GLOBAL CREDIT STRATEGY: It's complicated

"Our views are diverse across regions and markets, reflecting the very different credit cycles we observe. We remain concerned about U.S. high-yield releveraging, which underpins our bearish views. But, we believe the growth of the foreign buyer will be a powerful tailwind for U.S. investment-grade credit next year."

– Barnaby Martin, Head of European Credit Strategy

Our view

U.S. makes the grade: Our optimism is highest for U.S. high grade, which has attractive valuations and improved fundamentals. The latter quality was missing in the summer as companies raced to beat the Federal Reserve's anticipated rate increase; as the Fed acts, that quirk should disappear. U.S. high grade also benefits from global weakness: persistent yield differentials between U.S. and other nations should drive foreign investors into the American fold. Our total return forecast: 3 to 4 percent.

High-yield slide: We believe high yield will be the biggest underperformer in 2016, as poor fundamentals, liquidity and investor sentiment outweigh the potential for reach for yield behavior. We expect high yield to drop 2 to 3 percent in 2016. Non-commodity sectors could fall by only 0.5 percent, while energy, metals and mining may plunge by more than 11 percent. Defaults might also rise to 5 to 6 percent on an issuer and par basis, with commodity issuers again leading the downward trend. On the other hand, we look for loans to outperform, possibly rising by 2 to 3 percent.

Emerging market split: This could be a tough year for credits in emerging markets, with stark divergence in returns from nation to nation. We still forecast positive overall results, with a 4.0 percent total return for high yield and 2.5 percent for investment grade.

Key calls

- **United States:** In U.S. high yield, we favor loans over bonds; companies emphasizing capex; domestically focused issuers, and small-cap firms. In high grade, we are overweight industrials and energy, underweight banks. 30-year corporates may return 6 to 7 percent.
- **Europe:** We favor BBBs over As because we believe high-quality bonds are at risk from one-off events. We prefer bank hybrids over corporate hybrids. In high yield, single Bs stand out against BBs.
- **Asia:** In the high-grade area, we prefer corporates to banks, and bank capital to senior banks. And, we like single As and BBB+ bonds.
- **Emerging markets:** Among regions, we're overweight on Latin America, neutral on emerging Europe, and underweight on Asia.