Private Bank

US Corporate Sector Views

Global Fixed Income Strategy | 3Q 2019

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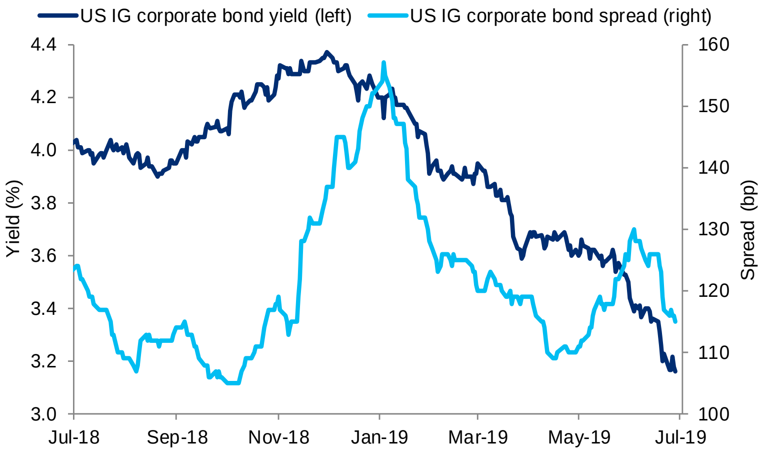
Latest CPB strategy views on corporate credit

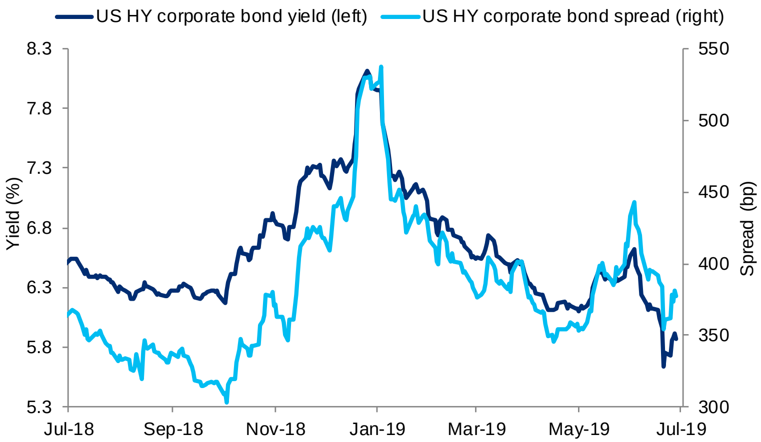
- US investment grade (IG) bonds have returned near 10% YTD, as spreads have tightened and yields have fallen to the lowest levels since 2017. We continue to recommend high quality US fixed income, with a preference for defensive sectors.
- We remain overweight US IG corporates, and favor extending duration. Though yield curves have flattened, spread curves are near their widest levels since 2016.
- In light of rising trade uncertainty, we downgrade our view on US HY from neutral to underweight. Though fundamentals (low default rates) and technicals remain supportive, the coming months may be challenging for risks assets.

IG corporate bond yields and spreads



Sources: Bloomberg Barclays Indices as of July 2, 2019

HY corporate bond yields and spreads



Sources: Bloomberg Barclays Indices as of July 2, 2019

US Investment Grade Corporates – Summary of sector views

Arrows imply our expectations of sector performance versus the Bloomberg Barclays US Intermediate Corporate Bond Index
Up arrow = outperform, Sideways arrow = market perform, Down arrow = underperform

Outperform

↑

Consumer – Non-cyclical
Consumer Products, Food-Beverage, Healthcare, Pharmaceuticals, Supermarkets, Tobacco

Financials – Banks
Banks, Brokerage

Financials – Non-Banks
Finance Cos, Insurance, REITs

Utilities
Electric, Natural gas

Neutral

↔

Basic Industries
Chemicals, Metals & Mining, Pulp-Paper

Capital Goods
Aerospace & Defense, Building Materials, Machinery, Diversified Manufacturing

Communications
Cable-Satellite, Media, Wireless, Wirelines

Energy
Independent, Integrated, Midstream, Oil Fields, Refining

Technology
Equipment-Hardware, Software

Underperform

↓

Consumer - Cyclical
Automotive, Services, Construction, Leisure, Lodging, Restaurants, Retailers

Source: Citi Private Bank, Bloomberg Barclays US Intermediate Corporate Bond Index as of July 2, 2019. The expressions of opinion are not intended to be a forecast of future events or a guarantee of future results. Indices are unmanaged. An investor cannot invest directly in an index. They are shown for illustrative purposes only and do not represent the performance of any specific investment. Index returns do not include any expenses, fees or sales charges, which would lower performance. For illustrative purposes only. Past performance is no guarantee of future results. Real results may vary.

US Investment Grade Corporates – Valuations & Performance

	Valuations				*YTD total return (%)*			*Last 3-mo. total return (%)*			*Last 12-mo. total return (%)*		
Sector[1]	Spread vs. Treasury (bp)	Spread vs. Index (bp)[2]	Yield to worst (%)	Modified Duration	Total return	vs. Index[2]	Excess return[3]	Total return	vs. Index[2]	Excess return[3]	Total return	vs. Index[2]	Excess return[3]
Basic Industries	113	24	3.0	4.4	7.3	0.3	3.5	3.5	0.1	1.0	9.1	0.6	3.1
Capital Goods	81	(8)	2.7	4.4	6.7	(0.3)	2.9	3.2	(0.1)	0.7	8.1	(0.4)	2.1
Communications	91	2	2.8	4.6	7.8	0.7	3.9	3.9	0.5	1.4	10.1	1.5	4.0
Consumer - Cyclical	97	8	2.8	4.1	7.1	0.0	3.2	3.4	0.1	0.9	8.0	(0.5)	2.0
Consumer - Non Cyclical	83	(6)	2.7	4.3	7.1	0.1	3.3	3.5	0.1	1.0	8.7	0.1	2.6
Energy	105	16	2.9	4.3	7.6	0.6	3.8	3.2	(0.2)	0.7	8.7	0.2	2.7
Financial sector - banks	88	(1)	2.7	4.0	7.0	(0.0)	3.2	3.3	(0.1)	0.8	8.5	(0.0)	2.5
Financial sector - non-banks	108	19	2.9	4.6	7.4	0.4	3.6	3.7	0.3	1.2	9.2	0.7	3.2
Technology Sector	85	(4)	2.7	4.3	6.7	(0.4)	2.8	3.2	(0.2)	0.7	8.1	(0.4)	2.1
Utilities Sector	88	(1)	2.8	4.7	6.3	(0.7)	2.5	3.3	(0.1)	0.8	8.0	(0.6)	1.9
IG Intermediate Corp Index	89	N/A	2.8	4.3	7.0	N/A	3.2	3.4	N/A	0.9	8.5	N/A	2.5

Source: Bloomberg as of July 2, 2019. 1) Sectors are derived from the Bloomberg Barclays US Intermediate Corporate Bond Index , 2) Spread or return difference vs Bloomberg Barclays US Intermediate Corporate Bond Index, 3) Excess return is the difference in return vs the Bloomberg Barclays US Intermediate Treasury Index. Note: YTD = year-to-date total return, 12m = total return over the last 12 months, Yield to worst = the lower of the yield to maturity or yield to call.

Key sector views

- **IG Utilities; Upgrade to Outperform:** The industry tends to be insulated from external shocks attributed to global trade wars, tariffs or economic weakness. As a result the sector tends to outperform during periods of risk-aversion.
- **IG Consumer – Non-cyclical; Upgrade to Outperform:** Healthcare/Pharma have demonstrated resilience in downturns as earnings have proven to be positive over the last three recessions.
- **IG Communications; Downgrade to Neutral:** Spreads remain relatively wide following a period of large M&A deals and rising leverage, though management teams have been vocal about reducing debt. Despite the ability to generate cash during economic downturns, valuations appear stretched. We would consider tactically adding exposures upon any meaningful spread widening.

US Investment Grade Corporates – Sector views

Arrows imply our expectations of sector performance versus the Bloomberg Barclays US Intermediate Corporate Bond Index
Up arrow = outperform, Sideways arrow = market perform, Down arrow = underperform

Basic Industries Chemicals, Metals & Mining, Pulp-Paper	↔	YTD return: +7.3% 12M return: +9.1%	• Remain neutral. Spreads still trade wide to benchmark, but have richened. Iron ore has rallied sharply YTD and supply dynamics may keep prices at elevated levels. Metals & Mining fundamentals remain strong with lower cost structures and deleveraging balance sheets. That said, metal prices may remain susceptible to slowing global growth.
Capital Goods Aerospace & Defense, Building Materials, Machinery, Diversified Manufacturing	↔	YTD return: +6.7% 12M return: +8.1%	• Neutral overall, though we favor Aerospace and Defense (A&D) over Building Materials. A&D (A- rated) offers defensive characteristics and low price volatility, while issuer balance sheets remain strong due to stable and predictable income streams. Building materials, on the other hand, may fall victim to a slowing economic growth, decline in capex and drop in construction spending.
Communications Cable-Satellite, Media, Wireless, Wirelines	↔	YTD return: +7.8% 12M return: +10.1%	• After strong outperformance YTD, we downgrade to neutral. Spreads remain relatively wide following a period of large M&A deals and rising leverage, though management teams have been vocal about reducing debt. Despite the ability to generate cash during economic downturns, valuations appear stretched, in our view. We would consider tactically adding exposures upon any meaningful spread widening.
Consumer - Cyclical Automotive, Services, Construction, Leisure, Lodging, Restaurants, Retailers	↓	YTD return: +7.1% 12M return: +8.0%	• Aside from Autos the sector trades rich to benchmark. Auto fundamentals have improved considerably since the global financial crisis, however a slowing economy, declines in new auto sales and the declining quality of finance portfolios raise some concerns. • Retail is penetrated by high quality issuers who have done a good job developing e-commerce offerings, though spreads are tight and likely to remain under pressure.
Consumer – Non-cyclical Consumer Products, Food-Beverage, Healthcare, Pharmaceuticals, Supermarkets, Tobacco	↑	YTD return: +7.1% 12M return: +8.7%	• Upgrade to Outperform. Healthcare/Pharma have demonstrated resilience in downturns as earnings have proven to be positive over the last three recessions. Over the long-term, these issuers may benefit from a growing middle-class (especially in Asia) and aging population. Need to be selective in Food/Beverage due to elevated M&A risk.

Source: Citi Private Bank, Bloomberg Barclays US Intermediate Corporate Bond Index as of July 2, 2019. Note: YTD = year-to-date, 12m = 12-month total return. The expressions of opinion are not intended to be a forecast of future events or a guarantee of future results. For illustrative purposes only.

US Investment Grade Corporates – Sector views cont.

Arrows imply our expectations of sector performance versus the Bloomberg Barclays US Intermediate Corporate Bond Index
Up arrow = outperform, Sideways arrow = market perform, Down arrow = underperform

Energy Independent, Integrated, Midstream, Oil Fields, Refining	↔	YTD return: +7.6% 12M return: +8.7%	• Following the drop in oil prices since April, Citi Commodity strategists have become more bullish, citing peak pessimism and constructive positioning. These positive tailwinds are what keep us from downgrading our view on energy, as such we remain neutral. Spreads have tightened significantly over the last few years and don't offer the same upside as earlier in the cycle. Spreads can outperform in a crude oil rally, but we remain defensive.
Financials - Banks Banking, Brokerage	↑	YTD return: +7.0% 12M return: +8.5%	• Inverted/flat Treasury curves could slow revenue growth, though credit fundamentals are strong, which should result in stable credit ratings and spreads. Banks offer high quality defensive characteristics and typically perform well in periods of market stress (ex-financial crisis). Reduced supply expectations due to enhanced capital buffers are supportive for technicals.
Financials – Non-Banks Finance Cos, Insurance, REITs	↑	YTD return: +7.4% 12M return: +9.2%	• REITs are generally defensive credits, outperforming almost every IG sector in 2018. In 2019, the sector has lagged the early year risk- rally outperformed in the May risk-sell off. Continue to stay positive, especially as a hedge for any drawdowns in market sentiment. • Finance companies trade wide. A flatter UST curve may be a headwind but steady cash flows, solid collateral and strong order books underpins their underlying strength.
Technology Equipment-Hardware, Software	↔	YTD return: +6.7% 12M return: +8.1%	• After virtually no issuance in 2018, supply this year is up once again, which as driven some of the YTD underperformance. Tech consist of high quality well known names supported by solid balance sheets and strong free cash flows. With an average rating of A+, Tech is the highest quality sector in all of US IG. Despite somewhat improved valuations, spreads are still rich. Remain neutral.
Utilities	↑	YTD return: +6.3% 12M return: +8.0%	• Consistent with our view to be more defensive in markets, we upgrade our view on Utilities to outperform. The industry tends to be insulated from external shocks attributed to global trade wars, tariffs or economic weakness. As a result the sector tends to outperform during periods of risk-aversion.

Private Bank

Source: Citi Private Bank, Bloomberg Barclays US Intermediate Corporate Bond Index as July 2, 2019. Note: YTD = year-to-date, 12m = 12-month total return. The expressions of opinion are not intended to be a forecast of future events or a guarantee of future results. For illustrative purposes only.

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US High Yield Corporates – Summary of sector views

Arrows imply our expectations of sector performance versus the Bloomberg Barclays US Corporate High Yield Bond Index
Up arrow = outperform, Sideways arrow = market perform, Down arrow = underperform

Outperform

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Consumer – Non-cyclical
Consumer Products, Food-Beverage, Healthcare, Pharmaceuticals, Supermarkets, Tobacco

Utilities

Neutral

↔

Capital Goods
Aerospace & Defense, Building Materials, Machinery, Diversified Manufacturing

Communications
Cable-Satellite, Media, Wireless, Wirelines

Financials
Banking, Brokerage, Finance Cos, Insurance, REITs

Underperform

⬇

Basic Industries
Chemicals, Metals & Mining, Pulp-Paper

Consumer - Cyclical
Automotive, Services, Construction, Leisure, Lodging, Restaurants, Retailers

Energy
Independent, Integrated, Midstream, Oil Fields, Refining

Technology
Equipment-Hardware, Software

Source: Citi Private Bank, Bloomberg Barclays US Corporate High Yield Bond Index as of July 2, 2019. The expressions of opinion are not intended to be a forecast of future events or a guarantee of future results. Indices are unmanaged. An investor cannot invest directly in an index. They are shown for illustrative purposes only and do not represent the performance of any specific investment. Index returns do not include any expenses, fees or sales charges, which would lower performance. For illustrative purposes only. Past performance is no guarantee of future results. Real results may vary.

US High Yield Corporates – Valuations & Performance

	Valuations				*YTD total return (%)*			*Last 3-mo. total return (%)*			*Last 12-mo. total return (%)*		
Sector[1]	Spread vs. Treasury (bp)	Spread vs. Index (bp)[2]	Yield to worst (%)	Duration (in years)	Total return	vs. Index[2]	Excess return[3]	Total return	vs. Index[2]	Excess return[3]	Total return	vs. Index[2]	Excess return[3]
Basic Industries	401	34	5.9	3.6	9.7	(0.5)	5.8	2.4	(0.1)	(0.0)	6.8	(0.9)	0.7
Capital Goods	312	(55)	5.0	3.0	10.5	0.3	6.6	3.0	0.5	0.5	9.2	1.5	3.1
Communications	366	(1)	5.5	3.3	11.1	1.0	7.3	3.9	1.4	1.4	11.0	3.3	4.9
Consumer - Cyclical	360	(7)	5.5	3.5	11.4	1.2	7.6	3.9	1.4	1.4	9.6	1.9	3.6
Consumer - Non Cyclical	435	68	6.2	3.0	10.9	0.8	7.1	2.6	0.1	0.1	10.7	3.0	4.6
Energy	592	225	7.8	3.9	9.1	(1.1)	5.2	(0.1)	(2.6)	(2.6)	1.0	(6.6)	(5.0)
Financial sector	333	(34)	5.2	3.9	11.8	1.7	8.0	3.9	1.4	1.4	10.0	2.3	3.9
Technology Sector	284	(83)	4.7	2.7	9.8	(0.4)	5.9	2.2	(0.3)	(0.3)	8.3	0.6	2.2
Utilities Sector	279	(88)	4.9	3.0	8.3	(1.9)	4.4	2.2	(0.3)	(0.3)	8.9	1.2	2.9
High Yield Corporate Index	367	N/A	5.8	3.2	10.2	N/A	6.3	2.5	N/A	0.0	7.7	N/A	1.6

Source: Bloomberg as of July 2, 2019. 1) Sectors are derived from the Bloomberg Barclays US Corporate High Yield Bond Index , 2) Spread or return difference vs US Corporate High Yield Bond Index , 3) Excess return is the difference in return vs the Bloomberg Barclays US Intermediate Treasury Index. Note: YTD = year-to-date total return, 12m = total return over the last 12 months, Yield to worst = the lower of the yield to maturity or yield to call.

Key sector views

- **HY Utilities; Upgrade to Outperform:** With higher credit ratings and stable revenue streams, Utilities display defensive characteristic that would likely be better supported during periods of rising risk-aversion and falling interest rates.
- **HY Communications; Downgrade to Neutral:** We continue to avoid the Wirelines sub-sector, as secular challenges offset dividend cuts and modest deleveraging. Conversely, we favor larger Wireless carriers who remain focused on debt reduction.
- **HY Energy; Downgrade to Underperform:** We turn defensive over deepening trade wars, which may negatively affect US growth and high beta credit sectors. We prefer to play any rebound in oil prices through investment grade Integrated Energy issuers.
- **HY Basic Industries; Downgrade to Underperform:** Metals/Mining spreads have cheapened some, but have much further room to widen further in a risk-off scenario, in our view. Commodity prices likely to be subject to any further deceleration in the global growth.

US High Yield Corporates – Sector views

Arrows imply our expectations of sector performance versus the Bloomberg Barclays US Intermediate Corporate Bond Index
Up arrow = outperform, Sideways arrow = market perform, Down arrow = underperform

Basic Industries Chemicals, Metals & Mining, Pulp-Paper	↓	YTD return: +9.7% 12M return: +6.8%	• Downgrade to Underperform. Metals/Mining spreads have cheapened some, but have much further room to widen further in a risk-off scenario, in our view. Though Iron ore prices have sharply risen this year, metals would likely be subject to any further deceleration in the global growth outlook.
Capital Goods Aerospace & Defense, Building Materials, Machinery, Diversified Manufacturing	↔	YTD return: +10.5% 12M return: +9.2%	• Spreads have richened in the year to date, and at current levels appear unattractive. That said, fundamentals are strong and the historically benefits from periods of risk-aversion which sees spreads outperform the broader HY bond index. Remain neutral.
Communications Cable-Satellite, Media, Wireless, Wirelines	↔	YTD return: +11.1% 12M return: +11.0%	• After solid YTD performance we downgrade to neutral. We continue to avoid the Wirelines sub-sector, as secular challenges offset dividend cuts and modest deleveraging. • Conversely, we favor larger Wireless carriers who remain focused on debt reduction. Spreads have tightened amid improving earnings and would look to be opportunistic should valuations weaken meaningfully.
Consumer - Cyclical Automotive, Services, Construction, Leisure, Lodging, Restaurants, Retailers	↓	YTD return: +11.4% 12M return: +9.6%	• Remain underweight. Sector has benefitted from increased risk-sentiment this year, with some sub-sector producing double-digit returns. We remain wary of this year's strong outperformance. In our view, this was more to do with short-term value in a beaten down issuers. We look to avoid Retail which is likely to face ongoing secular headwinds to battle with e-commerce offerings from the larger players in the industry, as well as Hotels and Restaurants which may face a slowing consumer should economic conditions turn.
Consumer – Non-cyclical Consumer Products, Food-Beverage, Healthcare, Pharmaceuticals, Supermarkets, Tobacco	↑	YTD return: +10.9% 12M return: +10.7%	• Despite strong performance YTD, we maintain our outperform. Likely to benefit with any risk aversion as defensive issuers are less impacted by external trade shocks or economic downturn. No momentum towards reforming healthcare or lowering drug prices is likely near-term especially with on going trade-deals at the top of the President's agenda.

Private Bank

Source: Citi Private Bank, Bloomberg Barclays US Corporate High Yield Bond Index as July 2, 2019. Note: YTD = year-to-date, 12m = 12-month total return. The expressions of opinion are not intended to be a forecast of future events or a guarantee of future results. For illustrative purposes only.

US High Yield Corporates – Sector views cont.

Arrows imply our expectations of sector performance versus the Bloomberg Barclays US Intermediate Corporate Bond Index
Up arrow = outperform, Sideways arrow = market perform, Down arrow = underperform

Energy Independent, Integrated, Midstream, Oil Fields, Refining	↓	YTD return: +9.1% 12M return: +1.0%	• The latest drop in crude oil prices has fueled a cheapening in credit spreads. However, we downgrade our view on Energy as we turn defensive over deepening trade wars, which may negatively affect US growth and high beta credit sectors. We prefer to play any rebound in oil prices through investment grade Integrated Energy issuers which have more diversified revenue streams and are less directly tied to oil price swings.
Financials Banking, Brokerage, Finance Cos, Insurance, REITs	↔	YTD return: +11.8% 12M return: +10.0%	• Aircraft leasers, our favored sub-sector within financials, continues to outperform up ~12% YTD. These issuers continue to benefit from diversified portfolios and strong order books. • We also like US-based banks whose YTD outperformance has been driven by sustained deposit growth and improving credit ratings. • Despite the rebound in performance this year, we look to avoid European domiciled banks (USD bonds). These issuers make up over 50% of the US HY bank sector. Slowing global growth may impact a fragile Euro-Area, especially Italy, where political risks remain volatile.
Technology Equipment-Hardware, Software	↓	YTD return: +9.8% 12M return: +8.3%	• Despite some areas of HY that have generated double-digit returns this year, HY tech continues to underperform. We remain underweight due too many idiosyncratic risks and rich valuations. Indeed, tech has the tightest spreads amid the entire HY universe. The composition of the sector consists of a diverse universe of firms across many different sub-industries. Some cross-over names offer value, but selectivity is key.
Utilities	↑	YTD return: +8.3% 12M return: +8.9%	• Upgrade to outperform. With higher credit ratings and stable revenue streams, Utilities display defensive characteristic that would likely be better supported during periods of rising risk-aversion and falling rates. However, spreads are tight and would be subject to underperformance should US growth stabilize and/or we see a resolution on trade.

Source: Citi Private Bank, Bloomberg Barclays US Corporate High Yield Bond Index as July 2, 2019. Note: YTD = year-to-date, 12m = 12-month total return. The expressions of opinion are not intended to be a forecast of future events or a guarantee of future results. For illustrative purposes only.

Glossary

Bloomberg Barclays US Intermediate Corporate Bond Index measures the investment grade, fixed-rate, taxable corporate bond market. It includes USD-denominated securities publicly issued by US and non-US industrial, utility and financial issuers. The index focuses on securities with maturities between 1-10 years.

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Bloomberg Barclays US Corporate High Yield Bond Index measures the USD-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba/BB+/BB+ or below. Bond from issuers with an emerging markets country of risk, based on the indices' EM country definition, are excluded.

Bloomberg Barclays US Intermediate Treasury Index measures US dollar-denominated, fixed-rate, nominal debt issued by the US Treasury. The index focuses on securities with maturities between 1-10 years.

Real estate investment trust (REIT) is a company that owns, and in most cases operates, income-producing real estate.

Bond Rating Equivalence

Alpha and/or numeric symbols used to give indications of relative credit quality. In the municipal market, these designations are published by the rating services. Internal ratings are also used by other market participants to indicate credit quality

Bond Credit Quality Ratings

	Rating Agencies		
Credit Risk	Moody's[1]	Standard and Poor's[2]	Fitch Ratings[2]
Investment Grade			
Highest Quality	Aaa	AAA	AAA
High Quality (Very Strong)	Aa	AA	AA
Upper medium Grade (Strong)	A	A	A
Medium Grade	Baa	BBB	BBB
Not Investment Grade			
Lower Medium Grade (Somewhat Speculative)	Ba	BB	BB
Low Grade (Speculative)	B	B	B
Poor Quality (May Default)	Caa	CCC	CCC
Most Speculative	Ca	CC	CC
No Interest Being Paid or Bankruptcy Petition Filed	C	D	C
In Default	C	D	D

Source: investinginbonds.com.

1. The ratings from Aa to Ca by Moody's may be modified by the additions of a 1, 2 or 3 to show relative standing within the category.
2. The ratings from AA to CC by Standard and Poor's and Fitch Ratings may be modified by the addition of a plus or minus to show relative standing within the category.

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