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Fixed Income Commentary High Yield Rallies Ahead of Earnings

The high yield market returned 0.98% in the week ending July 9, as spreads were nearly 20 basis points (bps) tighter and all-in yields dipped below 9% again (the lows were 8% in late April). Equities were bid and the S&P 500 rallied over 55 points to close at 1,078, after briefly hitting new lows for the year on July 1. Based on JPMorgan data, CCCs and Bs tightened the same amount and the CCC/B spread remained at +454 bps. Despite the \$166 million outflow, high yield felt bid during the week (higher stocks did not hurt) and recent new issues have performed well. Fidelity National priced a \$1.1 billion Ba2/BB- deal late Friday at 7 5/8% (down from “low 8s” initial price talk) and it promptly traded higher on the break to \$103 bid (7%).

All eyes turn to earnings over the next few weeks and outlooks will be the key focus. S&P 500 2010 estimated operating earnings are currently \$81.60, rising to \$95.68 and \$109.67 in 2011 and 2012, respectively. As former Merrill Lynch economist David Rosenberg points out, this means that 2011 will break the 2008 record of \$88 by a healthy margin with “nominal GDP rising at a 3.0-4.0% annual rate at best in the next six quarters and at a time when margins are already back to cycle peaks.” The bottom line is that stocks and Treasury bonds seem to be implying complete opposite scenarios.

Performance for the week

	Yield %	Spread		WTD
	7/9	7/2	7/9	Change
High Yield	8.88	732 bp	713 bp	-19 bp
Split BBB	6.43	433 bp	426 bp	-7 bp
BB	7.43	525 bp	510 bp	-15 bp
B	10.56	731 bp	706 bp	-25 bp
CCC	13.27	1,185 bp	1,160 bp	-25 bp
BB/B		206 bp	197 bp	-9 bp
CCC/B		454 bp	454 bp	0 bp
5-yr UST		182 bp	184 bp	2 bp

Source: JPMorgan, Bloomberg

New Issues / Fund Flows

- High yield bond mutual funds saw outflows of \$166 million
- Leveraged loan mutual funds saw inflows of \$39 million
- Nine bond deals priced, totaling \$4.7 billion
- Two loan deals priced, totaling \$1.8 billion

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