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Fixed Income Commentary

High Yield Holds Up as Equities Fall

Earnings season finally kicked off when Alcoa reported decent results Monday that exceeded reduced expectations. While leverage declined to 4.4x and they will likely avoid a downgrade to junk, the stock is down 39% from its highs in January and the aluminum spot price is down 21% from April. Thus, while results beat expectations, a lot of bad news was already priced into the market. In general, earnings were pretty good from Citigroup, JPMorgan Chase and GE, but the focus was clearly on weaker economic data in the equity markets as positive news from BP and Goldman Sachs failed to produce a rally. The S&P fell 32 points on Friday, erasing a solid week of gains, to end the week down 13 points (-1.2%). Despite the weakness in equities, high yield performed well and was relatively unfazed by Friday's weakness.

The high yield market returned 1.0% last week and recent new issues have been a food fight given the recent inflows. Last week's \$1.3 billion inflow was the second \$1 billion+ inflow in the last month and the second largest in seven years, providing a nice bid to the limited new issuance and secondary levels as well. In fact, high yield spreads ended the week 5 basis points tighter, continuing the recent theme of credit outperforming stocks. From 6/11 to 7/16, high yield bonds returned 3.9% while the S&P 500 declined 2.4%. Nevertheless, risky assets have generally moved sideways since May, which reflects the large degree of uncertainty in the market.

Will the European bank stress tests coming later this week produce the same result as the 2009 U.S. bank stress tests? Will earnings continue to impress and meet high expectations

(record profits projected for 2011)? Or will fears of slower economic growth begin to produce a negative feedback loop that helps put the fragile recovery on hold? Answers to these questions may take some time as de-leveraging following a financial crisis typically takes more time than a normal recession.

Performance for the week

	Yield %	Spread		WTD
	7/16	7/9	7/16	Change
High Yield	8.67	713 bp	708 bp	-5 bp
Split BBB	6.24	426 bp	418 bp	-8 bp
BB	7.18	510 bp	504 bp	-6 bp
B	8.58	706 bp	708 bp	1 bp
CCC	13.04	1,160 bp	1,152 bp	-8 bp
BB/B		197 bp	204 bp	7 bp
CCC/B		454 bp	444 bp	-9 bp
5-yr UST		182 bp	184 bp	2 bp

Source: JPMorgan, Bloomberg

New Issues / Fund Flows

- Five bond deals priced, totaling \$2.8 billion
- High yield bond mutual funds +\$1.3 billion
- Leveraged loan mutual funds +\$41 million

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