recessionary levels.

Valuation

Global IG spreads at wide levels



Source: Vontobel, ICE BofA Global Corporate Index, Moody's, as of September 2022.

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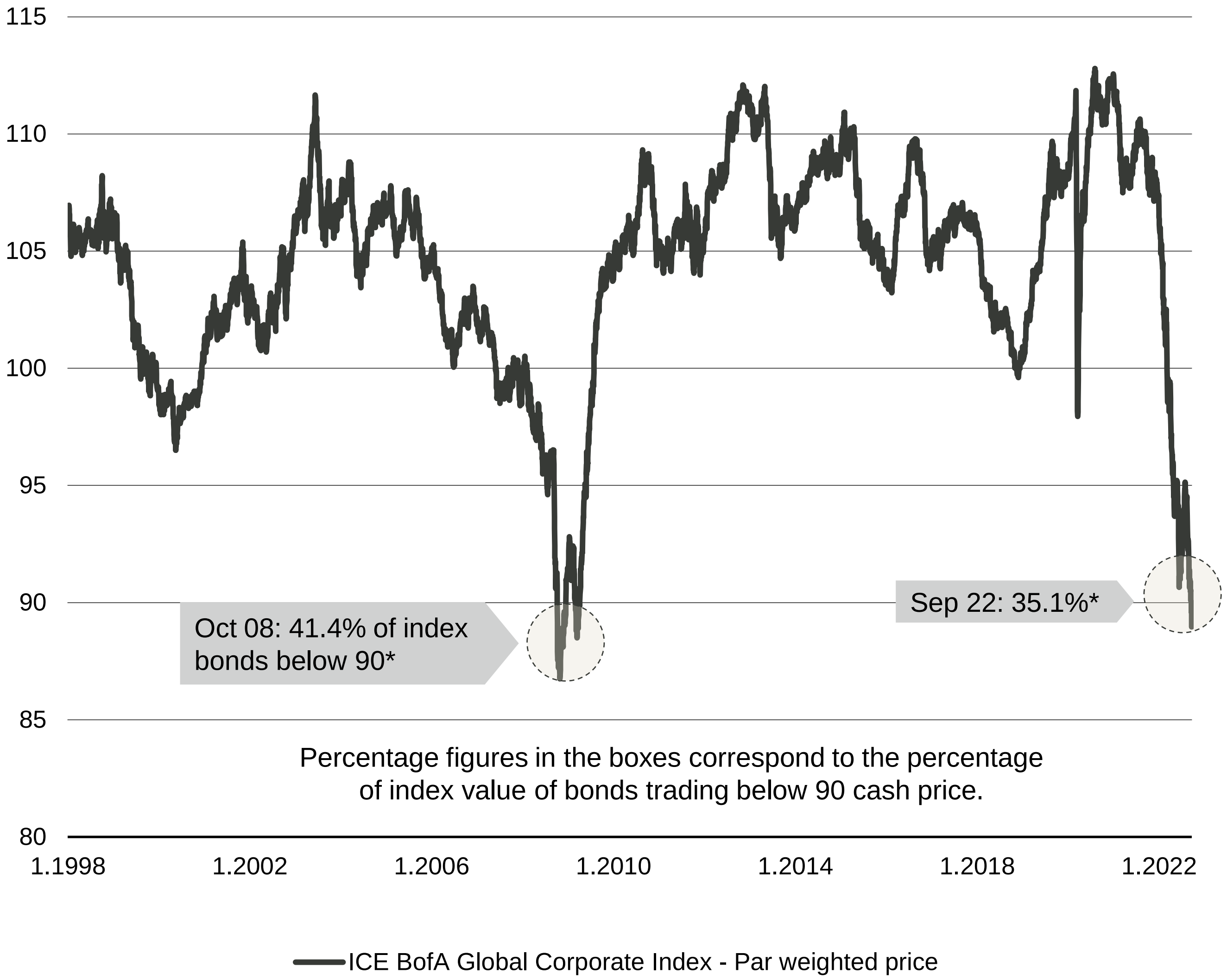
#9. Yields up significantly and bond prices down...

Valuation

Yields up, duration down since the start of 2022

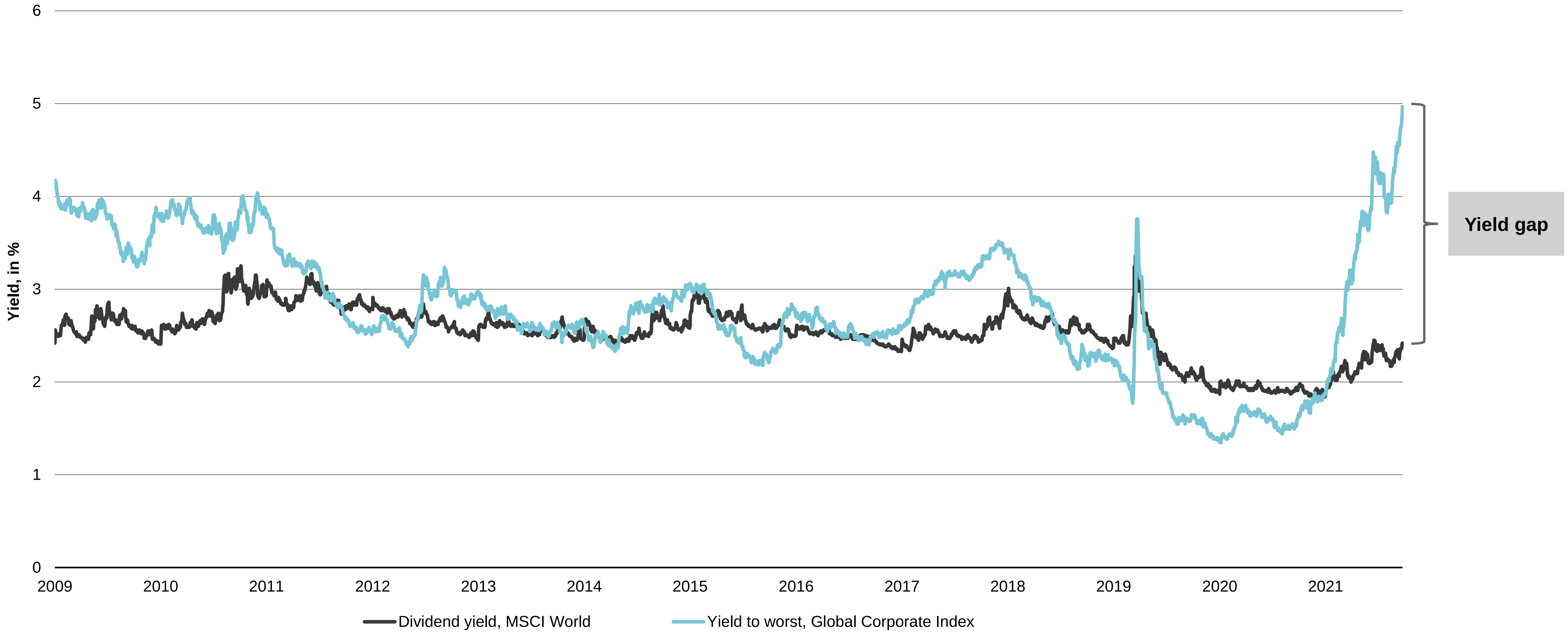
Near record amount of low cash price bonds



Source: Vontobel, ICE BofA Global Corporate Index, as of September 2022.

...and corporate bond yields are ahead of dividend yields.

Investment Grade yields are at decade highs



Source: Bloomberg, BofA ML, as of September 2022.

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#10. How to benefit from this environment?

How does the world look?	**Macroeconomics:** Lower growth and high inflation, requiring central banks to act. However, visibility should increase going forward.	**Microeconomics:** Resilient credit metrics, leaving corporates in a robust position to weather margin pressure.	**Technicals:** Lower issuance of corporate bonds is supportive.	**Valuation:** Substantially higher yields and wider spreads should attract investors.
How may investors extract value?	Diversify risks on a **global scale.** Take an active approach and favor defensive sectors.	Benefit from a stable to **improving rating trend** and potential rising stars.	Screen for new issues with an **attractive premium** and **higher coupons**.	Benefit from **low cash price** bonds. Higher coupons will translate into **higher income** for investors.

Source: Vontobel Asset Management, as of September 2022.

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This is not the end…

…as there are obviously more topics on investors' minds – and we are more than happy to share our thoughts with you.

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Thank you.

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