S&P CAPITAL IQ
McGRAW HILL FINANCIAL

FIXED INCOME IQ

Credit Markets

Quarterly Fixed Income Trends

North America

July 2015 | Issue 6

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North America

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EDITORS' NOTE

High yield performed well in Q2 2015, while investment grade posted losses as the market began to anticipate rate increases in the second half of 2015. Spreads increased but other risk signals remained varied.

Q2 2015 Overview:

- **Overall, credit markets were mixed –** Anticipation of rate increases caused investors to shed investment grade debt while high yield posted positive returns for second quarter in a row.
- **U.S. sovereign risk decreased** as global market volatility in China and Europe strengthened the U.S. as a safe haven.
- **Spreads increased for most sectors and investment grade** – Markets re-priced risk upwards this quarter for all sectors and for investment grade debt. Only high yield debt saw spreads tighten from last quarter.
- **Risk signals mixed this quarter -** Median equity market-based probabilities of default improved on a quarterly basis while fundamental probabilities of default showed deterioration in all but one sector.
- **Issuance continues to be healthy –** Issuance increased in most ratings categories on a year-over-year basis with the biggest increase coming from the BBB spectrum, following a similar trend from last quarter.

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MARKET TRENDS

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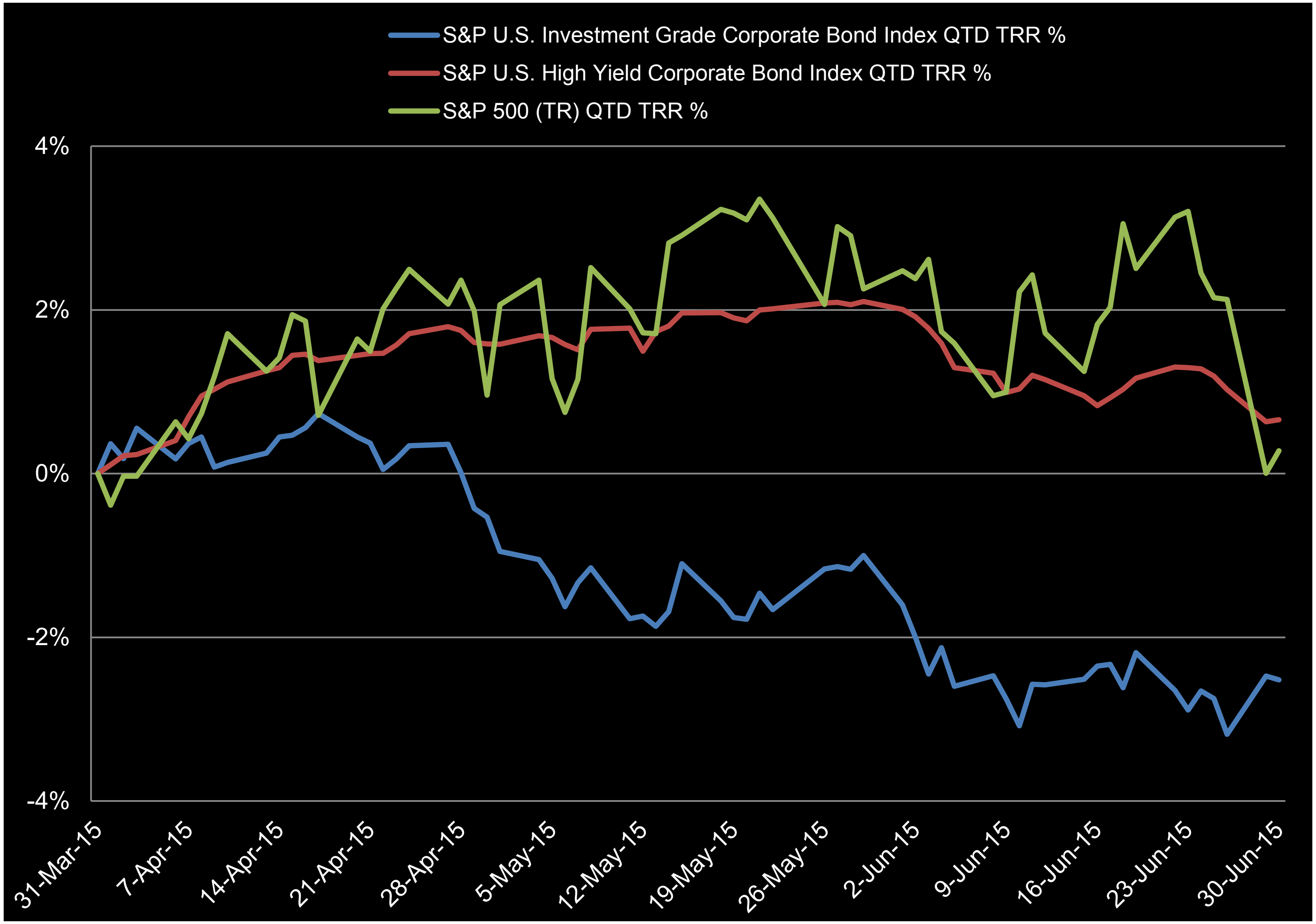
Relative Performance of Fixed Income Indices

NOTES:

- As of June 30th, the S&P U.S. Investment Grade and High Yield Corporate Bond Indices generated -2.52% and .66% in total returns, respectively during the last three months. During that same period, the S&P 500® finished the quarter with a .28% gain.
- As the economy slowly continued to strengthen with labor markets maintaining momentum, investors were looking for rates to increase which caused investment grade bonds to drop in Q2 2015. High yield was the top performer in Q2 as equity prices were volatile due to global market issues stemming from Greece and China.



Source: S&P Capital IQ as of July 1, 2015.

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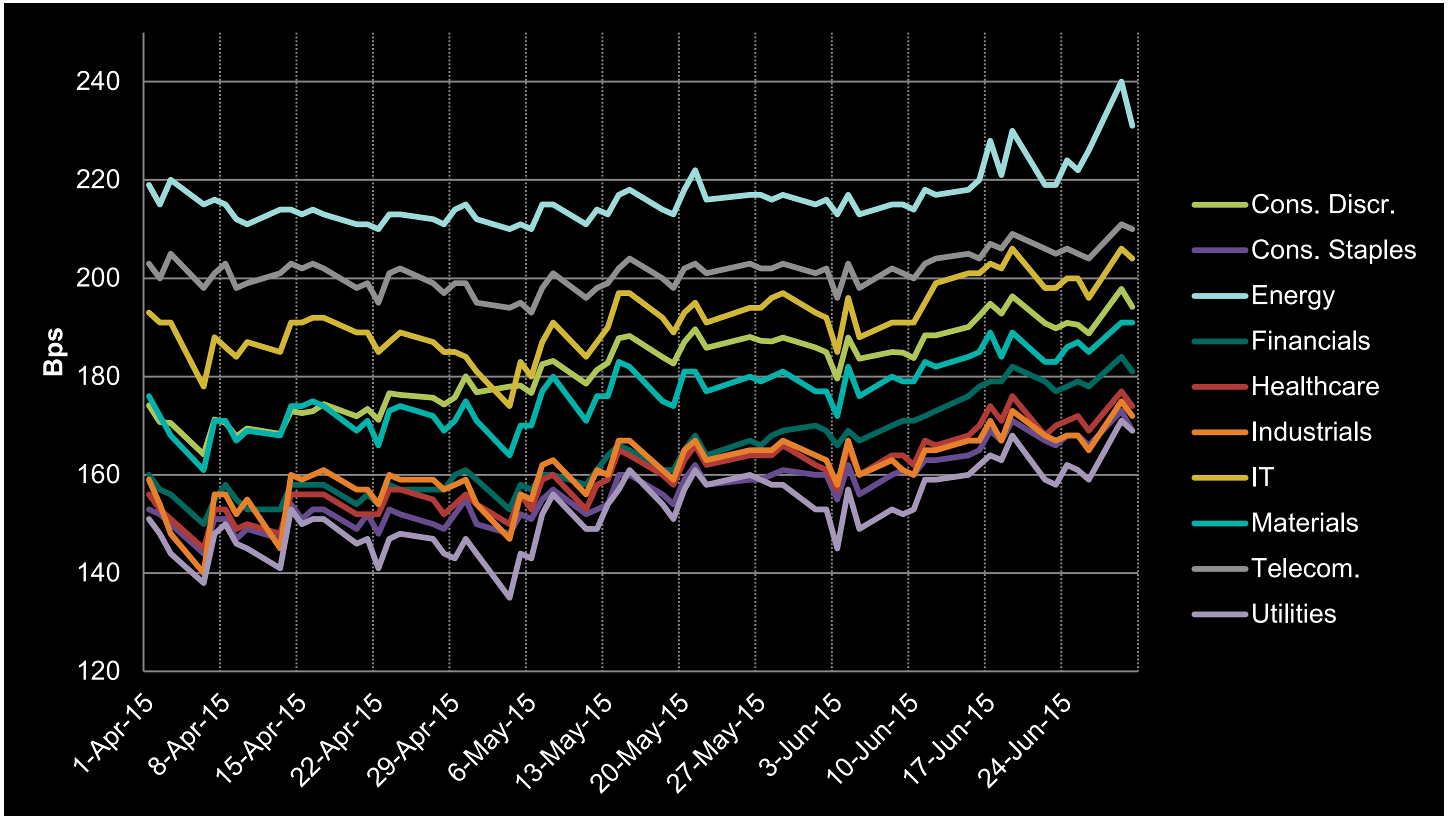
10 Year BBB Sector Z-Spreads

NOTES:

- All sector z-spreads widened this quarter, coinciding with similar movement in Treasury rates.
- The largest widening on a percentage basis in Q2 was in financials, which moved from 160bps to 181bps.
- Telecom and IT ended the quarter with the smallest widening on an absolute basis.



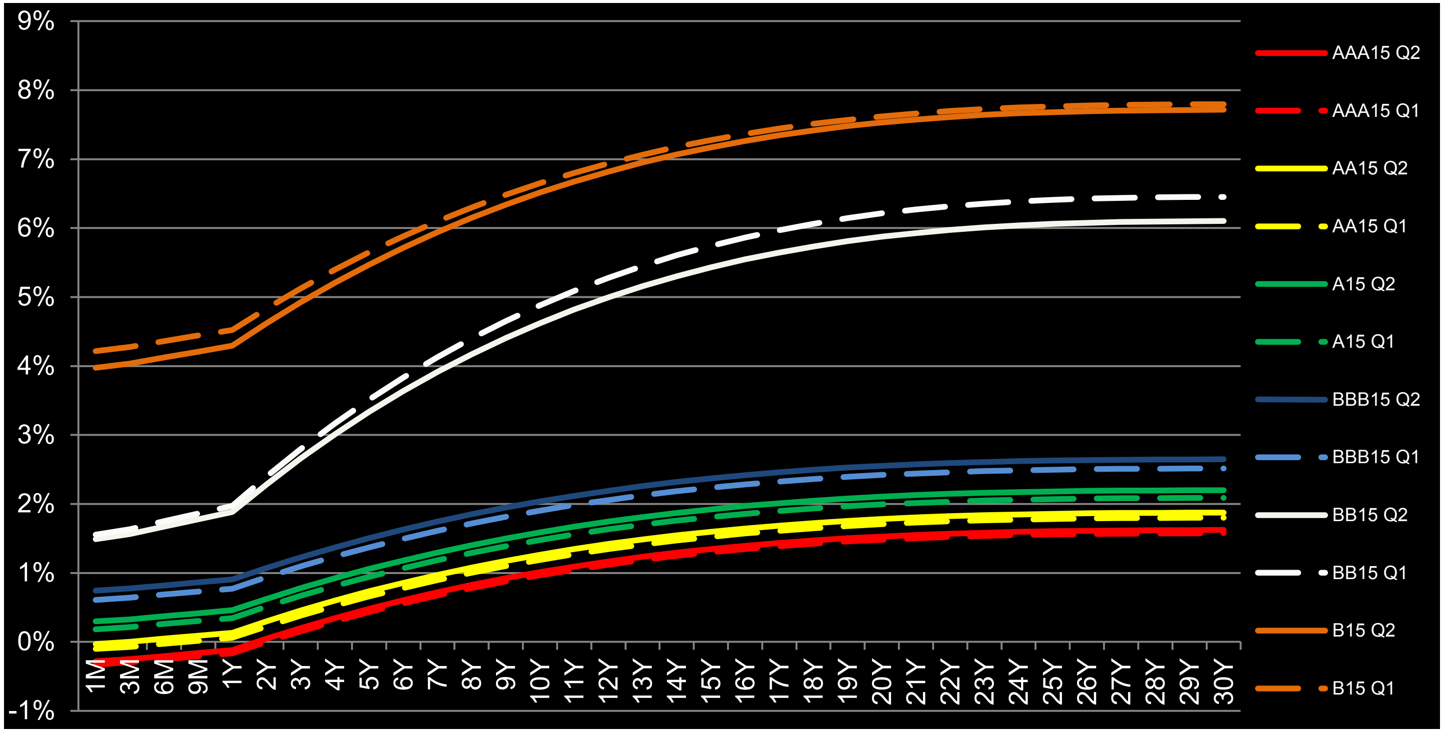
	Cons. Discr.	Cons. Staples	Energy	Financials	Healthcare	Industrials	IT	Materials	Telecom.	Utilities
BPS Change	20	16	12	21	18	13	11	15	7	18
Total % Change	11.49%	10.46%	5.48%	13.13%	11.54%	8.18%	5.70%	8.52%	3.45%	11.92%

All spreads and yield curves are proprietary data developed from buy-side indicative quotes. All bonds are USD denominated.
Source: S&P Capital IQ as of July 1, 2015.

Z-Spread Ratings Term Structure (Quarter over Quarter)

NOTES:

- Investment grade z-spreads widened over the quarter, across the term structure.
- Within the investment grade space, we observed a parallel shift upward throughout the term structure.
- Similar to last quarter in high yield, we noticed the BB curve tightened much more on the long end while the B curve experienced greater tightening on the short end. The tightening of the BB spreads was much stronger this quarter than Q1 2015.



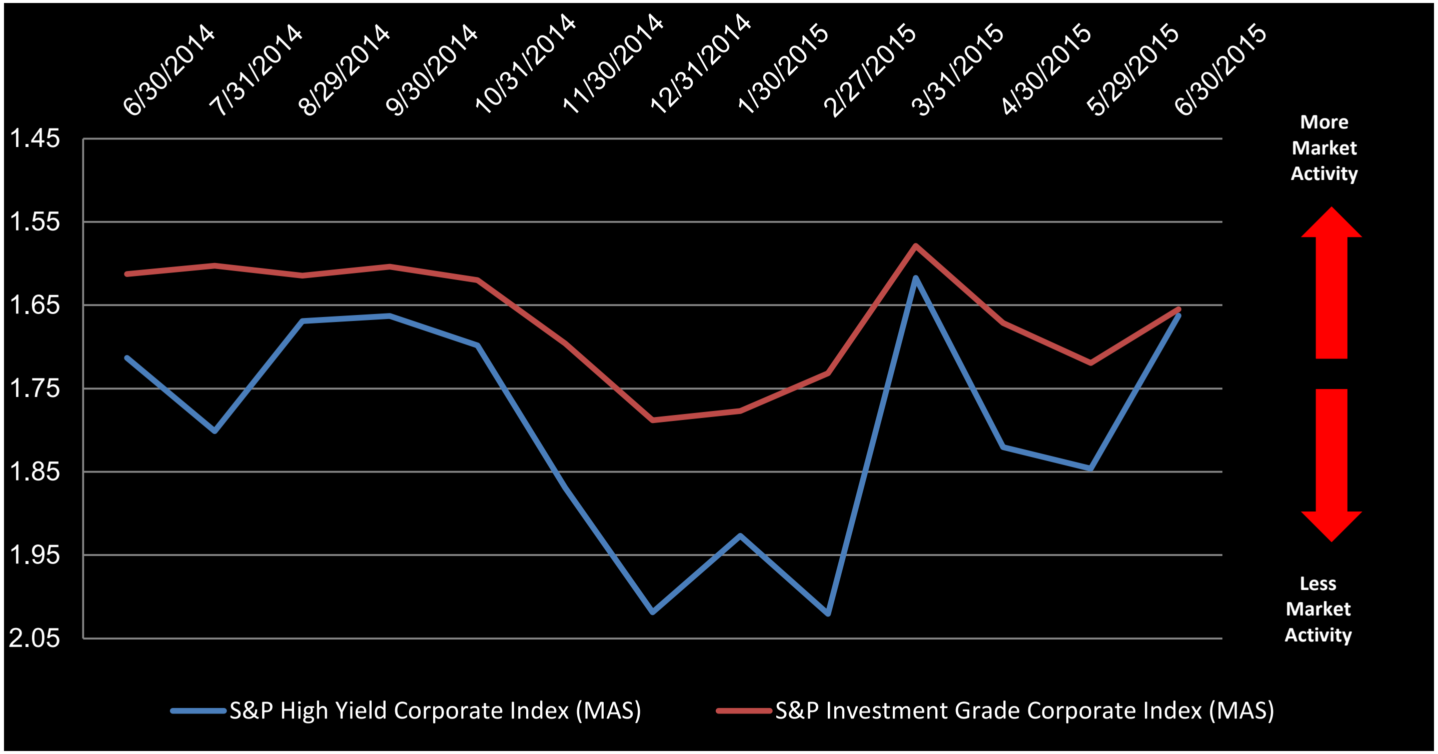
bps Change QoQ	1Y	5Y	10Y	15Y	20Y	30Y
AAA	4.67	4.67	4.67	4.67	4.67	4.67
AA	7.40	7.40	7.40	7.40	7.40	7.40
A	11.17	11.17	11.17	11.17	11.17	11.17
BBB	13.35	13.35	13.35	13.35	13.35	13.35
BB	-8.82	-17.90	-25.96	-25.96	-33.81	-35.23
B	-22.85	-17.82	-13.35	-13.35	-9.01	-8.22

All spreads and yield curves are proprietary data developed from buy-side indicative quotes. All bonds are USD denominated.
Source: S&P Capital IQ as of July 1, 2015.

Investment Grade vs. High Yield Market Activity

NOTES:

- Market activity fell from its a 12-month high in March for both investment grade and high yield. In the second quarter, activity hit lows in May but rebounded in June.
- Within high yield, telecom and energy had the most activity. Within investment grade, telecom and IT led the way with the most activity.



MAS	6/30/14	7/31/14	8/29/14	9/30/14	10/31/14	11/30/14	12/31/14	1/30/15	2/27/15	3/31/15	4/30/15	5/29/15	6/30/15
S&P High Yield Corporate Index	1.71	1.80	1.67	1.66	1.70	1.87	2.02	1.93	2.02	1.62	1.82	1.85	1.66
S&P Investment Grade Corporate Index	1.61	1.60	1.61	1.60	1.62	1.70	1.79	1.78	1.73	1.58	1.67	1.72	1.66

Source: S&P Capital IQ as of July 1, 2015. **Market Activity Score (MAS)** is a derived analytic created to provide an indication of the level of trade and market activity associated with a given security. It is developed from a review of all available trades and quotes based on price staleness, number of quotes/market makers and trade data. It is scaled from 1 (high MAS) to 5 (low MAS).

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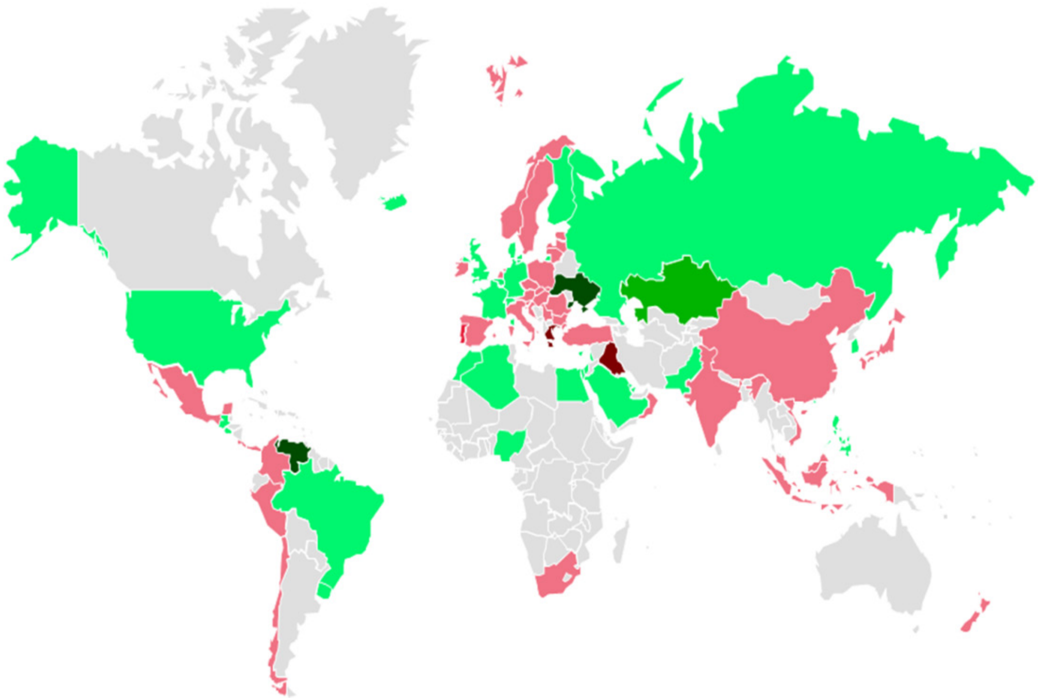
Sovereign CDS Heat Map

NOTES:

- The heat map provides a quarter-over-quarter view of the bps change in sovereign CDS spreads.
- The country with the largest increase in CDS spreads was Greece, as debt repayment issues lingered. Its spreads widened by 3,974 bps throughout the quarter.
- The countries with the largest improvement in CDS spread were Ukraine and Venezuela. Their spreads tightened by 3,521 and 300 bps, respectively.



Key	Change in CDS Spread
	<-200
	-200 to <-50
	-50 to <0
	0
	>0 to 50
	>50 to 200
	>200

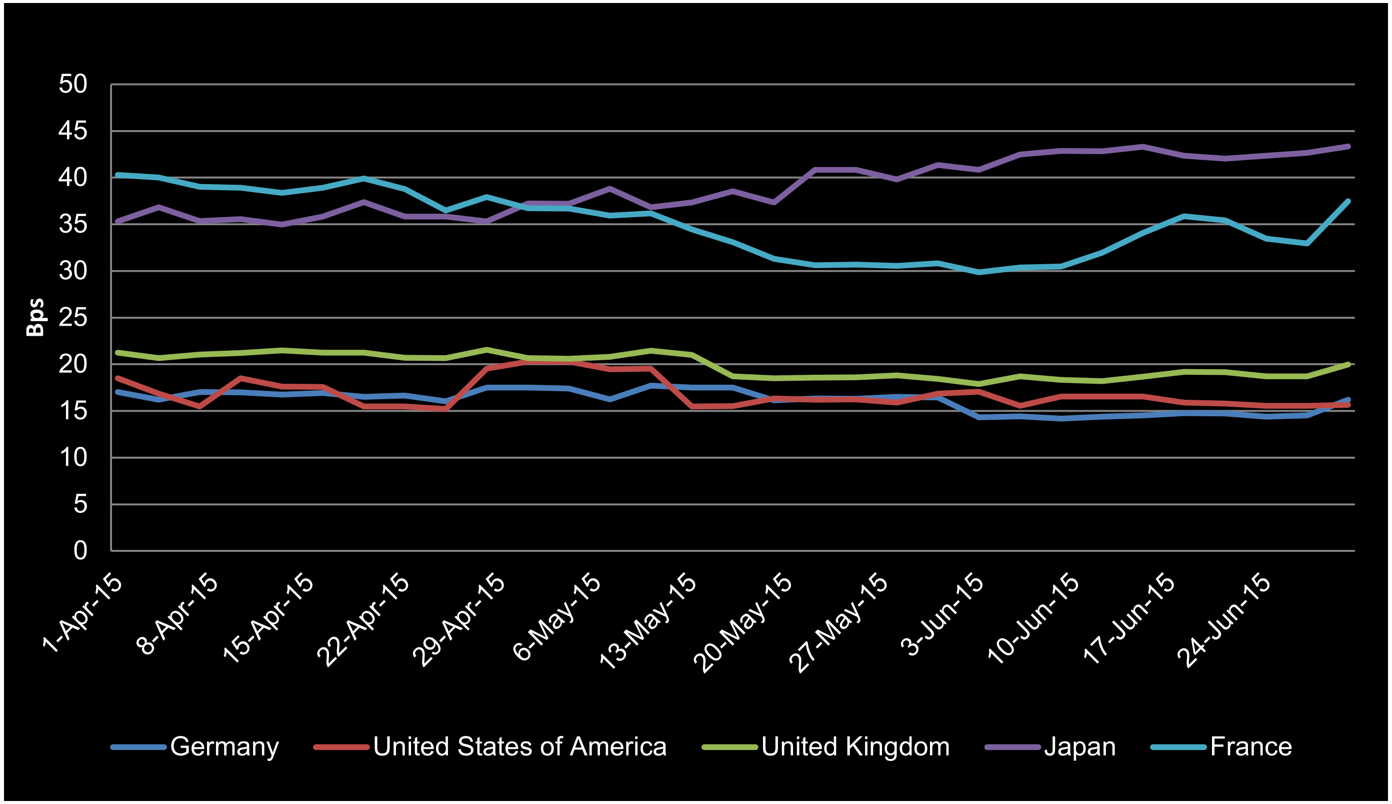
Country	6/30/2015 CDS Spread	Avg # Quotes per Day
CDS Most Risky		
Greece	6739	200 to 10
Venezuela	4691	>200
Ukraine	4096	200 to 10
Cyprus	437	<10
Nigeria	425	<10
El Salvador	416	<10
Pakistan	410	<10
Lebanon	358	<10
Russia	341	>200
Egypt	313	<10
CDS Least Risky		
Swiss Confederation	14	<10
Norway	15	200 to 10
Sweden	15	200 to 10
United States of America	16	200 to 10
Germany	16	>200
Denmark	20	200 to 10
United Kingdom	20	>200
Netherlands	20	>200
Finland	21	200 to 10
New Zealand	31	<10

Source: S&P Capital IQ as of July 1, 2015.

Sovereign CDS Regional Focus: United States

NOTES:

- The U.S. CDS spread compared to G5 nations.
- The U.S. saw a tightening in its CDS spread throughout the quarter moving from 18.5 to 15.6 bps.
- The U.S. is now the country with the tightest CDS spread closely followed by Germany and the U.K.
- Japan was the biggest mover again this quarter, with its spread widening by 22.7% to 43.3 bps.



	United States	United Kingdom	Japan	France	Germany
BPS Change	-2.84	-1.27	8.03	-2.79	-0.82
Total % Change	-15.3%	-6.0%	22.7%	-6.9%	-4.8%

Source: S&P Capital IQ as of July 1, 2015.

CREDIT TRENDS

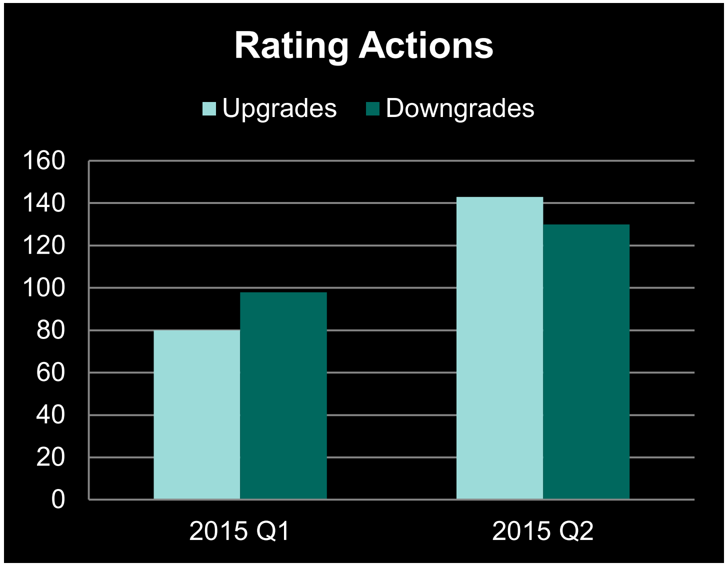
S&P Ratings Trends

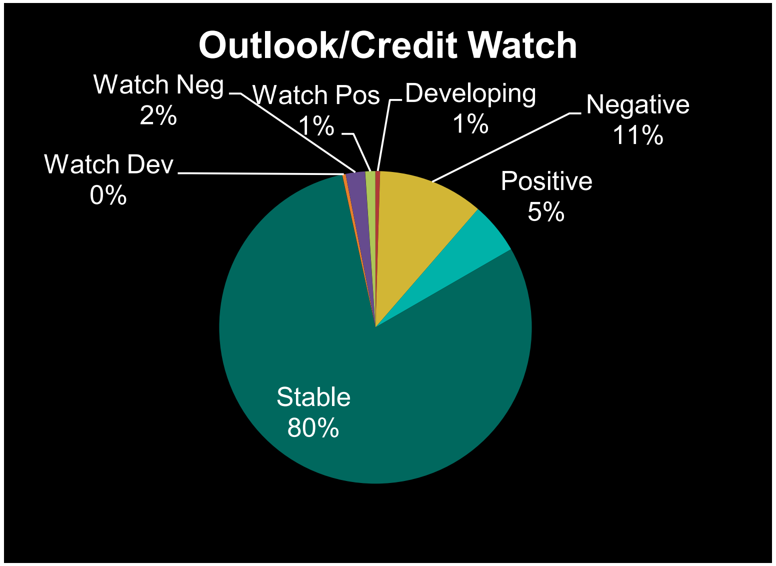
NOTES:

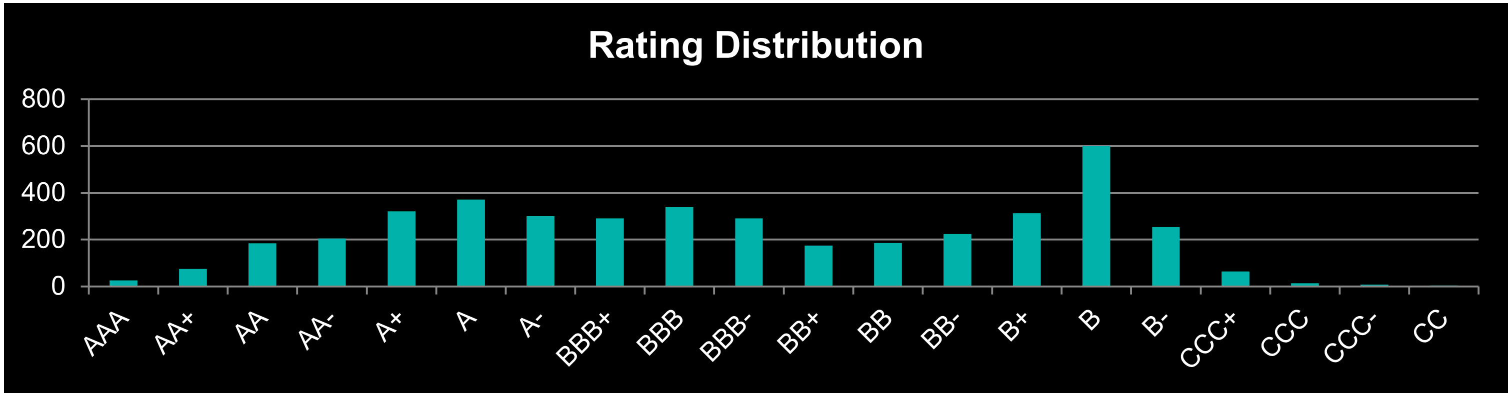
- There was much more activity as the count of upgrades and downgrades surpassed last quarter. Q2 2015 saw a reversal in the upgrade to downgrade trend for the 3rd straight quarter. The number of companies with positive outlook decreased this quarter to 5% from 8% last quarter.

S&P Ratings Services Outlook:

- Risk aversion could be amplified by Greece's exit from the Eurozone, or from credit contagion associated with decelerating Chinese GDP growth, but we see these as manageable near-term risks.
- The need for monetary stimulus in the U.S. is fading, but disrupted credit markets or disappointing economic news could slow the pace of Fed policy normalization.





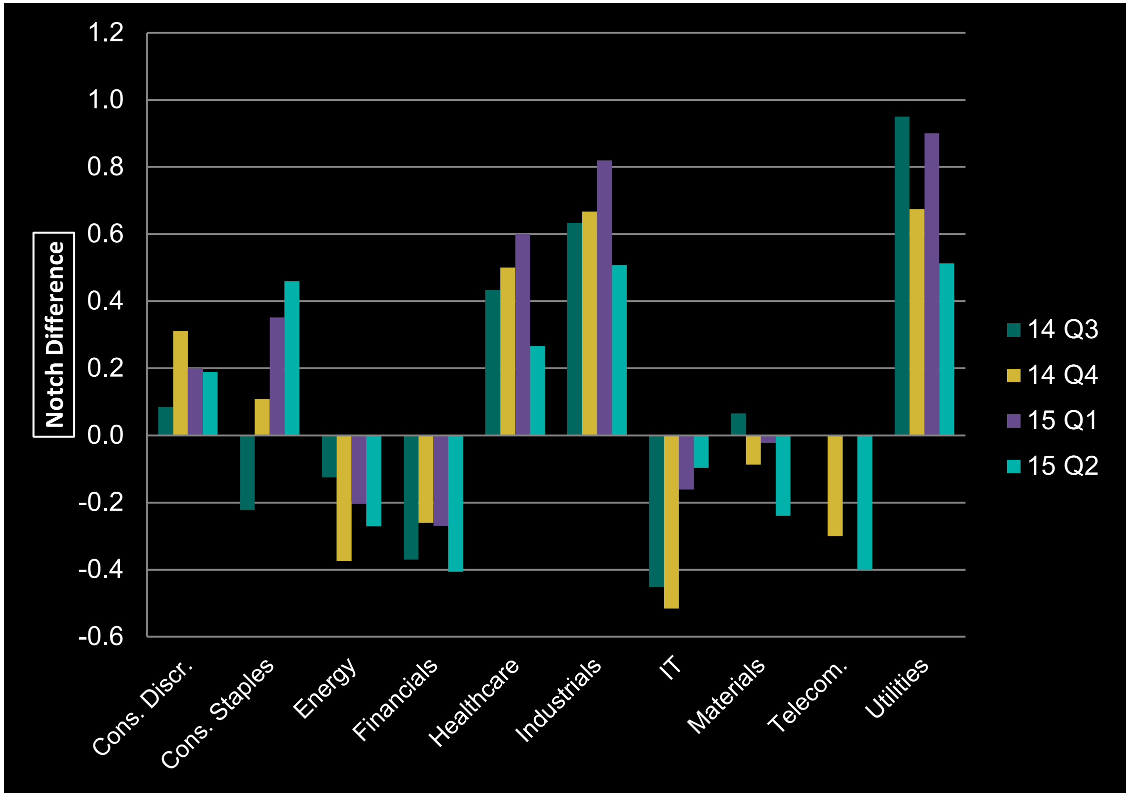


Constituents include all rated companies with a Local Currency Long Term Rating and S&P Capital IQ sector classification in the U.S. and Canada. Source: S&P Capital IQ as of July 1, 2015 and Global Credit Portal 'Credit Conditions: A Resilient U.S. Economy Shields North America Credit Conditions From Increasing Risks' published on July 14, 2015.

CDS Market Sentiment By Sector

NOTES:

- Overall, the CDS market indicated better perceived credit quality in 5 of the 10 sectors than did their corresponding S&P Ratings. The reversal came in the telecom sector. The highest positive notch differences came from industrials.
- Financials and telecom had the strongest negative sentiment in CDS vs. S&P Ratings in Q2 2015.



VALUE CONVERSION:

S&P Rating	CDS MDS	Value
AAA	aaa	23
AA+	aa+	22
AA	aa	21
AA-	aa-	20
A+	a+	19
A	a	18
A-	a-	17
BBB+	bbb+	16
BBB	bbb	15
BBB-	bbb-	14
BB+	bb+	13
BB	bb	12
BB-	bb-	11
B+	b+	10
B	b	9
B-	b-	8
CCC+	ccc+	7
CCC	ccc	6
CCC-	ccc-	5
CC	cc	4
C	c	3
D	d	2
SD	sd	1
NR	nr	0

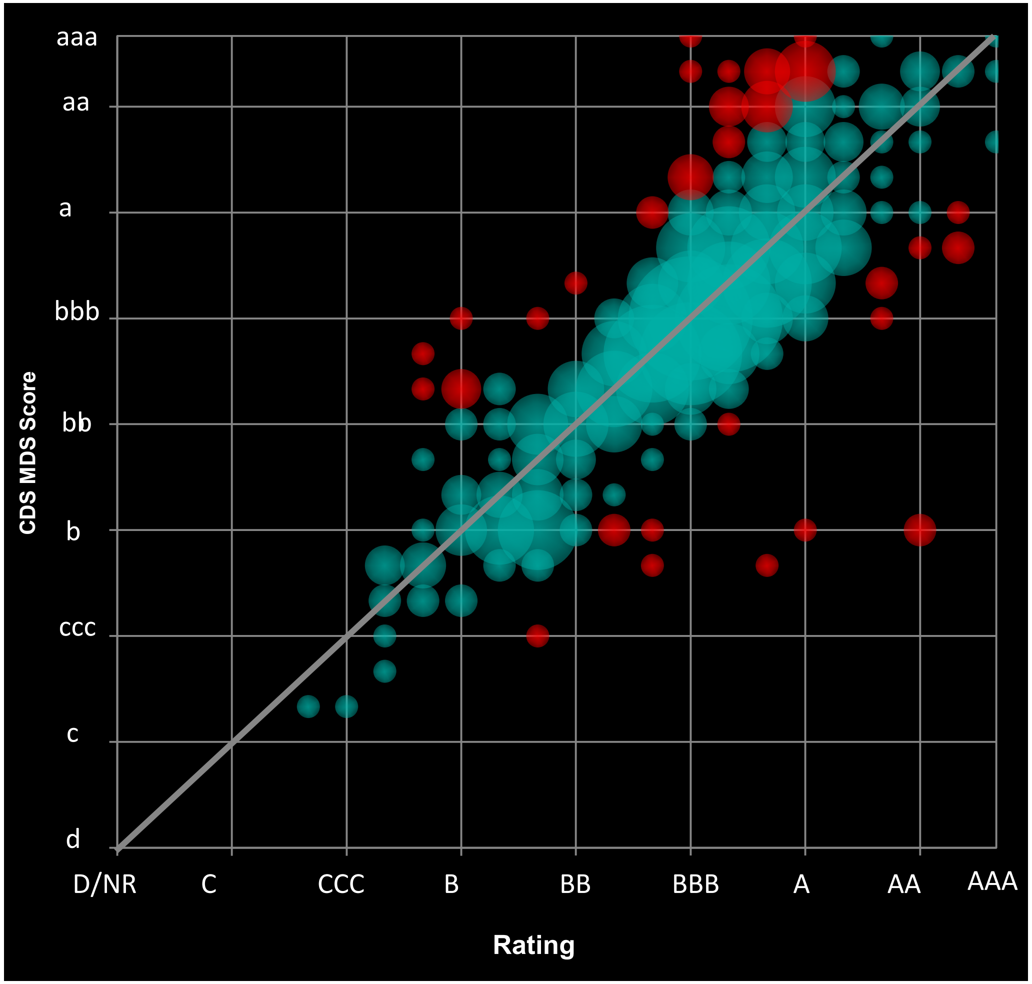
	Cons. Discr.		Cons. Staples		Energy		Financials		Healthcare		Industrials		IT		Materials		Telecom.		Utilities	
	CDS MDS	S&P Rating	CDS MDS	S&P Rating	CDS MDS	S&P Rating	CDS MDS	S&P Rating	CDS MDS	S&P Rating	CDS MDS	S&P Rating	CDS MDS	S&P Rating	CDS MDS	S&P Rating	CDS MDS	S&P Rating	CDS MDS	S&P Rating
14 Q3	13.01	12.93	15.25	15.47	15.17	15.29	15.51	15.88	16.53	16.10	15.65	15.02	14.84	15.29	14.52	14.46	13.80	13.80	16.18	15.23
14 Q4	13.18	12.89	15.54	15.43	14.98	15.35	15.64	15.90	16.57	16.07	15.78	15.12	14.84	15.35	14.37	14.46	13.50	13.80	15.90	15.23
15 Q1	13.16	12.98	15.62	15.27	14.92	15.12	15.63	15.90	16.70	16.10	15.89	15.07	15.19	15.35	14.33	14.35	13.60	13.60	16.13	15.23
15 Q2	13.15	12.98	15.68	15.22	14.61	14.92	15.50	15.90	16.40	16.13	15.64	15.13	15.26	15.35	14.11	14.35	13.20	13.60	15.73	15.22

The Market Derived Signal (MDS) is a quantitative analytic that uses Credit Default Swaps (CDS) to facilitate the interpretation of how the CDS markets generally view the credit quality of well-known firms and sovereigns. It aims to capture the market's sentiment regarding an entity's perceived credit risk. One of the objectives of the MDS is to identify where market sentiment may differ from the issuer credit rating. CDS spreads are used to compute the difference between an entity's actual spread and expected spread for a given rating. Universe is all companies that have an S&P Long-Term Local Rating, primary headquarters in the U.S. or Canada, and an S&P Capital IQ sector classification. Source: S&P Capital IQ as of July 1, 2015.

CDS Market Outliers

NOTES:

- We have highlighted companies with some of the biggest divergences between their S&P Rating and their CDS Market Derived Signal in red. This provides us with a list of firms whose market sentiment is significantly different than its Rating. As shown by the blue circles, the vast majority of firms were scored +/- 3 notches from their Credit Rating.
- We notice that the CDS market has more bullish outliers than bearish, especially in the lower end of the investment grade spectrum. In addition, as compared to last quarter we observe more outliers in the B rated spectrum that have CDS spreads trading at higher levels. Both trends are similar to last quarter.



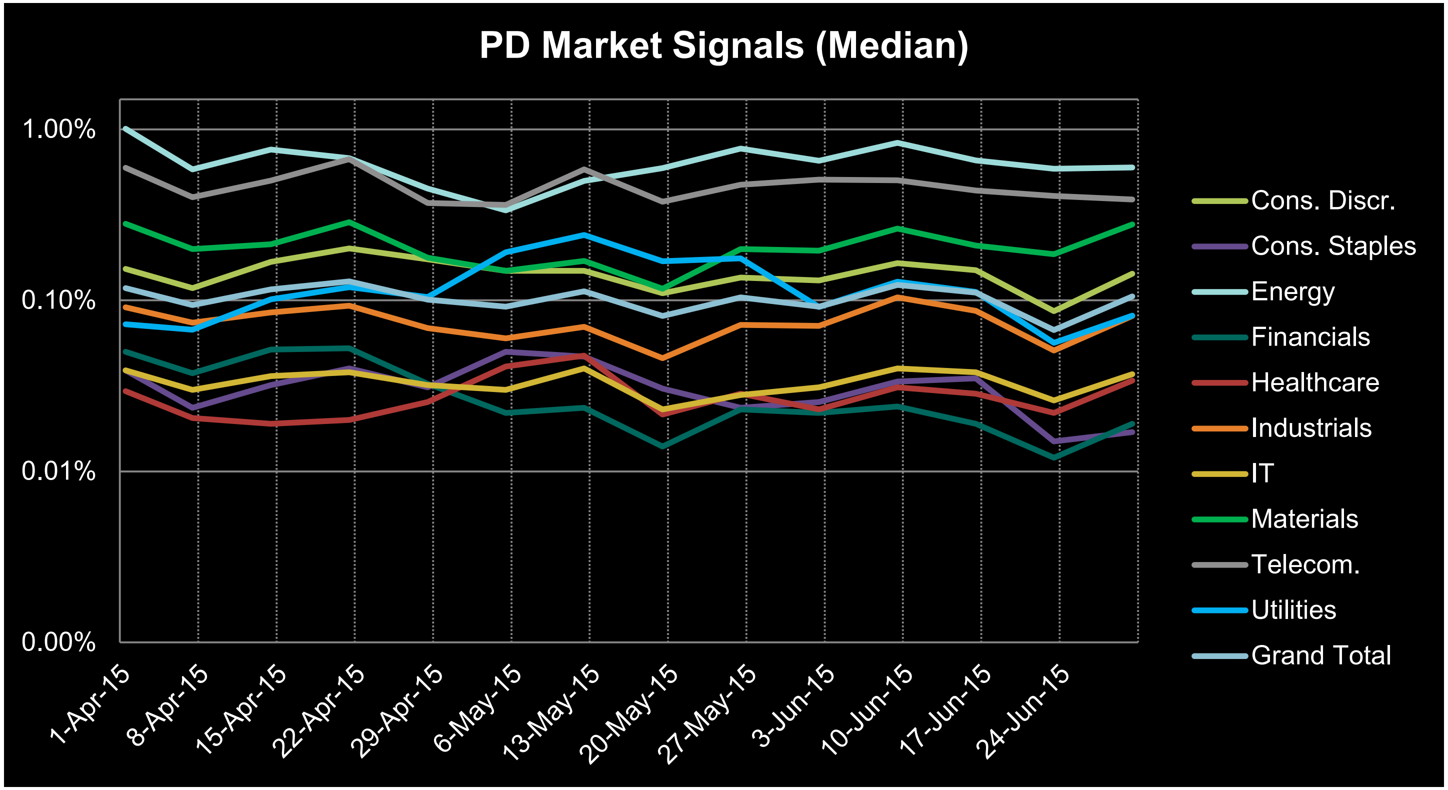
Company	CDS MDS	S&P Rating
CDS MDS Positive Divergence		
American Electric Power Co., Inc.	a+	BBB
MeadWestvaco Corporation	a+	BBB
Rohm and Haas Company	a+	BBB
Hospira Inc.	a	BBB-
Kinder Morgan Energy Partners, L.P.	a	BBB-
The E. W. Scripps Company	bbb+	BB
H. J. Heinz Company	bbb	BB-
Alcatel-Lucent USA, Inc.	bb+	B
CDS MDS Negative Divergence		
General Electric Capital Corporation	a	AA+
Berkshire Hathaway Inc.	a-	AA
Amazon.com Inc.	bbb+	AA-
The Toronto-Dominion Bank	bbb+	AA-
Diamond Offshore Drilling, Inc.	bb	BBB+
Chesapeake Energy Corporation	b	BB+
Transocean Inc.	b	BB+
General Electric Company	a-	AA+

The Market Derived Signal (MDS) is a quantitative analytic that uses Credit Default Swaps (CDS) to facilitate the interpretation of how the CDS markets generally view the credit quality of well-known firms and sovereigns. It aims to capture the market's sentiment regarding an entity's perceived credit risk. One of the objectives of the MDS is to identify where market sentiment may differ from the issuer credit rating. CDS spreads are used to compute the difference between an entity's actual spread and expected spread for a given rating. Universe is all companies that have an S&P Long-Term Local Rating, primary headquarters in the U.S. or Canada, and an S&P Capital IQ sector classification. Source: S&P Capital IQ as of July 1, 2015

Equity Market Sentiment Implied Default Risk By Sector

NOTES:

- In Q2 2015, 8 of the 10 sectors had improving PD Market Signals. Telecom, consumer staples, and financials changed to tightening from widening PDs this quarter.
- Overall median PDs decreased by 11% in Q2 continuing its trend from Q1.
- Financials had the largest improvement in PD in addition to being one of the safer sectors. Additionally, energy continued to see its credit improve as oil prices stabilized.



	Cons. Discr.	Cons. Staples	Energy	Financials	Healthcare	Industrials	IT	Materials	Telecom.	Utilities	Grand Total
4/1/2015	0.15%	0.04%	1.01%	0.05%	0.03%	0.09%	0.04%	0.28%	0.60%	0.07%	0.12%
6/30/2015	0.14%	0.02%	0.60%	0.02%	0.03%	0.08%	0.04%	0.28%	0.39%	0.08%	0.11%
% Change	-6.23%	-56.41%	-40.54%	-62.00%	15.25%	-10.99%	-5.13%	-0.71%	-34.73%	12.41%	-10.59%

S&P Capital IQ's proprietary probability of default (PD) model, 'Market Signals', is a unique analytical model which provides daily changing, 1-year forward looking PDs of publicly listed companies based on a cutting-edge econometric framework. Universe is all companies that have an S&P Long-Term Local Rating, primary headquarters in the U.S. or Canada, and an S&P Capital IQ sector classification. Source: S&P Capital IQ as of July 1, 2015.

Fundamental Implied Default Risk By Sector

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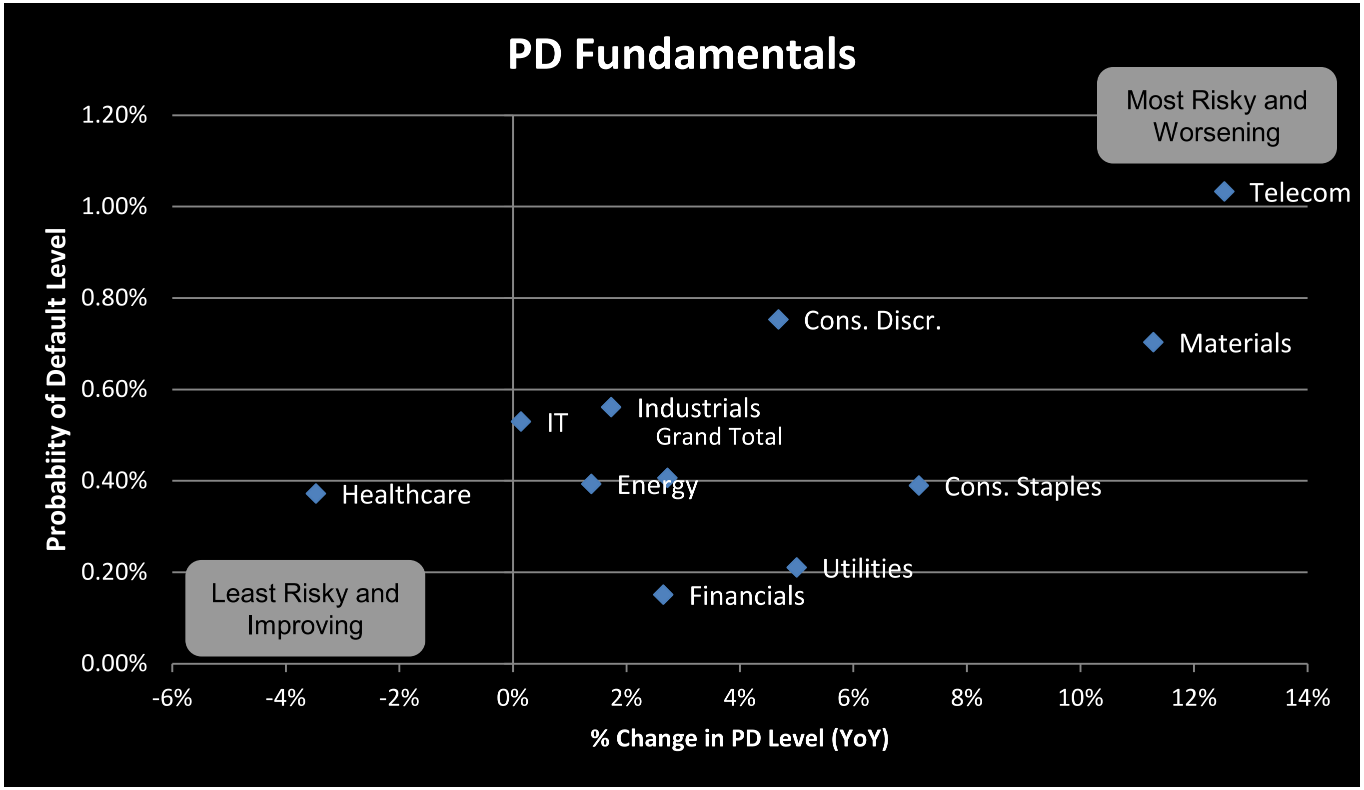
NOTES:

- Fundamentals deteriorated during the second quarter as median PDs increased by 3% year-over-year.
- 9 of the 10 sectors show worsening PDs on a year-over-year basis as compared to only 4 out of 10 last quarter.
- The healthcare sector had two consecutive quarters of median credit improvement.
- Telecom sector fundamentals continue to worsen by the largest percentage, similar to last quarter.



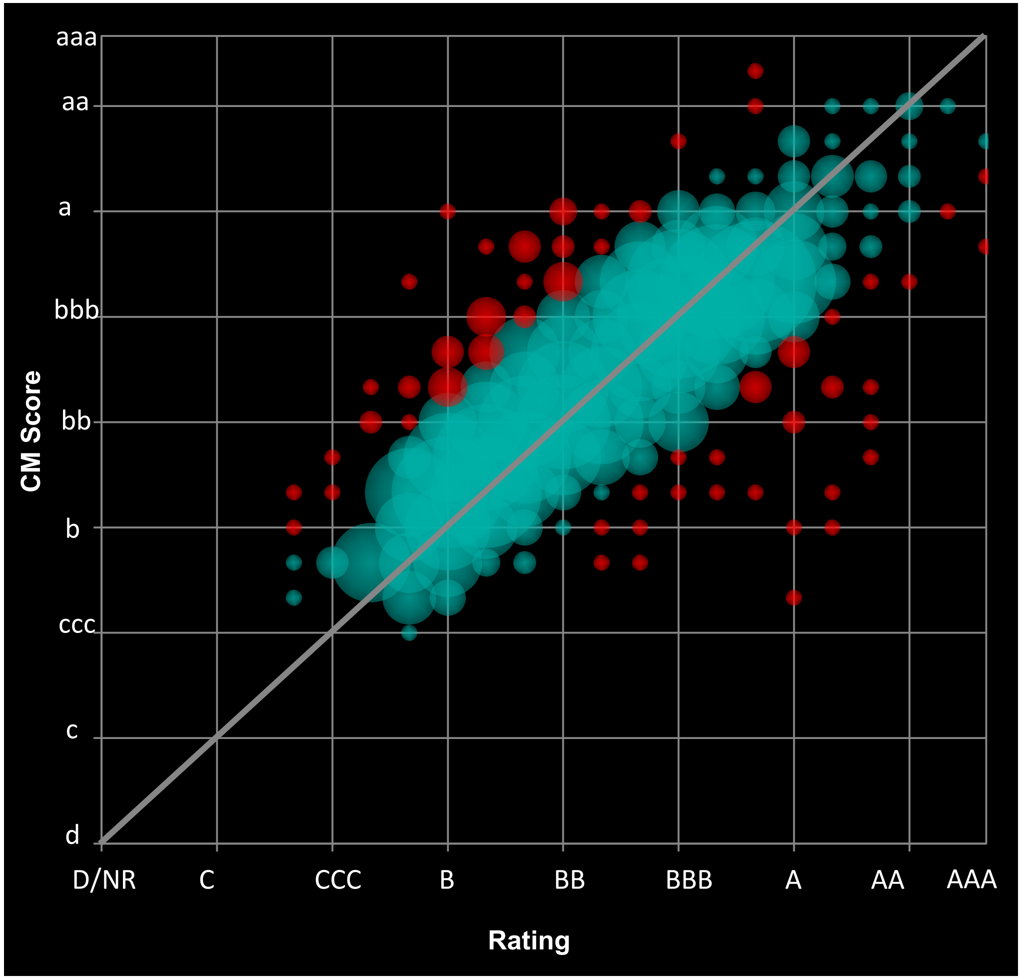
	Cons. Discr.	Cons. Staples	Energy	Financials	Healthcare	Industrials	IT	Materials	Telecom.	Utilities	Grand Total
% Change (YoY)	5%	7%	1%	3%	-3%	2%	0%	11%	13%	5%	3%
PD Level (Median)	0.75%	0.39%	0.39%	0.15%	0.37%	0.56%	0.53%	0.70%	1.03%	0.21%	0.41%

S&P Capital IQ's proprietary probability of default (PD) model, 'PD Model Fundamentals', provides an innovative approach to assessing potential default that separates credit risk into two components—financial risk and business risk. The PDs are applicable for any public or private company and provide a short- to mid-term view of credit risk. They are based purely on fundamental data—financial ratios and macro factors – and are updated when new financials are released or there is some change in the macro factors. Universe is all companies that have an S&P Long-Term Local Rating, primary headquarters in the U.S. or Canada, and an S&P Capital IQ sector classification. Source: S&P Capital IQ as of July 1, 2015.

Quantitatively Viewed Ratings Outliers

NOTES:

- We have highlighted companies with some of the biggest divergences between their S&P Rating and their purely quantitative CreditModel (CM) Score in red. This provides us with a list of firms with fundamental attributes that make them positive or negative outliers. As shown by the blue circles, the vast majority of firms were scored +/- 3 notches from their Credit Rating.
- Within the universe we observed a higher distribution of companies with higher CM Scores than Ratings, continuing from last quarter.



Company	CM Score	S&P Rating
CreditModel Positive Divergence		
CVR Refining, LP	bbb-	B+
IAMGOLD Corp.	bbb-	B+
Visteon Corporation	bbb-	B+
Gulfport Energy Corp.	bb+	B
Life Time Fitness, Inc.	bb+	B
Paragon Offshore plc	bb+	B
The Wendy's Company	bb+	B
Office Depot, Inc.	bb	B-
CreditModel Negative Divergence		
Madison Gas and Electric Company	bbb+	AA-
Northwest Natural Gas Company	bbb	A+
Gaz Métro inc	bbb-	A
The Sherwin-Williams Company	bbb-	A
Adobe Systems Incorporated	bb+	A-
Altera Corp.	bb+	A-
Northern Natural Gas Company	bb+	A-
Nova Gas Transmission Ltd.	bb+	A-

Lower-case nomenclature is used to differentiate S&P Capital IQ's PD CreditModel Scores from credit ratings issued by Standard & Poor's Rating Services. CreditModel Score is trained on ratings, rather than on default data, which helps CreditModel generate a long-term stable view of credit risk that is aligned with a ratings process.
Source: S&P Capital IQ as of July 1, 2015.

FINANCIAL RATIO TRENDS

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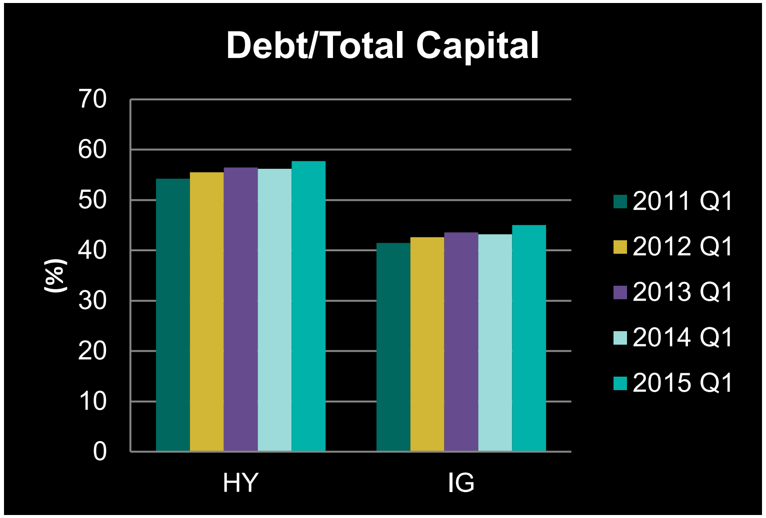
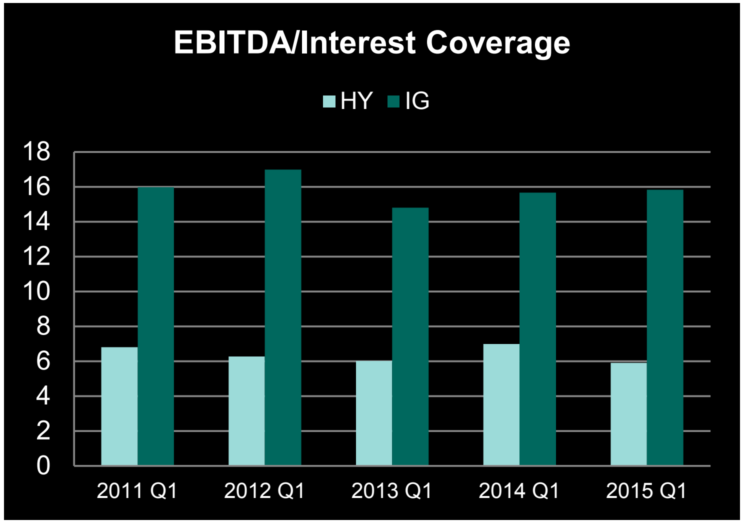
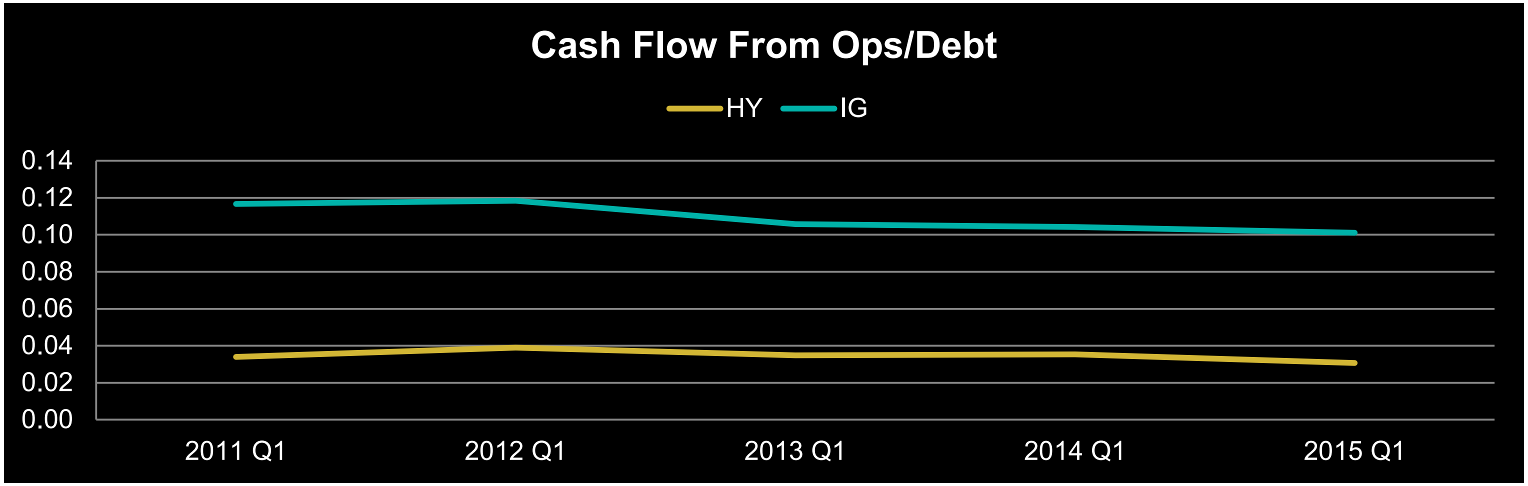
Financial Ratio Trends

NOTES:

- Debt/Total Capital levels continued to rise year-over-year for both universes. On a quarter-over-quarter basis, investment grade companies have seen debt/total capital levels rise to 45% from 44%.
- EBITDA/Interest Coverage levels were down significantly for high yield companies going from 6.9 to 5.9 over the last year. Investment grade remains relatively flat for the past year.
- Cash Flows/Debt levels declined as companies continued to issue more debt due to low interest rates.







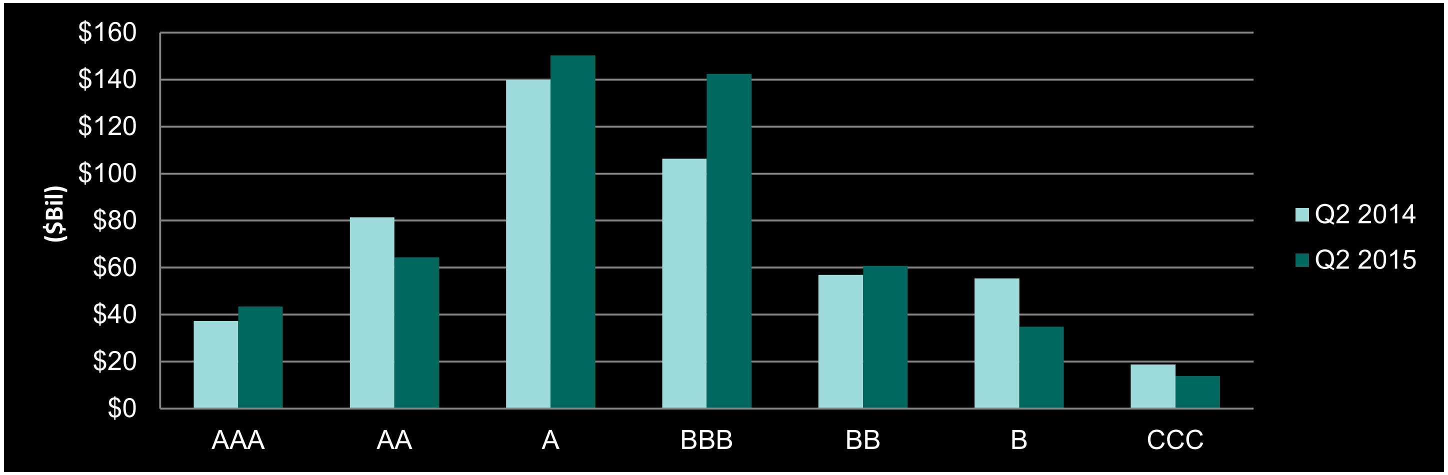
Universe is all non-financial companies that have an S&P Long-Term Local Rating, primary headquarters in the U.S. or Canada, and an S&P Capital IQ sector classification. Source: S&P Capital IQ as of July 1, 2015.

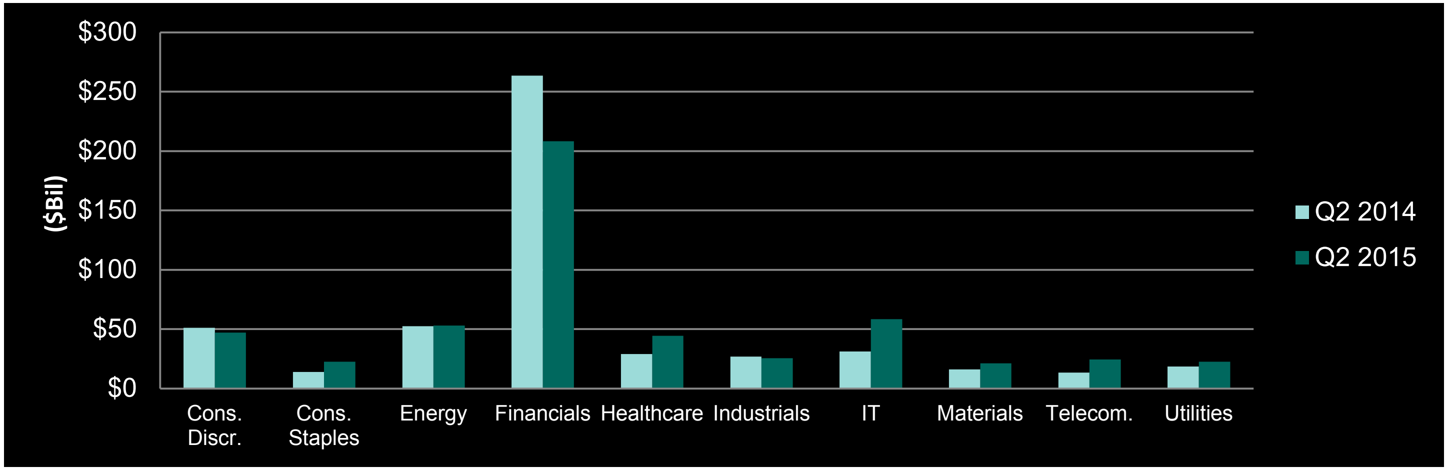
ISSUANCE TRENDS

Issuance Trends By Rating Category

NOTES:

- Issuance was higher at the lower end of investment grade issuers. BBB saw the largest increase in new volume.
- Only BB issuers increased issuance within high yield, while the riskiest areas in high yield saw declines in issuance.
- 7 of the 10 sectors increased issuance year-over-year with IT having the largest increase.
- Some of the biggest issuers this quarter include AT&T and Abbvie.



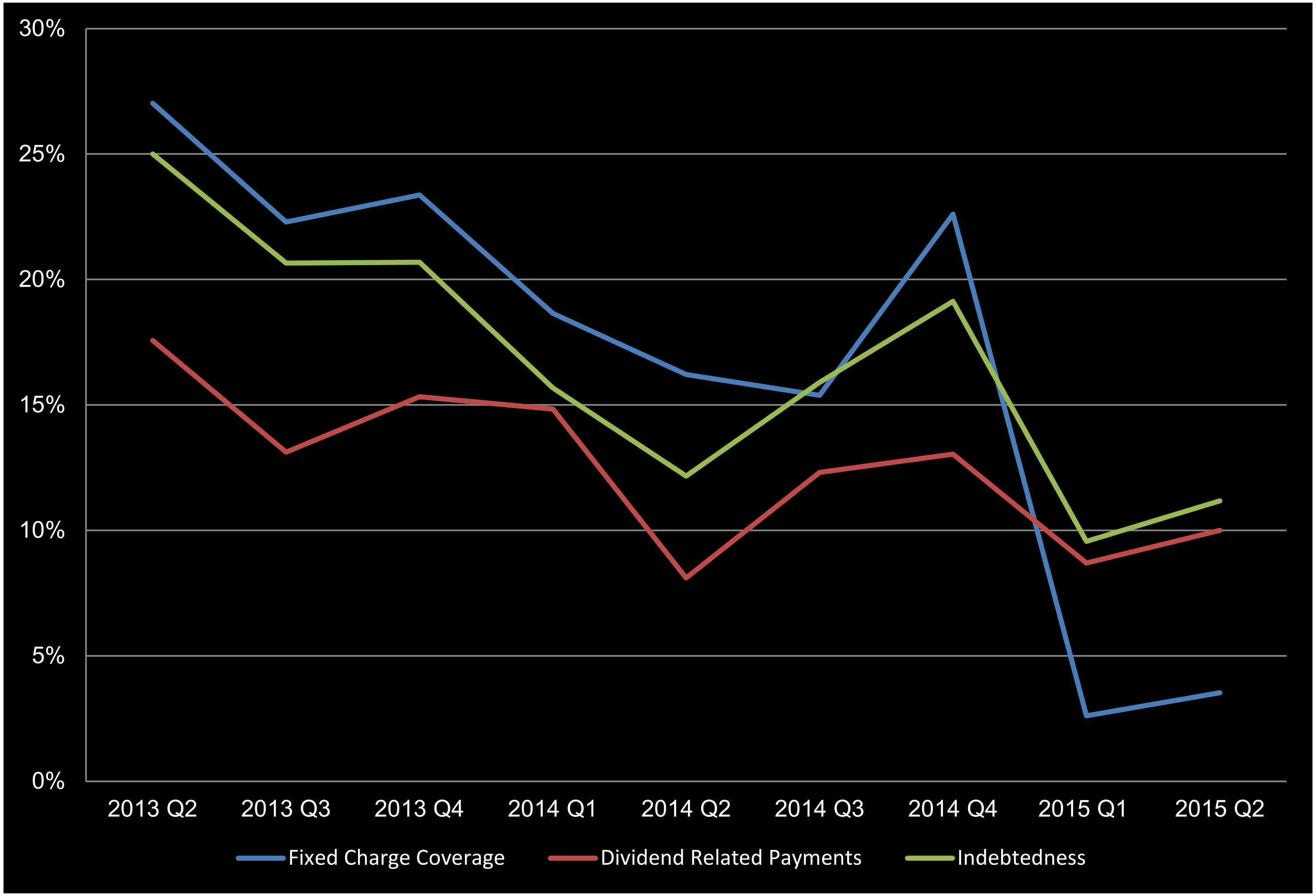


Issuers are public and private companies globally that issue USD debt in U.S. bond markets. Securities include bonds, convertibles, notes and MTNs. Amounts are aggregated by Date of Issuance. All values in USD $ billions. Source: S&P Capital IQ as of July 1, 2015.

Covenants for High Yield Issuance

NOTES:

- The graph represents the percentage of companies with each type of covenant within new high yield issuance.
- We observed a slight increase in Q2 2015 covenants from low levels in Q1 amid weaker high yield issuance markets.
- The fixed charge covenant continues to stay at lower levels compared to 2014.



Universe incudes all high yield corporate debt issuance that is denominated in USD.
Source: S&P Capital IQ as of July 1, 2015.

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