SECTOR VALUATION
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CCC – C Versus BB – B Momentum-Based Strategy

Momentum of Return by Rating

Streak	Observation	Successes	Success Rate	# of Standard Deviation	Probability
(Months)			(%)		(%)
CCC - C > BB - B					
1	61	35	57.4	0.3	38.3
2	35	26	71.4	2.9	0.2
3	25	16	64.0	0.8	21.2
CCC - C < BB - B					
1	61	35	57.4	2.1	1.8
2	35	18	51.4	0.9	18.4
3	18	9	50.0	0.5	30.9
Observation Period: January 1989 - March 2016					
Breakdown for all months: CCC - C > BB - B=55.7%, BB - B > CCC-C=44.3%					
Source: ICE BofA Merrill Lynch Index System, used with permission					

CCC – C versus BB – B Indicated Momentum – Based Strategy

- Momentum favors an underweighting or overweighting in only 29% of all months.
- Benefits of this approach are realized over the long run, not in the short term.
- Overweight CCC – C sector when it has beaten BB – B sector two months in a row, but not after a three – month or longer streak.
- Overweight BB – B sector after initial month of beating CCC – C sector.

CCC – C versus BB – B Market Anticipation Strategy

High Yield Market Return	Return Differential	
(Quarterly)	CCC - C minus BB - B	
	Mean	Median
Positive	+1.44%	+0.81%
Negative	-3.46%	-3.91%
Observation Period: 4Q 1988 - 1Q 2018		
Source: ICE BofA Merrill Lynch Index System, used with permission		

- So if you believe you can predict market direction, overweight CCC – C when you’re bullish and underweight CCC – C when you’re bearish

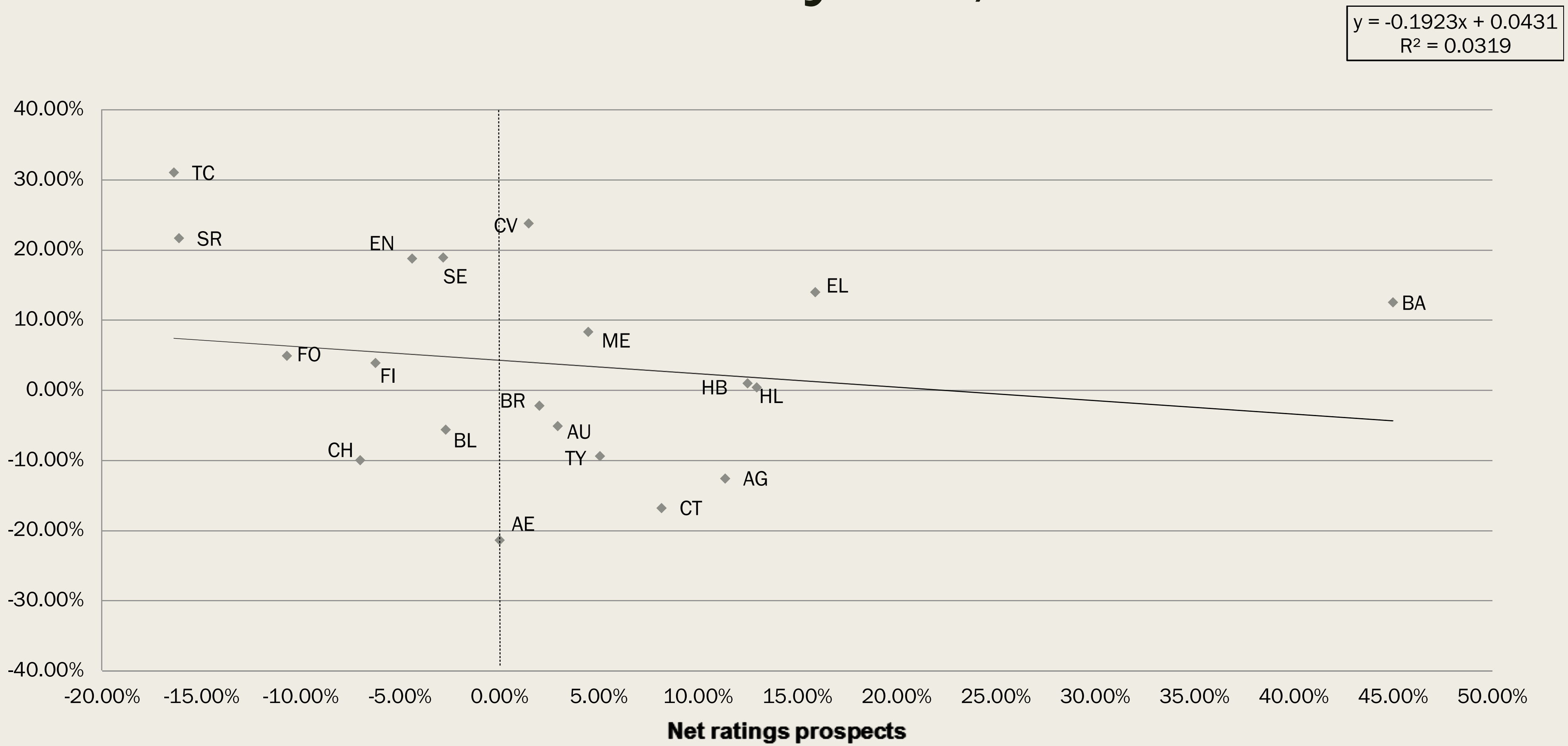
Industry Selection Concepts

- Equalized Ratings Mix
- Rating Prospects – Outlooks + Watchlistings
- Quadrants

NW	Cheap vs. Ratings Negative Ratings Prospects	NE	Cheap vs. Ratings Positive Ratings Prospects
SW	Expensive vs. Ratings Negative Ratings Prospects	SE	Expensive vs. Ratings Negative Ratings Prospects

- Regression Line

Relative Value Analysis for Major High Yield Industries – May 31, 2018



Sources: ICE BofA Merrill Lynch Index System, used with permission; Bloomberg

Note: Calculations exclude issues trading below 50

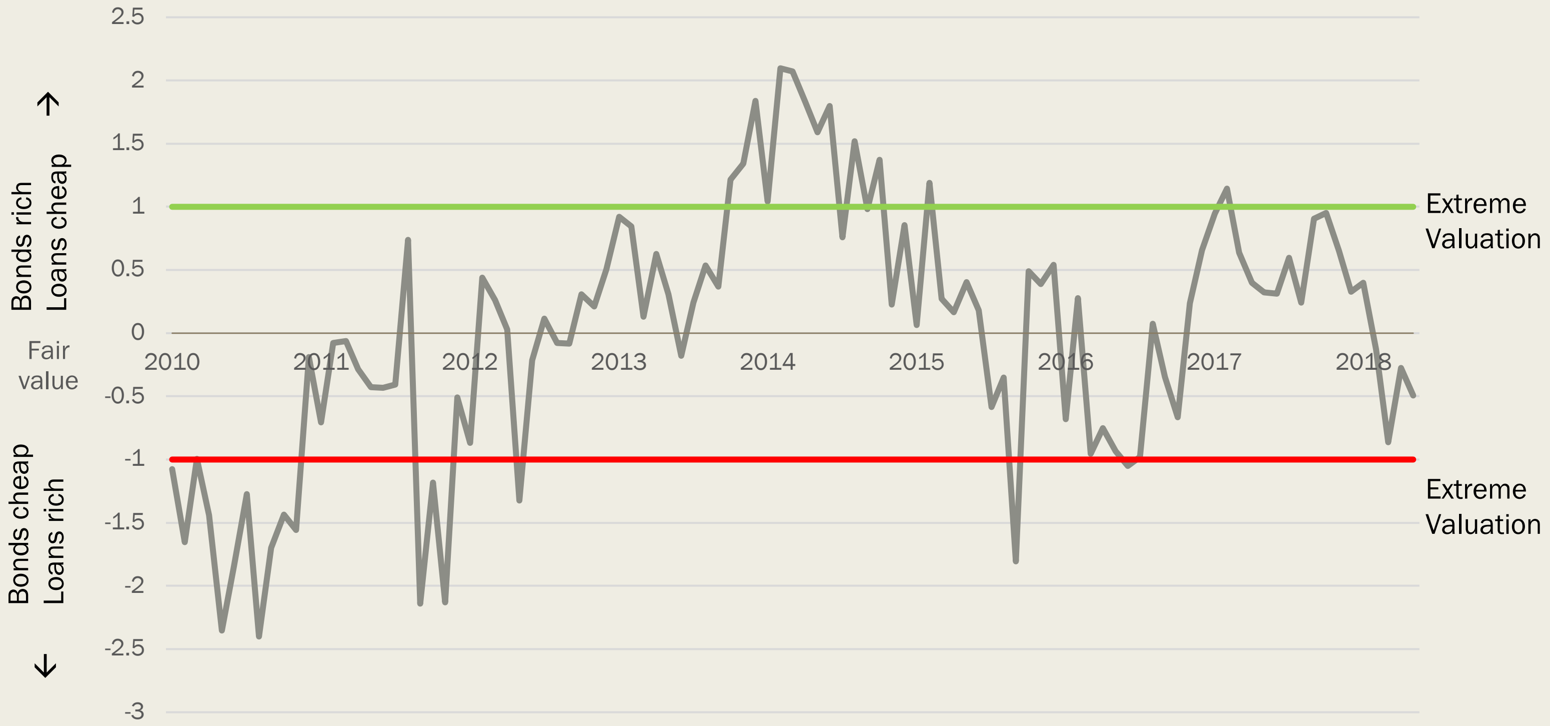
Leveraged Loans versus High Yield Bonds Concepts

- Three-Year Discounted Spread for Loans (Source: S&P Global Market Intelligence/LCD).
- Has some claim to being a market convention.
- = (Nominal Spread + (((100 - Avg. Bid)*100/3))/Avg. Bid/100)
- Nominal Spread includes LIBOR floor benefit
- Defaulted Loans are excluded

Loans versus Bonds
Equalized Ratings Mix

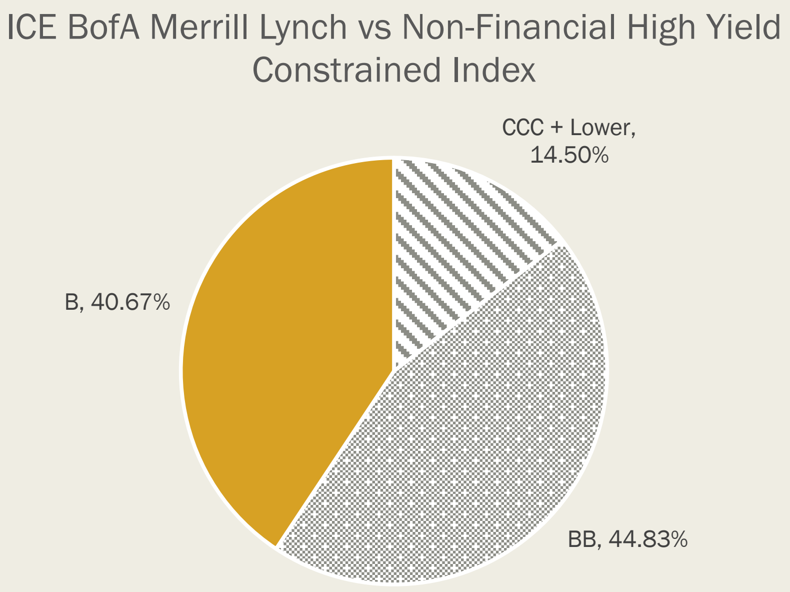
- Spread of ICE BofA Merrill Lynch US High Yield Index is adjusted for minor amounts of investment grade debt in the loan index.
- To avoid inappropriate raw spread comparisons (proportions of secured paper differ between loans and bonds) we convert the spread to an index based on mean monthly spread (49.71 basis points) and standard deviation of 38.87 basis points in 2010 – 2017 observation period.

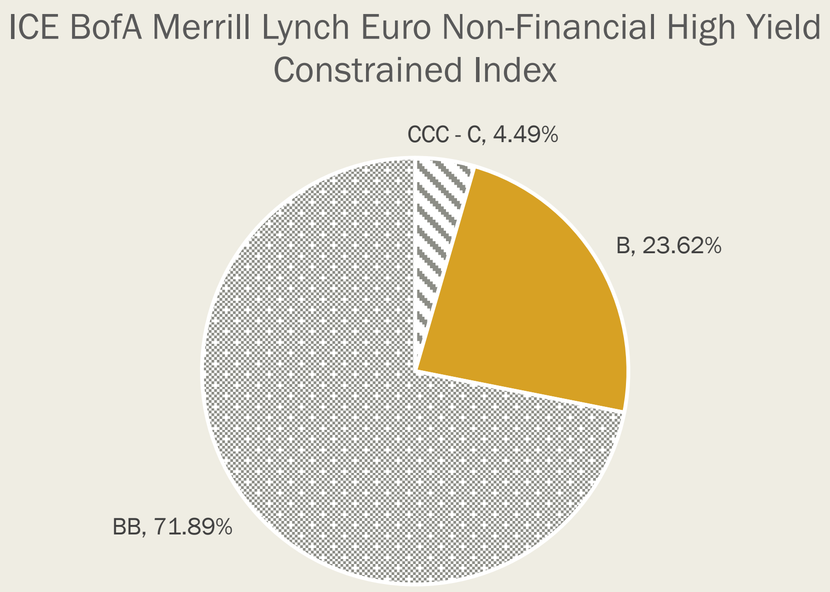
Loans versus Bonds Fair Value Index 2010 – 2018*, Monthly



* Through May 31, 2018
Sources: ICE BofA Merrill Lynch Index System, used with permission; S&P Global Market Intelligence

Europe versus U.S.
Importance of Equalizing the Ratings Mix





Source: ICE BofA Merrill Lynch Index System, used with permission

Europe versus U.S.

- Why is zero not in the third quantile? (Europe trades cheap to the U.S. on average, after adjustment for difference in ratings mix.)
- Possible explanations:
  1. *European companies are overrated relative to U.S. companies, despite rating agencies' best efforts to achieve interregional equivalency.*
  2. *European companies are not relatively overrated but investors believe they are.*
  3. *Investors in the European market are more risk-averse than investors in the U.S. market and therefore demand a larger risk premium for equivalent risk. (This may reflect a less well developed vulture market in Europe.)*
  4. *European issues carry larger liquidity premiums than their U.S. counterparts because the secondary market is less well developed in Europe.*

Europe versus U.S. Empirical Findings

	Equalized Ratings Mix Difference	Europe's Valuation	Europe Recommendation
Quintile	(Basis Points)		
1	149.1 or more	Very Cheap	Overweight
2	48.2 to 149.0	Moderately Cheap	Neutral
3	20.1 to 48.1	Fairly Valued	Neutral
4	-12.1 to 20.0	Moderately Rich	Neutral
5	-12.0 or less	Very Rich	Overweight
Observation Period: 2003-2012, Quarterly			
Source: ICE BofA Merrill Lynch Index System, used with permission			

Emerging Markets versus U.S. Empirical Findings

Equalized Ratings Mix Difference		
(Basis Points)		
Quintile	EM - U.S.	EM Recommendation
1	149.1 or more	Overweight
2	48.2 to 149.0	Neutral
3	-12.1 to 20.0	Neutral
4	-12.0 or less	Underweight
Based on ICE BofAML High Yield US Emerging Markets Corporate Plus Index and ICE BofA Merrill Lynch US High Yield Index		
Observation Period: December 1998 to December 2016, semiannually		
Source: ICE BofA Merrill Lynch Index System		

THANK YOU!

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Portions of the findings in this presentation were originally published by S&P Global Market Intelligence/LCD