

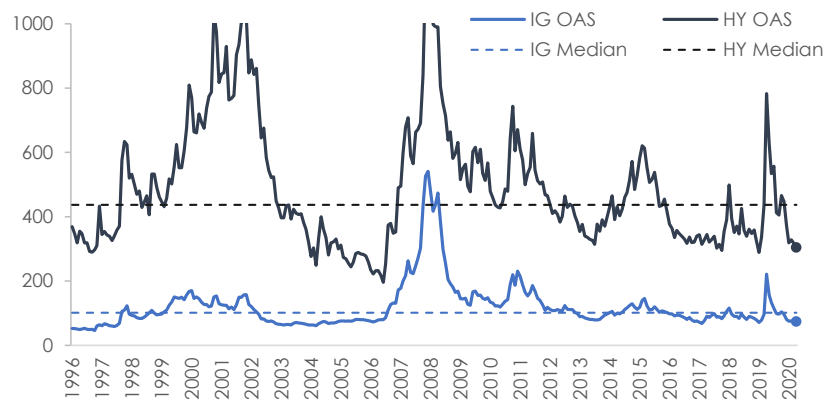
Global Credit

Credit Quality

► **Maintain Corp High Yield OW but Favor Municipal IG.** The Fed remains accommodative, and the economic outlook is strong. As a result, we broadly favor a HY OW to earn a higher yield and protect against rising rates via lower duration. Importantly, this is not a bet on additional spread tightening given spreads are already tight. Overall, we expect HY to outperform on a total return basis vs IG but note a lower expected level of outperformance since we upgraded the area in May 2020.

► **Actionable Ideas:** In Corp HY, we favor emphasizing BB via FALN, ANGL, and HYBB. In Muni HY, we favor an active approach, such as iShares's recently launched HYMU, but State Street's HYMB and VanEck's HYD are passive alternatives.

Figure 30: Corporate Credit Quality - IG & HY OAS

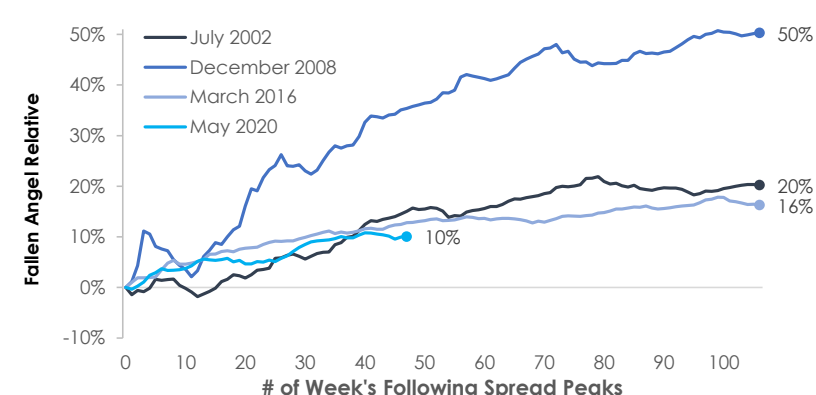


Source: MarketDesk Research

Prefer HY Over IG to Earn a Higher Yield & Protect Against Rising Rates ...

- Our HY OW is driven by the group's higher absolute yields vs corp IG, not a bet on additional spread tightening. As a secondary factor, HY's lower duration also offers protection against rising rates. We expect HY's total return to outpace IG but note a lower expected level of outperformance.
- Figure 30 charts corp IG and corp HY option adjusted spreads (OAS) over the past 25-years. IG and HY OAS both currently sit near multi-decade lows.

Figure 31: Fallen Angels Outperformance over BB Corp Bonds

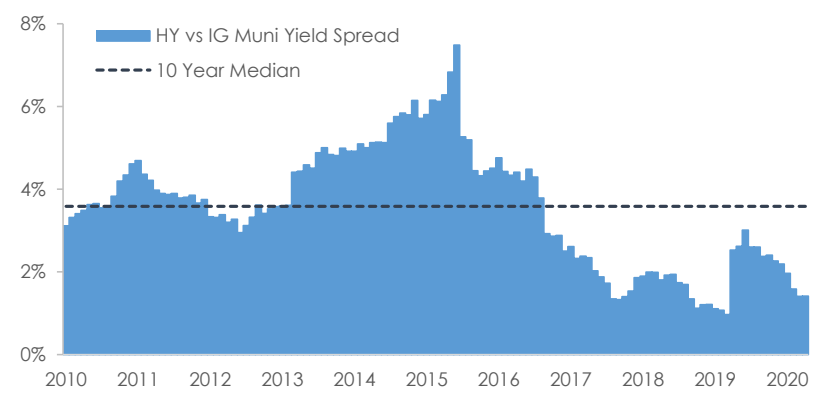


Source: MarketDesk Research

History Favors Fallen Angels Over Broad BB During Early Stages of Credit Cycle ...

- The pandemic's 'fallen angels' are ready to become the recovery's 'rising stars'. Credit rating upgrades from HY to IG as the economy rebounds reprice bonds higher. The current recovery is lagging prior cycles, but history suggests fallen angels can continue to outperform.
- Figure 31 charts the cumulative total return gap between fallen angels and the broad BB index after the spread between the two peaked in the 2002, 2008, 2016, and 2020 credit cycles. Fallen angels historically outperform the broad BB index on a total return basis in the following two years.

Figure 32: Municipals - HY vs IG Credit Spread



Source: MarketDesk Research

Muni HY-IG Spread Does Not Compensate for Hidden Default Risk ...

- HY municipal credit spreads do not compensate investors for the hidden risks across state and local municipalities. In contrast to corporates, we favor IG over HY within municipals.
- Figure 32 charts the HY-IG municipal spread over the past decade. The HY-IG spread currently sits near a decade low and is too low for us to comfortably take on hidden credit risk. We favor an active approach. Blackrock's HYMU fits, although it is less than 1-month old and still deploying capital. As an alternative, State Street's HYMB and VanEck's HYD offer broad, passive exposure.

Asset Allocation Views