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ANALYTICS

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Decisions


# Credit Markets Today and Beyond

John Lonski, Chief Market Economist, Moody's Analytics  
Glenn Levine, CreditEdge Research, Moody's Analytics


November 21, 2019

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## Today's Speakers



Presenter  
**John Lonski**  
Chief Market Economist



Presenter  
**Glenn Levine**  
CreditEdge Research

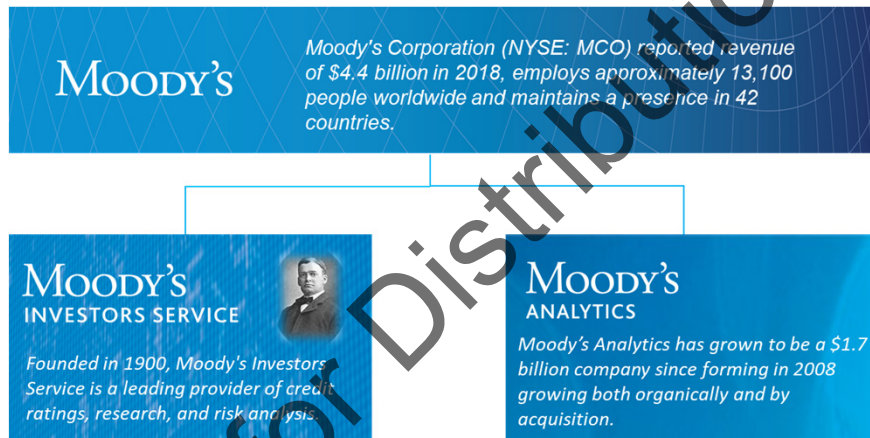


Moderator  
**Ryan Donahue**  
CreditEdge Product Team

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## CreditEdge webinar on December 3



### Environmental, Social & Governance & Credit Risk

Ideas for Fixed Income Investors

December 3, 2019 | 10 am EST | 3 pm GMT  
Webinar

Register at

[www.moodyanalytics.com/events](http://www.moodyanalytics.com/events)

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## Agenda

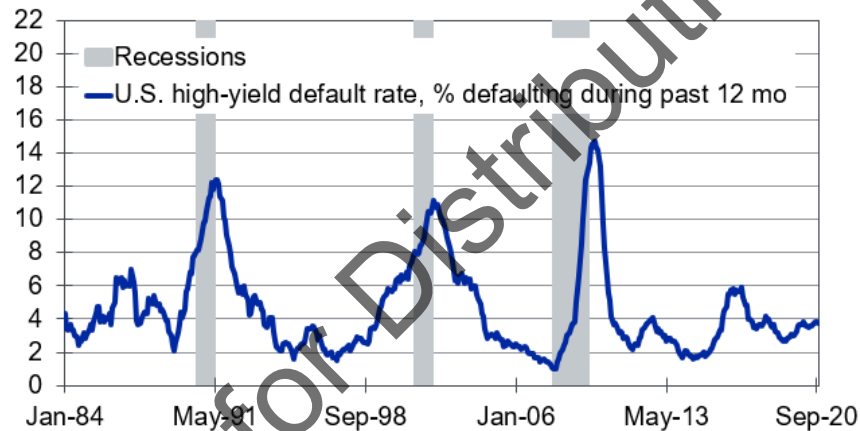
1. What are the financial markets telling us?
2. Which sectors are exposed to a recession?
3. Tools to prepare for the next recession
4. Q&A

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# 1

What are the financial  
markets telling us?

## Each Recent Recession Led to a U.S. High-Yield Default Rate of at least 11%



Sources: Moody's Investors Service, NBER, Moody's Analytics

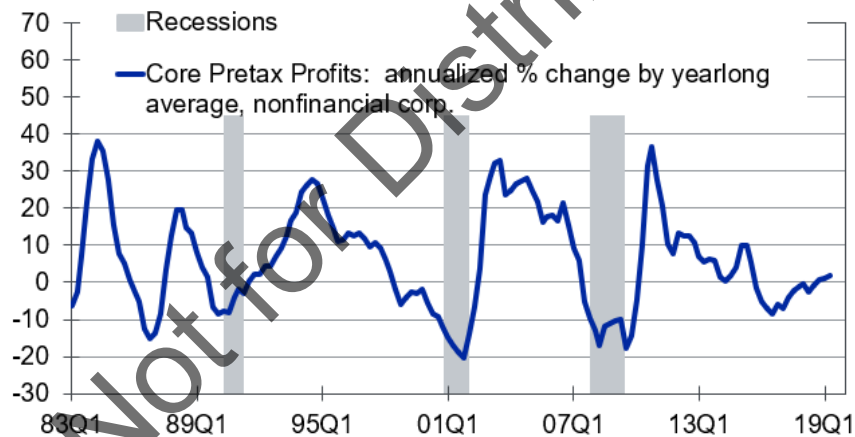
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## Contraction of Profits Preceded Each Previous Recession



Sources: BEA, NBER, Moody's Analytics

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## Recent Yield Curve Inversion Resembled that of 1998, as Opposed to Inversions of 1999-2000 and 2006-2007



Sources: Federal Reserve, NBER, Moody's Analytics

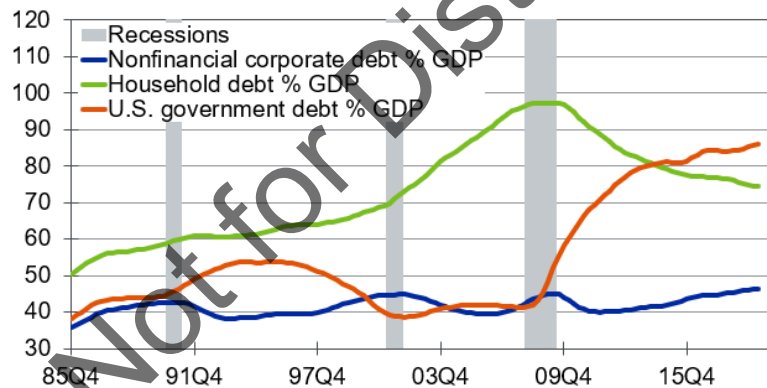
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## Latest Rise by U.S. Nonfinancial-Sector Debt Seems Very Mild Compared to 2002-2007's Surge by Household-Sector Debt



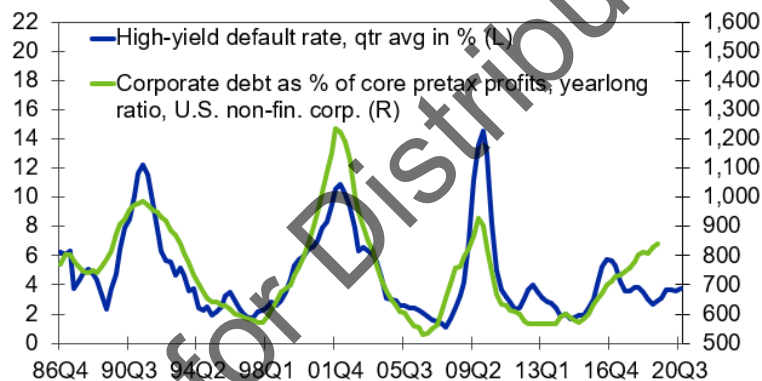
Sources: Federal Reserve, NBER, Moody's Analytics

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## Historically High Ratio of Nonfinancial-Corp. Debt to Core Pretax Profits Warns of a Higher Default Rate



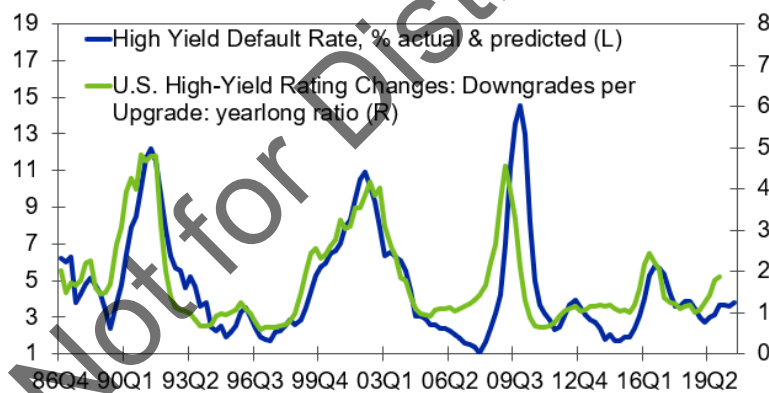
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## 2019's High-Yield Downgrade per Upgrade Ratio Favors a 4.8% Midpoint for Fourth-Quarter 2020's Default Rate

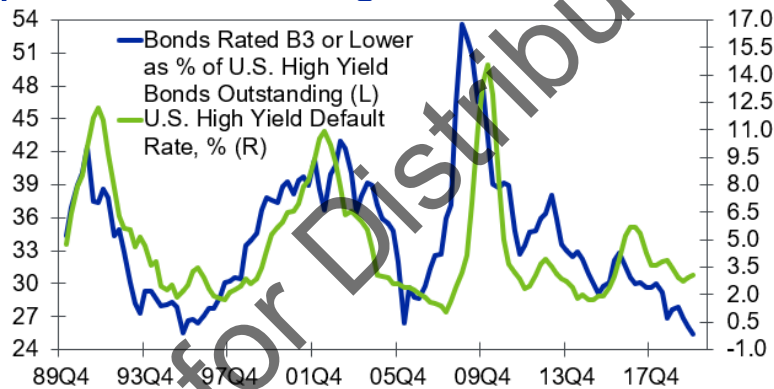


Sources: Moody's Investors Service, Moody's Analytics

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## Record Low Ratio of Riskier Bonds to U.S. High-Yield Corporate Bonds Outstanding May Help to Contain High-Yield Default Rate



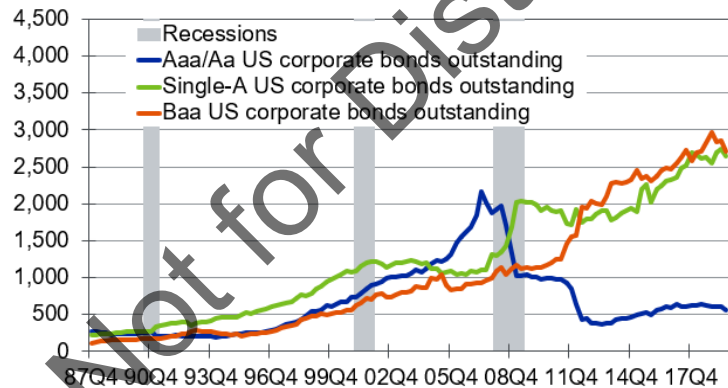
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## Avg Cumulative Five-Year Default Rates Are 0.25% for Aaa/Aa, 0.77% for Single-A, 1.50% for Baa, and 19.12% for High-Yield

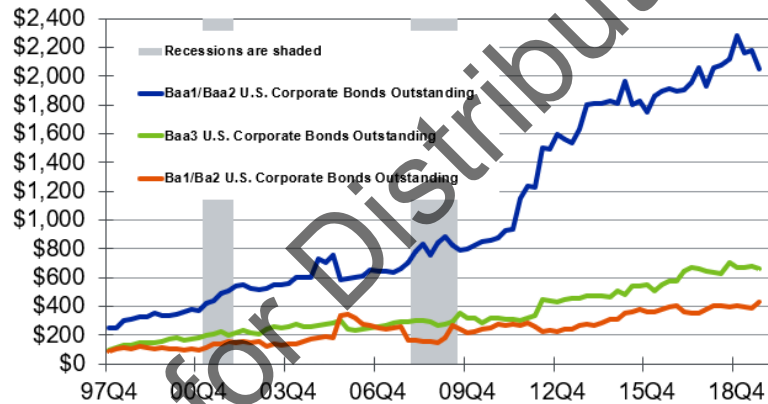


Sources: BEA, NBER, Moody's Analytics

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## Baa3 Drops from 2007's 30% to Recent 24% of Outstanding Baa-Grade U.S. Corporate Bonds



Sources: Moody's Investors Service, Moody's Analytics

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## Recessions Start After Unemployment Rate's 3-month Average Turns Higher



Sources: Bureau of Labor Statistics, NBER, Moody's Analytics

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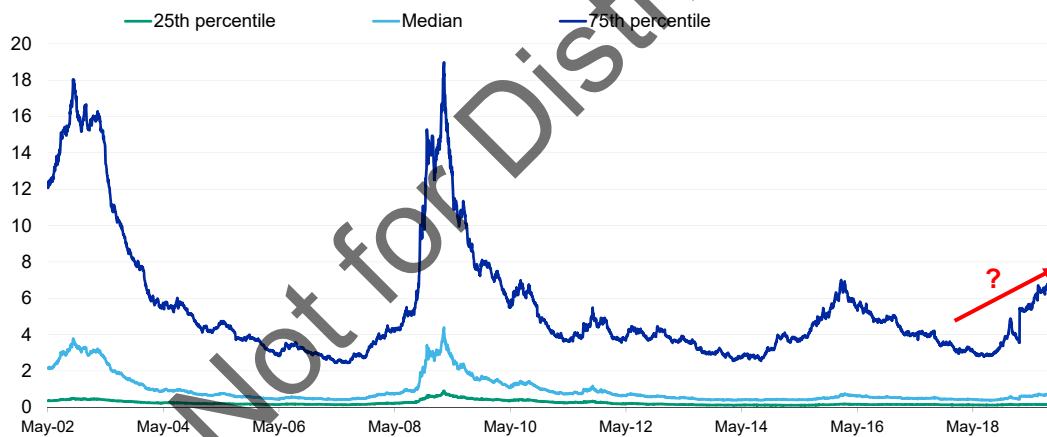
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Which sectors are exposed to a recession?

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## How risky is the corporate sector?

Distribution of 1-year EDF, North American firms

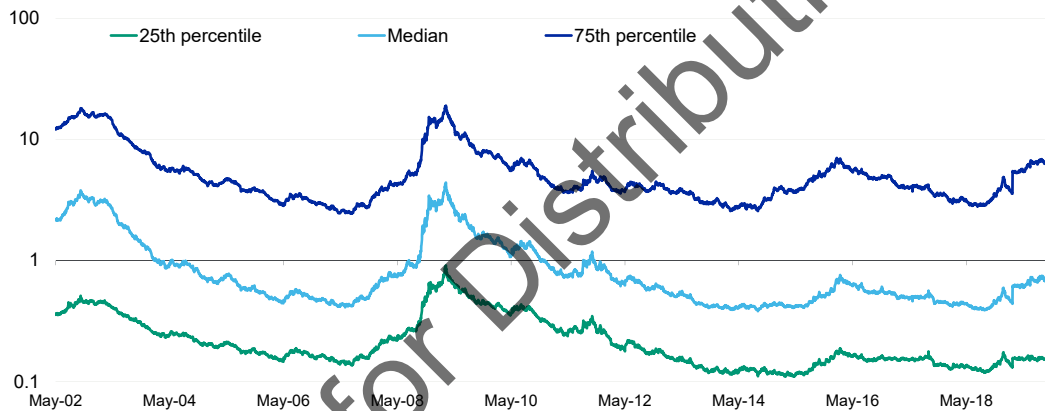


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## Credit risk is increasing among the riskiest segment

Distribution of 1-year EDF, North American firms

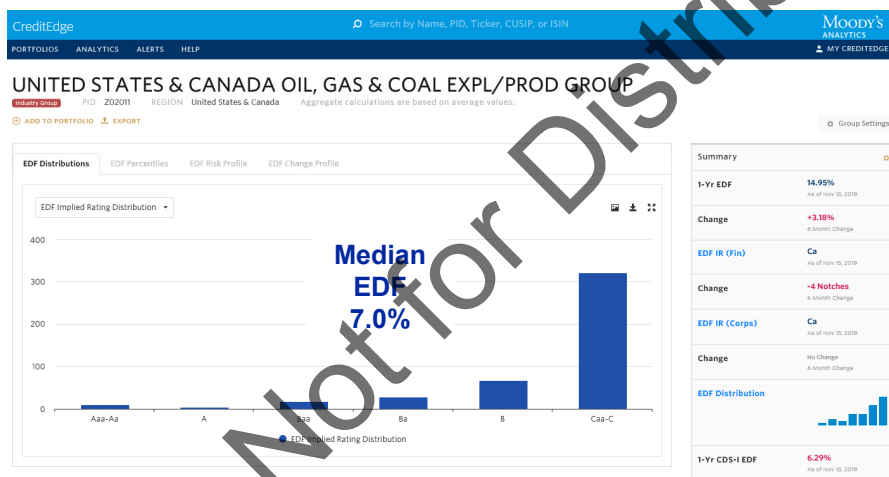


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## Which are the riskiest industries right now?



Median EDF

Telephone 4.1%

Mining 3.9%

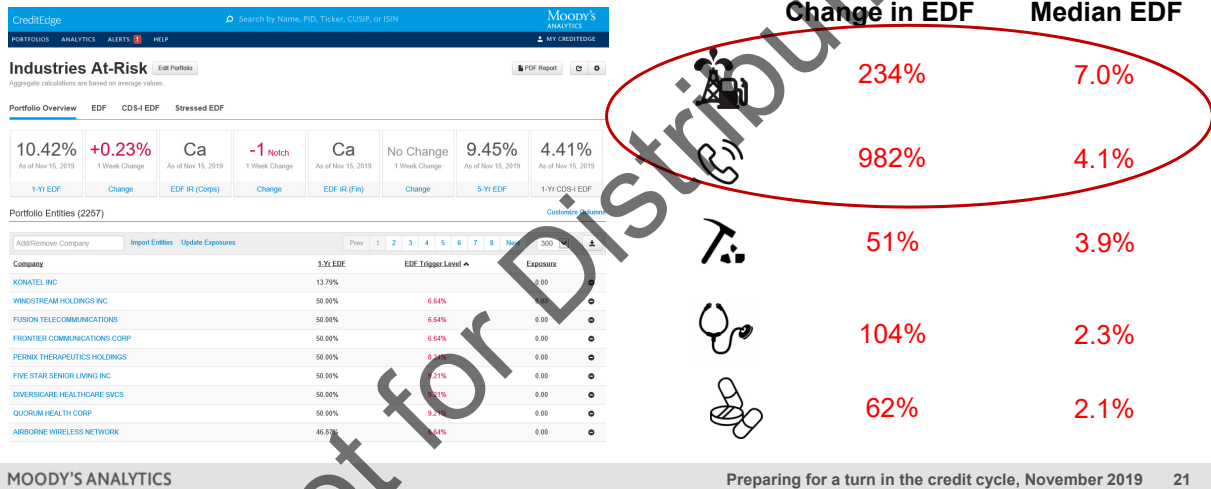
Medical services 2.3%

Pharmaceuticals 2.1%

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## Which industries have seen the biggest increase in risk since mid-2018?



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## Tools to prepare for the next recession

## Stress testing your C&I loan book

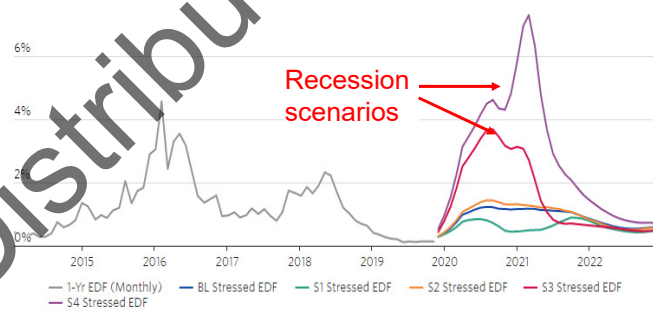
### SPRINT CORP

PID 913025 TICKER NYS-S TYPE CORP COUNTRY UNITED STATES INDUSTRY TELEPHONE

#### What-if calculator



#### Stressed EDF



	Current	Override
Short-Term Liabilities	11,289.00	21,289.00
Long-Term Liabilities	43,526.00	43,526.00

Company adds debt

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## Cyclical industries that are already struggling will do poorly in a recession

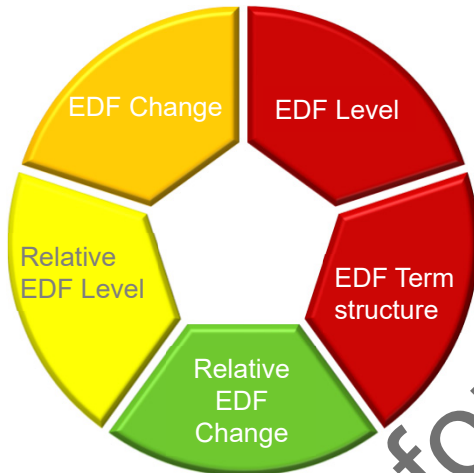
Share of investment grade implied rating, recession scenario

Industry	IG share (current)	IG share (recession scenario)
Oil, gas & coal expl/prod	22%	6%
Telecommunications	42%	25%
Mining	22%	4%
Pharmaceuticals	29%	9%
Medical services	45%	21%
<b>Overall</b>	<b>52%</b>	<b>21%</b>

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## A toolkit for monitoring credit risk



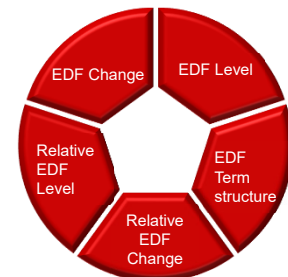
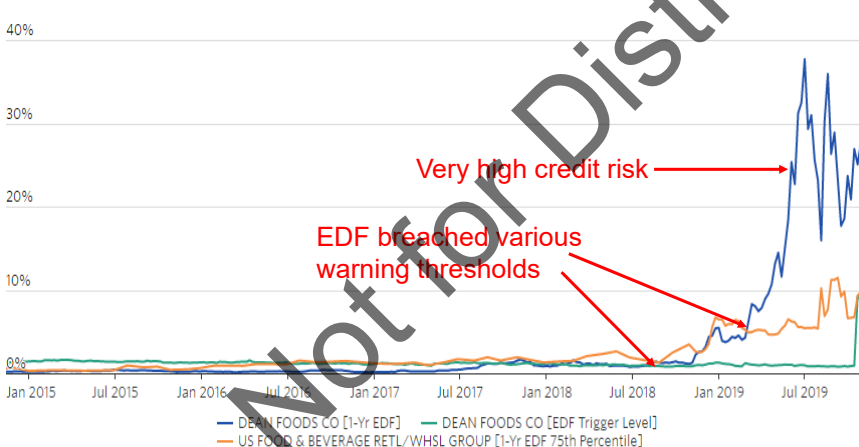
- ✓ We use the “traffic light” approach to monitor credit risk along multiple dimensions
- ✓ This toolkit can help credit risk managers make better decisions, faster

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## Dean Foods filed for bankruptcy last week (Nov 12) – were there warning signs?



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## The Early Warning Toolkit allows you to efficiently monitor your portfolio of exposures

Firm Name	Exposure Amount	EDF Implied Rating	1Y EDF	Deterioration Probability	1Y EDF Above Trigger Level	1Y EDF Change	Term Structure Inversion	Relative 1Y EDF	Relative 1Y EDF Change
Dean Foods Company	527,471.00	C	43.05%	70.00%	Yes	Deteriorating	Yes	Above 90th Pctl	Deteriorating
Akorn, Inc.	656,763.00	Ca	11.92%	47.69%	Yes	Deteriorating	Yes	75th Pctl < 90th Pctl	Improving
Lannett Company, Inc.	246,959.00	Caa3	9.30%	34.92%	No	Improving	Yes	50th Pctl < 75th Pctl	Improving
Fossil Group, Inc.	837,975.00	Caa3	8.30%	27.15%	Yes	Deteriorating	Yes	75th Pctl < 90th Pctl	Improving
AMAG Pharmaceuticals, Inc.	176,127.00	Caa2	3.38%	25.62%	No	Deteriorating	No	50th Pctl < 75th Pctl	Deteriorating
Revlon Consumer Products Corpo	364,844.00	Caa1	2.97%	15.44%	No	Deteriorating	No	50th Pctl < 75th Pctl	Improving
Bausch Health Companies Inc.	791,308.00	Caa1	2.07%	9.16%	No	Improving	No	25th Pctl < 50th Pctl	Improving
Mylan N.V.	466,683.00	B3	1.37%	3.87%	No	Deteriorating	Yes	25th Pctl < 50th Pctl	Deteriorating
Mattel, Inc.	806,742.00	B3	1.22%	16.18%	No	Deteriorating	Yes	50th Pctl < 75th Pctl	Improving
Samsonite International S.A.	274,790.00	B3	0.94%	13.17%	No	Deteriorating	No	50th Pctl < 75th Pctl	Improving
Avon Products, Inc.	727,755.00	B2	0.77%	10.44%	No	Improving	No	75th Pctl < 90th Pctl	Improving
Owens-Illinois Inc.	428,489.00	B2	0.60%	11.23%	No	Deteriorating	No	25th Pctl < 50th Pctl	Improving
Phibro Animal Health Corporatio	175,416.00	B1	0.43%	10.52%	No	Deteriorating	No	Below 25th Pctl	No Change
Frigoglass SAIC	701,887.00	B1	0.30%	10.09%	No	Improving	No	50th Pctl < 75th Pctl	Improving
Harley-Davidson, Inc.	559,466.00	Ba3	0.24%	7.81%	No	Deteriorating	No	25th Pctl < 50th Pctl	Improving
Yamaha Motor Company Limited	945,815.00	Ba2	0.16%	5.16%	No	Improving	No	50th Pctl < 75th Pctl	Improving
Piaggio & C. S.p.A.	763,761.00	Ba2	0.10%	6.71%	No	Improving	No	25th Pctl < 50th Pctl	Improving
Edgewell Personal Care Co.	232,335.00	Ba2	0.10%	8.36%	No	Deteriorating	No	25th Pctl < 50th Pctl	Deteriorating
Hikma Pharmaceuticals PLC	159,168.00	Ba1	0.07%	8.21%	No	Deteriorating	No	25th Pctl < 50th Pctl	Improving

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