

**WEEKLY
MARKET OUTLOOK**

Moody's Analytics Research

Weekly Market Outlook Contributors:

Moody's Analytics/New York:

John Lonski
Chief Economist
1.212.553.7144
john.lonski@moodys.com

Yukyung Choi
Quantitative Research

Moody's Analytics/Asia-Pacific:

Shahana Mukherjee
Economist

Moody's Analytics/Europe:

Barbara Araujo Teixeira
Economist

Moody's Analytics/U.S.:

Damien Moore
Chief Economist

Steven Shields
Economist

Editor

Reid Kanaley

Contact: help@economy.com

Corporate Bond Issuance Boom May Steady Credit Quality, On Balance

Credit Markets Review and Outlook by John Lonski

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The Week Ahead

We preview economic reports and forecasts from the US, UK/Europe, and Asia/Pacific regions.

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The Long View

Full updated stories and key credit market metrics: Scary markets may frighten Congress into delivering stimulus.

Credit Spreads	<u>Investment Grade</u> : Year-end 2020's average investment grade bond spread may resemble its recent 138 basis points. <u>High Yield</u> : The high-yield spread may top its recent 552 bp by year-end 2020.
Defaults	<u>US HY default rate</u> : According to Moody's Investors Service, the U.S.' trailing 12-month high-yield default rate jumped from August 2019's 3.1% to August 2020's 8.7% and may average 10.6% during 2020's final quarter.
Issuance	<u>For 2019's</u> offerings of US\$-denominated corporate bonds, IG bond issuance rose by 2.6% to \$1.309 trillion, while high-yield bond issuance surged by 55.8% to \$432 billion. <u>In 2020</u> , US\$-denominated corporate bond issuance is expected to soar higher by 52.4% for IG to \$1.995 trillion, while high-yield supply may rise 21.5% to \$526 billion.

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Ratings Round-Up

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Credit spreads, CDS movers, issuance.

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Moody's Capital Markets Research recent publications

Links to commentaries on: Default rate, volatility, credit quality, unprecedented stimulus, bond yields, record savings rates, demographic change, high tech, complacency, Fed intervention, speculation, risk, credit stress, rate cuts, optimism, coronavirus, corporate credit, spreads, leverage, VIX.

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[Click here for Moody's Credit Outlook](#), our sister publication containing Moody's rating agency analysis of recent news events, summaries of recent rating changes, and summaries of recent research.

Credit Markets Review and Outlook

Credit Markets Review and Outlook

By John Lonski, Chief Economist, Moody's Capital Markets Research, Inc.

Corporate Bond Issuance Boom May Steady Credit Quality, On Balance

Corporate bond issuance by U.S. companies continues to boom. Not even heightened equity market volatility was able to materially slow borrowing by investment-grade corporates. In terms of a moving 12-month sum, the issuance of investment-grade bonds by U.S. companies advanced 70% year-over-year to a record high \$1.508 trillion for the year-ended August 2020.

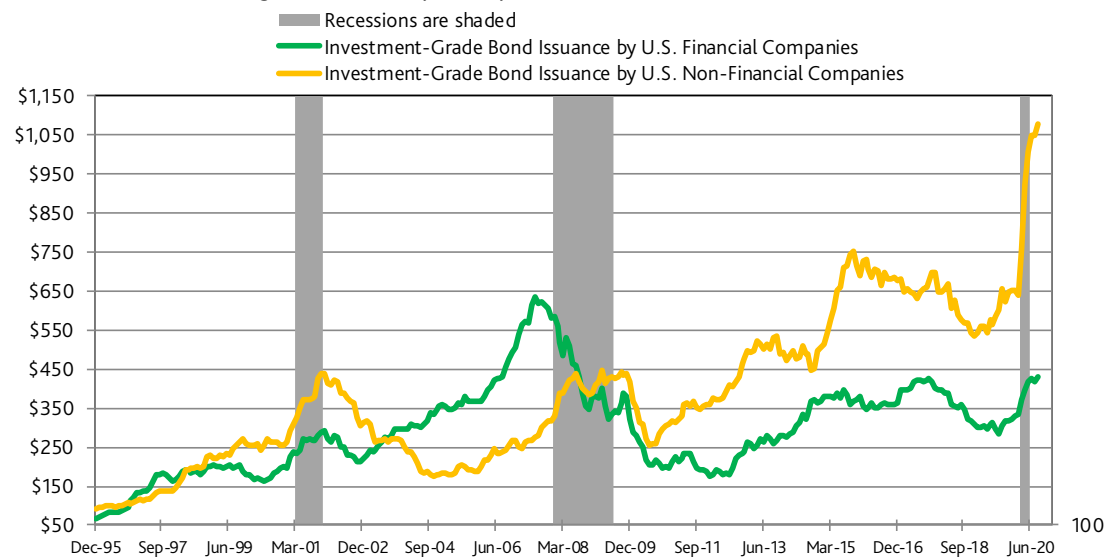
Prior to 2020, the former zenith was the significantly lower \$1.113 trillion of the span-ended November 2017. However, for the 12-months-ended November 2018, such IG bond issuance had contracted by 23% to \$859 billion.

U.S. nonfinancial companies have led the latest surge by IG bond offerings. During the year-ended August 2020, the 79% annual advance by the bond issuance of U.S. nonfinancial companies to a record \$1.078 trillion well outran the accompanying 51% annual increase by U.S. financial companies to \$430 billion.

The story was far different prior to 2008-2009's financial crisis. From June 2003 through August 2008, the moving 12-month sum of IG bond issuance by U.S. financial institutions exceeded that of nonfinancial companies. When financial company issuance set its record high at the \$634 billion of the year-ended June 2007, nonfinancial company issuance was a much smaller \$276 billion. From June 2003 through June 2007, the average annualized growth rates for investment-grade issuance were 25% for financial companies and 1% for nonfinancial companies. The ensuing financial crisis revealed that 2003-2007's surge by financial company bond issuance was fundamentally overdone.

Figure 1: August 2020's Yearlong Sum for Investment-Grade Bond Issuance by U.S. Nonfinancial Companies Soared Higher by 79% YY to Record \$1.078 Trillion
moving 12-month sums in \$ billions

sources: Dealogic, NBER, Moody's Analytics



West European IG Corporate Bond Supply Remains Well Under 2009's Zenith

Investment-grade bond issuance by West European companies has been relatively muted compared to their American counterparts. For the 12-months-ended August, IG bond offerings from West European companies rose by 5% annually to \$927 billion, wherein issuance by financial institutions sank by 14% to \$473 billion and offerings from nonfinancial companies advanced by 35% to \$454 billion.

Credit Markets Review and Outlook

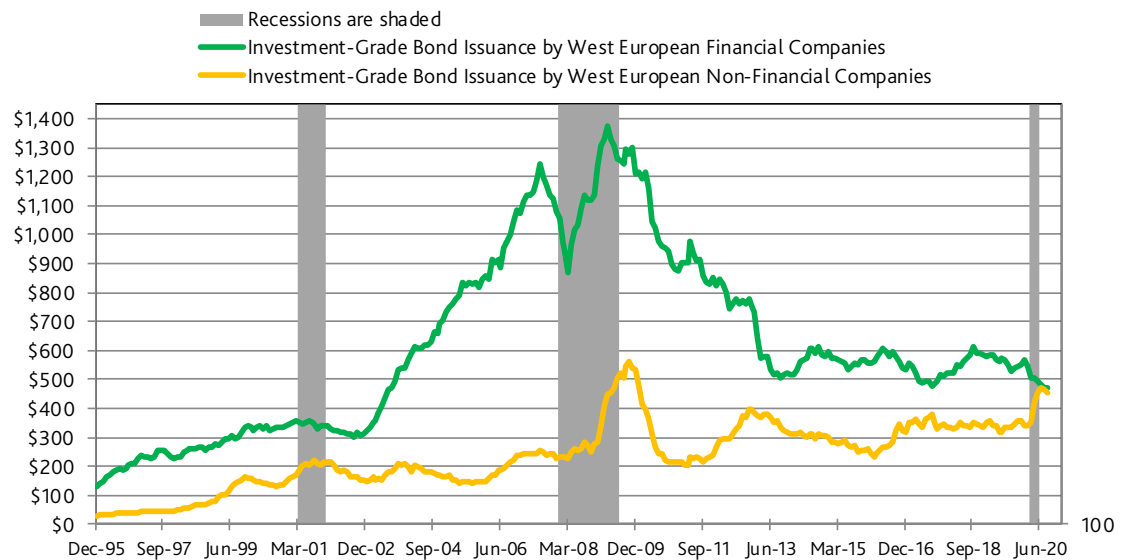
The record high 12-month sum for West European IG corporate bond issuance was set back in November 2009 at \$1.842 trillion. Government backing that stemmed from the Great Recession helps to explain that record high. The 12-month IG bond issuance by West European financial companies peaked at the \$1.371 trillion of March 2009, while comparable nonfinancial-company bond offerings crested at the \$563 billion of October 2009.

Note that much unlike the U.S., West European investment-grade corporate bond issuance has almost always been led by financial institutions. However, recent data suggest that nonfinancial companies might soon take the lead.

Figure 2: August 2020's Yearlong Sum for Investment-Grade Bond Issuance by West European Financial Companies Was 60% Under 2006-2009's Average

moving 12-month sums in \$ billions

sources: Dealogic, NBER, Moody's Analytics



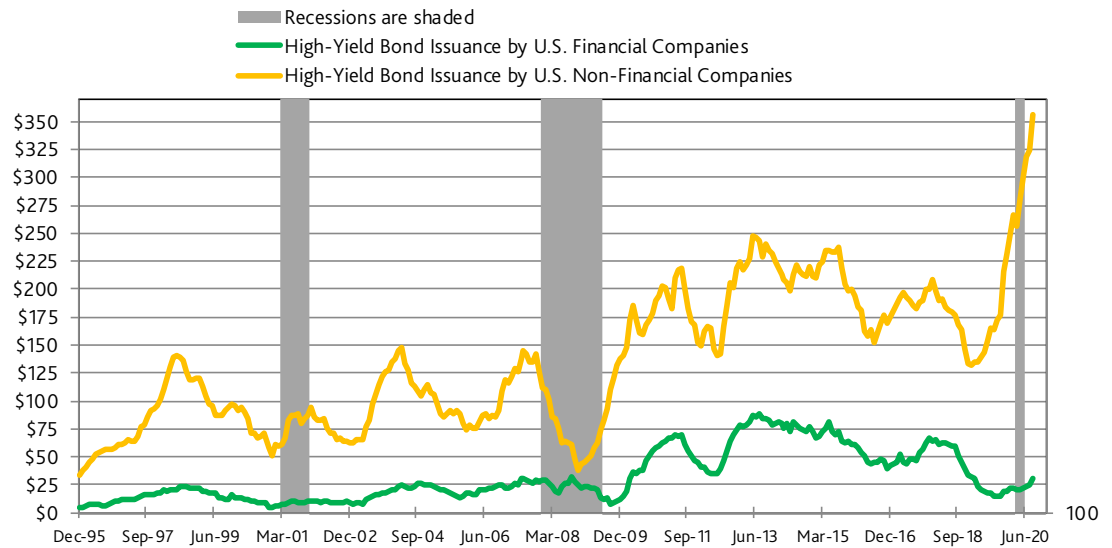
U.S. High-Yield Bond Issuance Skyrockets by 119% Y/Y for 12-Months-Ended August

No one dared to predict back in March of this year that high-yield bond issuance by U.S. companies was about to lift-off in a manner seldom seen before. More specifically, during the 12-months-ended August 2020, the issuance of HY corporate bonds by U.S. businesses skyrocketed 119% annually to a record-high \$387 billion.

Leading the charge was the 119% annual surge by HY bond offerings from nonfinancial companies to a record-high \$357 billion. Though HY bond offerings from U.S. financial companies advanced 118%, the \$31 billion total for the 12-months-ended August was far less than July 2013's zenith of \$89 billion.

Credit Markets Review and Outlook

Figure 3: Yearlong Sum for High-Yield Bond Issuance by U.S. Nonfinancial Companies Set a New Record High as of August 2020
 moving 12-month sums in \$ billions
 source: Dealogic, NBER, Moody's Analytics

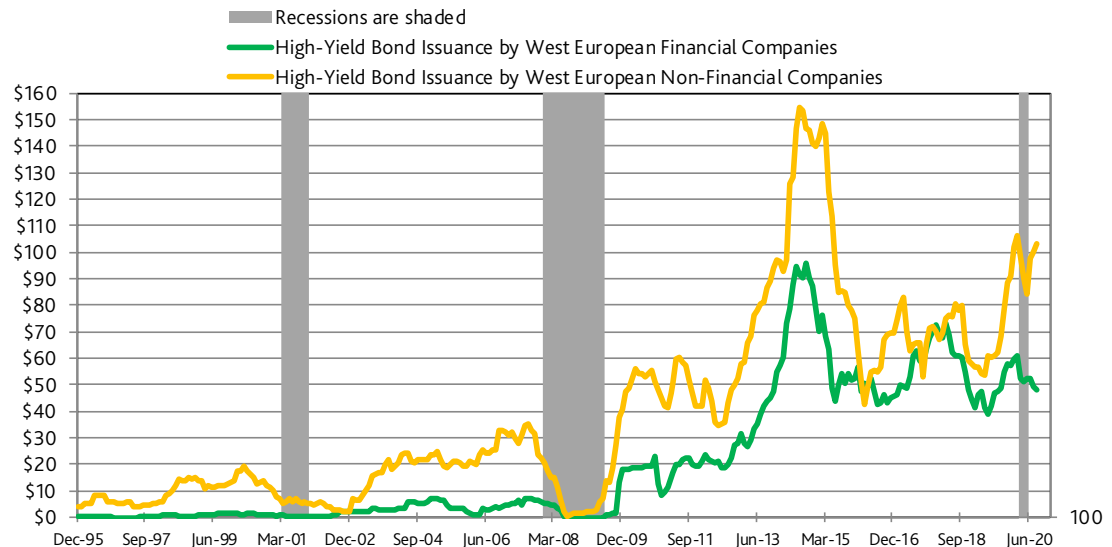


High-Yield Bond Offerings from West European Issuers Grow Briskly from a Low Base

High-yield bond offerings from West European companies increased by 38% annually to \$152 billion for the 12-months-ended August. The latter was far under July 2014's record high of \$246 billion.

Unlike the U.S., financial institutions are more prominent among West European issuers of HY bonds. For the year-ended August, HY bonds issued by financial companies edged up by 2% annually to \$48 billion, while new HY bond supply from nonfinancial companies surged higher by 65% annually to \$103 billion. Both were far under their respective record highs of \$96 billion for financial companies (set in September 2014) and \$154 billion for nonfinancial companies (July 2014). Though HY bond offerings from West European nonfinancial companies will probably set a new zenith by 2027, the same cannot be said for financial companies.

Figure 4: Financial Companies Account for 32% of West European High-Yield Bond Issuance Versus Just 8% of U.S. High-Yield Bond Offerings
 moving 12-month sums in \$ billions
 sources: Dealogic, NBER, Moody's Analytics



Credit Markets Review and Outlook

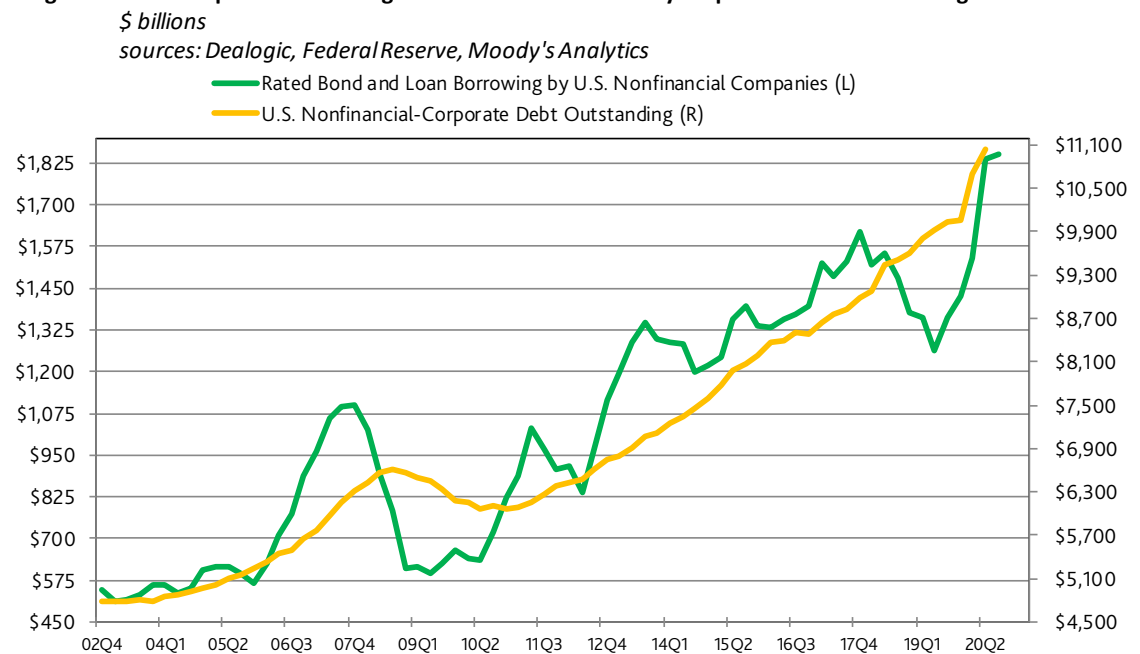
Elevated Ratio of Borrowing to Outstanding Debt Limits Upside for U.S. Borrowing

For the third quarter to date, the rated borrowing by U.S. nonfinancial companies (IG plus HY corporate bond offerings plus newly rated loans) approximates 18.4% of third-quarter 2019's \$10.039 trillion of outstanding U.S. nonfinancial-corporate debt. The ratio is less than the record-high 20.4% of 2013's third quarter, but significantly above the long-term median of 15.3%.

For the 19 quarters where the ratio of rated borrowing to the nonfinancial-corporate debt of a year earlier was between 17.5% and 20%, the yearlong sum of rated borrowing one year later would decline annually for 68% of the observations. For the 19 cited quarters, the median annual percent change showed a decline of 3.2% where the five highest percent changes averaged 6% and five lowest showed an average annual contraction of 29%.

The outstandings of U.S. nonfinancial corporate debt equaled an unprecedented \$11.041 trillion as of 2020's second quarter. If corporate borrowing were to suddenly return to its long-term median of 15.3% of debt during then gross nonfinancial corporate borrowing would drop to \$1.7 trillion for the 12-months-ended June 2021 for a prospective year-over-year decline of 8%.

Figure 5: Gross Corporate Borrowing Follows the Trend Taken by Corporate Debt Outstanding

**Bond Issuance Surge Lengthens Maturities to the Benefit of Credit Quality**

To a considerable degree, the latest upswing by U.S. corporate bond issuance has refinanced outstanding shorter-term and variable-rate debt consisting of loans and commercial paper. The lengthening of maturities often at borrowing costs not seen in decades has enhanced financial flexibility.

For U.S. nonfinancial companies, the ratio of short-term debt to total corporate debt rose from a first-quarter 2017 low of 27.1% to the 33.0% of 2020's first quarter. The corporate bond issuance surge helped to lower the ratio to 31.1% in the second quarter and, in all likelihood, the ratio continues to decline. Following the Great Recession, the ratio eventually sank from a third-quarter 2008 high of 35.1% to the 24.9% bottom of 2010's final quarter.

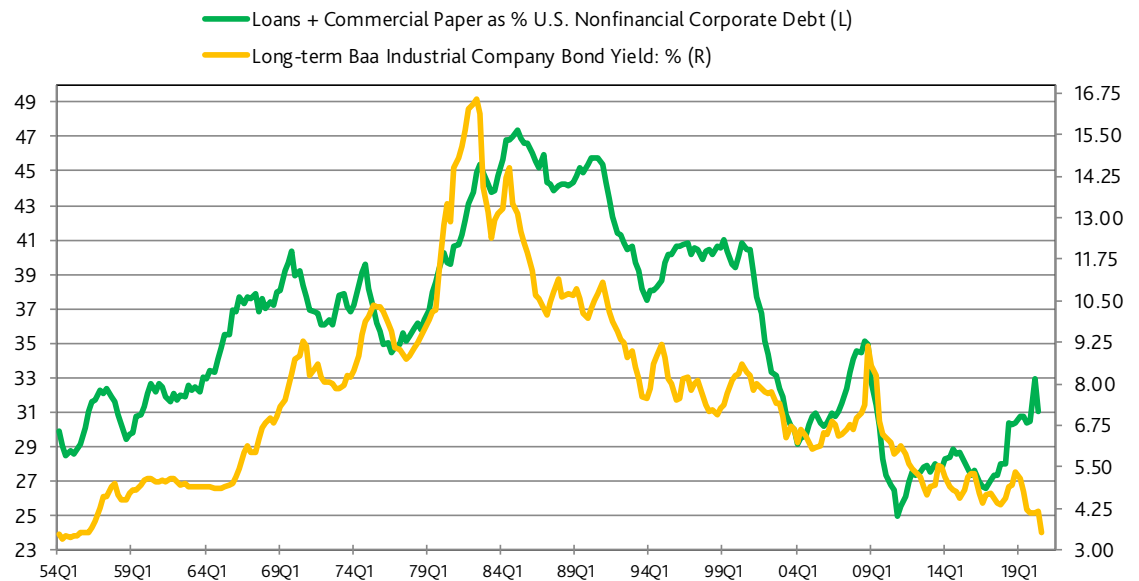
A notable drop by medium-grade corporate bond yields has facilitated the "terming out" of corporate debt. Moody's Analytics' long-term Baa industrial company bond yield has dropped from a fourth-quarter 2019 average of 4.08% to the 3.52% average of the third quarter to date. Not since 1955 has the quarter-long average of the Baa industrial yield been this low.

In stark contrast, the Great Recession saw the Baa industrial yield soar from a fourth-quarter 2006 low of 6.45% to a fourth-quarter 2008 high of 9.12%. That helps to explain why financial markets have fared so much better in the COVID-19 recession compared with the Great Recession.

Credit Markets Review and Outlook

Figure 6: Lowest Long-term Baa Industrial Company Bond Yield since 1955 Helps Lower Ratio of Loans + CP to Total Corporate Debt

sources: Moody's Analytics, Federal Reserve Financial Accounts of U.S.



Terminating Out of Corporate Debt Hints of De-Leveraging

The sum of the outstandings of bank-held commercial and industrial loans plus nonfinancial-company commercial paper soared higher by a sample record-high of 21% from a year earlier during 2020's second quarter. The latter helps to explain why second-quarter 2020's nonfinancial-corporate debt advanced 11.2% yearly to a record-high \$11.04 trillion. The drive to secure cash in response to an unprecedented shutdown of global business activity of unknown duration stoked the second-quarter's ascent by corporate debt.

A subsequent decline by the sum of C&I loans plus CP from May's record-high favors slower growth ahead by corporate debt. An outright shrinkage of corporate debt is likely according to how corporate debt contracted following each of the last three recessions to the benefit of corporate credit quality.

For example, the annual percent change of U.S. nonfinancial-corporate debt sank immediately after the Great Recession. After peaking at the 11.4% of the span-ended June 2008, the moving yearlong average of corporate debt slowed to a 2.7% rise by June 2009 before contracting 5.2% annually for the span-ended June 2010.

The Week Ahead – U.S., Europe, Asia-Pacific

THE U.S.

By Damien Moore of Moody's Analytics

Riding High on Equities

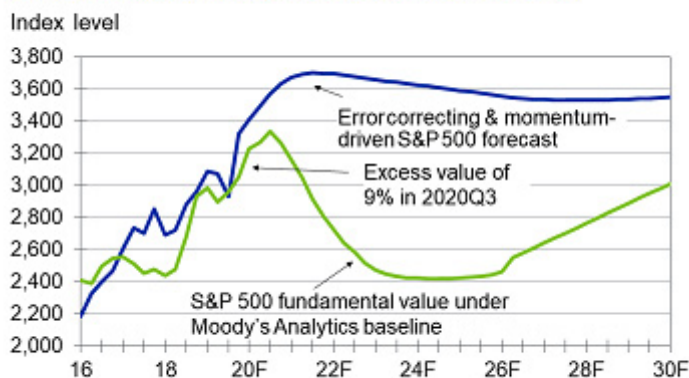
Despite an economy that is struggling to rebound from COVID-19 woes, the pandemic-defying stock market hit an all-time high before experiencing a mild correction in early September. After almost topping 3,600 points in early September, the Standard & Poor's 500 retreated 7% from September 2 to September 8. The VIX climbed into the 30s over that period but has stabilized back to the low-20s levels that it has averaged since mid-July. The yield on 10-year Treasury securities remained steady at 0.7%, mirroring the low or negative yields in most of the developed world. Credit spreads on corporate debt and other instruments remain low thanks in part to the backstop provided by the Federal Reserve's emergency lending programs.

Fundamentals support high values

The S&P 500 price-earnings ratio is currently around 29, sufficiently above the historical average of 22 that has many pundits shouting "bubble." But the combination of extraordinarily low long-term interest rates and the unusual nature of the downturn supports a high multiple. Low long-term interest rates reduce the hurdle rate for all long-term investments, including equities, and thereby raise the price that can be supported by a given level of earnings. Furthermore, the COVID-19 recovery is expected to produce a strong recovery in profitability, and it is longer-term, not current, profitability that ultimately determines the sustainability of a given market valuation.

Moody's Analytics constructed a discounted cash flow measure of fundamental value that incorporates the effects of earnings and interest rates. To construct the measure, Moody's Analytics regressed the index value on current earnings divided by the Treasury rate plus an estimate of the equity risk premium, fixed at 3.5%, and kept the fitted values. The value of the index compared with the fitted value of the metric indicates how over- or undervalued each measure is relative to fundamental value. At an index value of around 3,400 late in the third quarter of 2020 and a fundamental of around 3,050, the market is around 9% overvalued.

Overvalued Now, More So in Future



Source: Moody's Analytics

The Week Ahead

According to Moody's Analytics earnings and interest rate forecasts, current valuation will not be supported by the fundamentals for long. Though corporate profits will exhibit some impressive growth over the next couple of quarters, the rate of growth will level off afterward. Long-term interest rates will steadily increase from 2021 onward, with the 10-year rate reaching 4.1% by 2030. Unless there is significant compression of the equity risk premium, the fundamentals will then weigh on values over the decade.

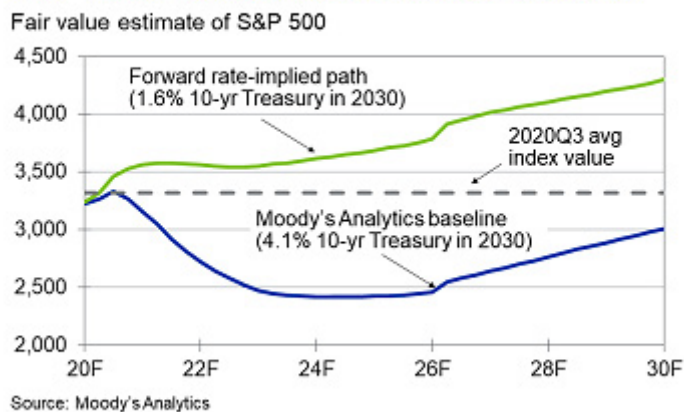
A simple error correcting model estimated on historical data suggests that departures from fundamental value can persist for long periods of time. The model embeds momentum factors that persistently drive market values from fundamentals before they correct. According to this model, momentum from earnings growth would continue to push equity values upward over the next few quarters, and then the weight of the error correction factors would kick in to slowly push actual values toward fundamentals. The large wedge between actual and fundamental values reflects the compression of the equity risk premium.

Increased sensitivity at low rates

An important lesson of the post-financial crisis era is that long-term assets have become increasingly responsive to interest rate changes as long-term interest rates have declined. The obvious linkage here is through the fundamentals of discounted cash flow valuations. The lower the discount rate, which for most assets tracks long-term rates, the more the fundamental value of an asset will shift in response to a fixed 1% increase or decrease in that rate.

This fact makes estimates of the trajectory of future fundamental values very sensitive to the interest rate path. One way to see that is to contrast the S&P 500 fundamental value under the Moody's Analytics projections for the 10-year yield implied by forward rates.

Fair Value Sensitive to the Rate Outlook



The latter suggests that fundamental values will rise above current prices and grow steadily through 2030. Of course, the forward implied rates are so-called risk-neutral projections that are generally expected by economists to underpredict the future path of rates in the current environment.

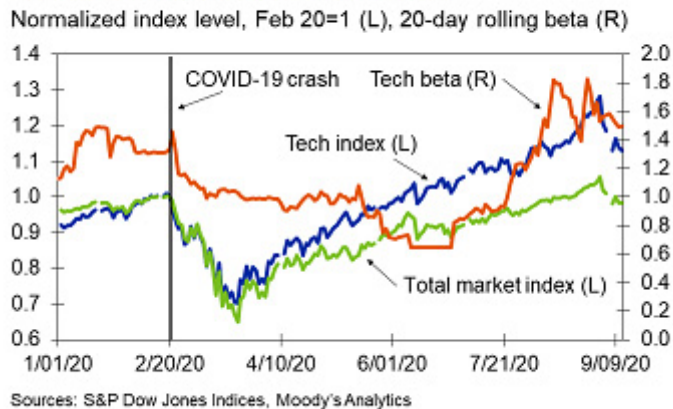
Tech stock dominance

The pandemic has delivered a large windfall to technology stocks, particularly the Big Five: Facebook, Amazon, Apple, Google and Microsoft. Having drawn bipartisan ire of lawmakers and the public over their outsize influence in the political process and the business world, the Big Five's unexpected gains as many households and businesses suffer during the pandemic seem particularly

The Week Ahead

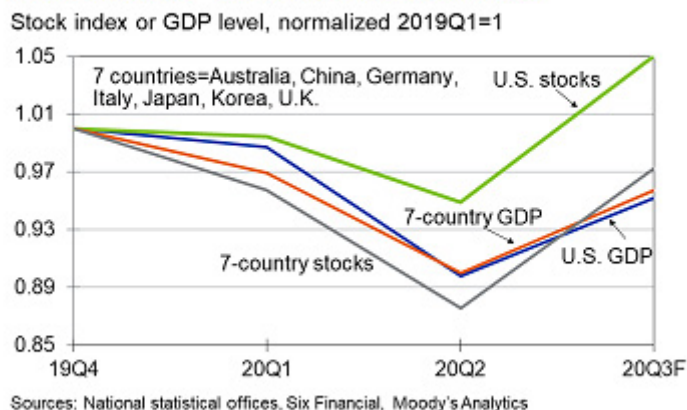
ill-timed. Sectorwide, technology stock prices were up more than 20% in early September on their level just prior to the crisis, while the market as a whole barely broke even.

Tech Stocks Stole the Show



Market observers have drawn comparisons between the Big Five and the robber barons of the 19th century and note that they represent a sign of excessive concentration of market power within the corporate sector that is holding back the broader economy. That factor may well explain the outsize gains experienced by the U.S. market compared with an average of leading foreign markets despite facing similar-sized GDP shocks.

U.S. Stocks' Outsize Performance



Stock market watchers see shades of the dot-com bubble in the tech stock runup, particularly during August's acceleration. The recent correction in values hit tech stocks harder; they were down almost 15%, compared with 7% for the market overall.

Is the tech runup just beta dynamics at play? Beta, a measure of the degree of responsiveness of an individual stock or portfolio return to shifts in the market index, has typically been above 1 for tech stocks. Thus, the gradual recovery in all stocks would be expected to benefit tech stocks disproportionately. Undercutting this argument is that tech betas are much closer to 1 over the past

The Week Ahead

decade than during the dot-com era. And until August, the rolling 20-day beta had moved well below 1 over the summer before moving well above 1 in August as market frothiness set in.

Alternatively, low interest rates may be contributing to high valuations of the tech sector. The valuations of many tech companies are more back-loaded than other firms' because they are expected to have stronger long-term profitability prospects than other types of companies. Low interest rates imply low discount factors for far-future cash flows, which effectively means that investors are putting more weight on long-term than short-term future profits. This is a potential vulnerability of the sector as rates rise.

Gradual decline in the near term

The outlook calls for stock market values to gradually decline in the near term, with the S&P 500 projected to gradually drop to back under 3,000 (around a 13% drop from current levels) by early 2021 as recovery from the pandemic is slower than market participants expect, followed by a gradual recovery. Treasury yields will stay near current levels before gradually rising in 2021.

Primary risks stem from a collapse in spending resulting from the failure of the government to provide a new stimulus package. With each passing day since expanded unemployment benefits and small-business lending lapsed, the U.S. economy steers toward more potential economic disaster. Collapsing personal and rental incomes triggering consumer credit and mortgage losses are downside risks for lenders, although banks remain well capitalized.

Another central risk stems from COVID-19 epidemiology and the potential of a second wave in the fall, as well as the timeline to a cure or vaccine. The election also presents risks. Republicans and Democrats have sharply differing implications for tax rates and hence asset values after the election. Internationally, a drawn-out pandemic could sow the seeds for strife in sovereign debt markets.

Next Week

The economic calendar is packed next week. Some of the key data include consumer confidence, international trade, revisions to second quarter GDP, vehicle sales, jobless claims, personal income and spending, ISM manufacturing index and the September employment report.

EUROPE

By Barbara Araujo Teixeira of Moody's Analytics

Job Losses Will Mount

CPI and the unemployment figures for the euro zone will steal the spotlight in a busy week. Regarding inflation, we expect the preliminary September release to bring better results than August's. Euro zone CPI prices plunged into deflation in August for the first time since the spring of 2016—they declined by 0.2% y/y after rising 0.4% in July. Fears were that deflation might become entrenched across the currency area and leave the European Central Bank in a very difficult position. But at the time of the release we cautioned against reading too much into the decline; it was due only to one-off effects that were expected to fade soon.

Notably, most of August's fall can be attributed to an expected correction in nonenergy goods inflation—to its lowest in more than six years—following a one-off jump in July. July's jump was due mainly to the timing of summer sales this year compared with 2019, since 2020 sales were disrupted by COVID-19. While prices normally plunge from June to July as retailers make use of aggressive discounting to clear shelves for autumn ranges, prices this year had been discounted since the start of the crisis. Also, countries such as France and Italy postponed the official start of this year's summer sales from June until mid-July (which meant they lasted well into August) to give retailers a breather after the lockdown. This resulted in a lot of noise in the June, July and August figures. Prices in the nonenergy goods sector likely began to normalize in September and should continue to do so in October, especially in the clothing sector, which should help push headline inflation back into positive territory.

We thus expect CPI prices to stagnate in September after falling by 0.2% y/y in August, driven mainly by an increase in core inflation. Risks to our core inflation outlook are balanced; while the correction in core goods inflation could be bigger than we expect, which would push inflation back into positive territory, services inflation likely declined due to the shock to overall demand.

On noncore inflation, we expect that deflation in the energy sector eased further but only slightly and in line with base effects in oil prices, while food inflation is expected to have more or less held steady. Risks to our noncore inflation outlook are nonetheless tilted to the upside, since food inflation could have gained some ground on the back of renewed COVID-19 restrictions. The resurgence in cases across many euro zone countries meant that governments limited consumer-facing services activities once again, and anecdotal evidence suggest that some people stocked up on food and reduced their eating-out spending, which could have pushed up supermarket prices. But we don't think this effect will be nearly as strong as it was back in March.

Labour market figures are likely to show that the euro zone's unemployment rate increased further in August, to 8.2% from 7.9%. Many European governments have started winding down their furlough or short-term work schemes, and all high-frequency evidence confirms that this has resulted in job losses. This trend will continue in coming months, putting further jobs at risk and raising the unemployment rate. Making this worse, social-distancing measures are being put back in place across the currency area. Our view is that joblessness will continue to rise through the rest of this year before peaking in the first quarter of 2021.

Final U.K. GDP figures for the second quarter will confirm that the U.K. GDP fell at its worst rate on record in the three months to June owing to COVID-19 restrictions. GDP contracted by 20.4% q/q after a 2.2% decline previously. We aren't penciling in any revisions to the numbers, but we don't rule them out, given the scale of statistical imputing that had to be made during the crisis as whole economic sectors were forced to close for several weeks during the quarter. The drop in U.K. activity was much worse than elsewhere in Europe, but this was mainly because restrictions in the country lasted much longer than elsewhere. For instance, while Germany had reopened most of its economy by the end of April/start of May, restaurants and hotels remained closed in the U.K. until the start of July. This suggests that the rebound in the third quarter will also be bigger in the U.K. than elsewhere.

The Week Ahead

Finally, the confidence and survey data are expected to confirm that sentiment eased across most European countries in September, owing fully to the resurgence of COVID-19 cases and to the reintroduction of some containment measures. This is expected to put a lid on the recovery and raises the risk of a renewed recession in the fourth quarter—which is not our base case yet.

	Key indicators	Units	Moody's Analytics	Last
Tues @ 9:00 a.m.	Spain: Retail Sales for August	% change	-0.5	1.1
Tues @ 10:00 a.m.	Euro Zone: Business and Consumer Sentiment for September	index	85.1	87.7
Wed @ 7:00 a.m.	Germany: Retail Sales for August	% change	-0.3	-0.9
Wed @ 7:45 a.m.	France: Household Consumption Survey for August	% change	-0.4	0.5
Wed @ 8:55 a.m.	Germany: Unemployment for September	%	6.5	6.4
Wed @ 9:30 a.m.	U.K.: GDP for Q2	% change	-20.4	-2.2
Wed @ 10:00 a.m.	Euro Zone: Preliminary Consumer Price Index for September	% change	0.0	-0.2
Thur @ 9:00 a.m.	Italy: Unemployment for August	%	10.1	9.7
Thur @ 10:00 a.m.	Euro Zone: Unemployment for August	%	8.2	7.9
Fri @ 2:00 p.m.	Russia: GDP for Q2	% change yr ago	-8.0	1.6

ASIA-PACIFIC

By Shahana Mukherjee of Moody's Analytics

Wary Buyers, Soft Foreign Demand Likely Raised Japan's Jobless Rate

Japan's unemployment rate is expected to have risen to 3.1% in August from 2.9% in July. Japan's economy has been severely impacted by the dual shocks to domestic and overseas demand induced by the COVID-19 pandemic. Despite having a relatively lower incidence of the outbreak compared with its regional counterparts, Japan has contended with a volatile infections curve domestically, which has kept households wary for an extended time. This, combined with significant softness in overseas demand, is expected to have weighed on corporate earnings and weakened employment prospects in August.

Japan's survey of large manufacturers is expected to show some improvement in the outlook. We expect the Tankan index to have eased to -24 for the September quarter, following a weaker reading of -34 for the June quarter. Even though overseas demand remained soft through this quarter, the pace of decline in exports has eased since May, when the shock to global trade bottomed out, and industrial activity has consequently returned to growth since June. The easing of restrictions across major economies through this quarter, combined with some pickup in consumption, is expected to have driven the lift in business confidence.

South Korea's exports are likely to have declined by a narrower margin of 4.5% in yearly terms in August, following a 9.9% decline in July. Unlike Japan, external demand has shown some improvement for South Korea in recent months, even though the pickup has largely been due to the surge in tech exports. We expect improving global demand for semiconductors and computers, along with the pickup in car sales in the first 20 days of August trade, to have supported the aggregate pickup in August.

Australia's retail sales are likely to have declined by 4% on a monthly basis in August, following a 3.2% pickup in July. While the rebound in consumer spending moderated in most parts of Australia, the strict restrictions imposed in the state of Victoria are expected to have severely dampened the second-most populated state's household spending through August and weighed heavily on the aggregate.

	Key indicators	Units	Moody's Analytics	Confidence	Risk	Last
Mon @ 2:00 p.m.	Malaysia Foreign Trade for August	MYR bil	19	3	↑	25.2
Tues @ 9:00 a.m.	South Korea Business Confidence for September	Index	63	3	↓	66
Tues @ 9:00 a.m.	South Korea Retail Sales for August	% change	2.5	3	↓	-6.0
Wed @ 9:50 a.m.	Japan Retail Sales for August	% change yr ago	1.5	3	↓	-2.8
Wed @ 9:50 a.m.	Japan Industrial Production for August	% change	1.8	3	↑	8.7
Thur @ 9:50 a.m.	Japan Tankan Survey for Q3	Index	-24	3	↑	-34
Thur @ 10:00 a.m.	South Korea Foreign Trade for September	US\$ bil	8.0	3	↓	4.12
Fri @ 9:30 a.m.	Japan Unemployment Rate for August	%	3.1	3	↓	2.9
Fri @ 11:30 a.m.	Australia Retail Sales for August	% change	-4.0	4	↑	3.2
Fri @ 3:00 p.m.	Japan Consumer Confidence for September	Index	31.0	3	↓	29.3

The Long View

On balance, 2020's bond issuance boom enhances financial flexibility by lengthening maturities and lowering interest expense.

By John Lonski, Chief Economist, Moody's Capital Markets Research Group
September 24, 2020

CREDIT SPREADS

As measured by Moody's long-term average corporate bond yield, the recent investment grade corporate bond yield spread of 138 basis points exceeded its 116 basis-point median of the 30 years ended 2019. This spread may be no wider than 135 bp by year-end 2020.

The recent high-yield bond spread of 552 bp is thinner than what is suggested by the accompanying long-term Baa industrial company bond yield spread of 221 bp and the recent VIX of 28.9 points. The latter has been historically associated with a 760-bp midpoint for the high-yield bond spread.

DEFAULTS

August 2020's U.S. high-yield default rate of 8.7% was up from August 2019's 3.1% and may approximate 11.3%, on average, by 2021's first quarter.

US CORPORATE BOND ISSUANCE

Second-quarter 2019's worldwide offerings of corporate bonds revealed an annual setback of 2.5% for IG and an annual advance of 17.6% for high-yield, wherein US\$-denominated offerings sank by 12.4% for IG and surged by 30.3% for high yield.

Third-quarter 2019's worldwide offerings of corporate bonds revealed annual advances of 15.2% for IG and 56.8% for high-yield, wherein US\$-denominated offerings soared higher by 36.8% for IG and 81.3% for high yield.

Fourth-quarter 2019's worldwide offerings of corporate bonds revealed annual advances of 15.3% for IG and 329% for high-yield, wherein US\$-denominated offerings dipped by 0.8% for IG and surged higher by 330% for high yield.

First-quarter 2020's worldwide offerings of corporate bonds revealed annual advances of 17.7% for IG and 26.5% for high-yield, wherein US\$-denominated offerings increased 43.7% for IG and grew 21.4% for high yield.

Second-quarter 2020's worldwide offerings of corporate bonds revealed annual surges of 69% for IG and 31% for high-yield, wherein US\$-denominated offerings increased 142% for IG and grew 45% for high yield.

For 2019, worldwide corporate bond offerings grew by 5.4% annually (to \$2.447 trillion) for IG and advanced by 49.2% for high yield (to \$561 billion). The projected annual percent increases for 2020's worldwide corporate bond offerings are a 15.0% advance for IG and 13.8% for high yield.

US ECONOMIC OUTLOOK

Unacceptably high unemployment and other low rates of resource utilization will rein in Treasury bond yields. As long as the global economy operates below trend, 1.00% will serve as the upper bound for the 10-year Treasury yield. Until COVID-19 risks fade substantially and election year risks recede, wider credit spreads are possible.

The Long View

EUROPE

By Barbara Araujo Teixeira and Ross Cioffi of Moody's Analytics
September 24, 2020

UNITED KINGDOM

U.K. Chancellor of the Exchequer Rishi Sunak announced on Thursday his much-awaited winter economic plan aimed at supporting the British economy through the coronavirus crisis over the coming months. All eyes were on the government's new Job Support Scheme, the main goal of which was to avoid the cliff edge for companies once the current Coronavirus Job Retention Scheme ends on October 31. Under the CJRS, the government is paying up to 80% of the wages of workers who have been furloughed by their employers (capped at £2,500) but who have been kept on the payroll. The end of the CJRS was expected to result in a barrage of job losses, as several companies that are under financial stress couldn't afford to start repaying employees their full salary and would have no choice but to lay them off instead.

We were disappointed by Thursday's announcements. The new Job Support Scheme fell much below markets' expectations, and our view is that it won't be enough to prevent the majority of the post-CJRS job losses. What the government is offering is that it will help employers pay the salaries of employees who are kept on shorter hours (minimum 33% of normal hours) rather than made redundant. The problem is that the support received by companies can reach at most 22% of an employee's salary and is capped at £697.92 per month, which represents just less than 30% of the support received under the CJRS.

In short, the programme stipulates that an employee needs to work at least one-third of the normal hours, and that these hours should be paid by the employer in full. For the hours the employee is not working, the government will pay for one-third of the usual pay, and the employer will pay for another third. This means that an employer would need to pay $33\% + 22\% = 55\%$ of the salary of someone working one-third of the time, while the government would pay 22%. The employee would receive 77% of the usual salary.

The problem is that this scheme does not motivate companies to keep their employees on partial hours instead of letting them go. For instance, if a company has 20 employees and needs them to work only half of the time, it would need to pay $50\% + 17\% = 67\%$ of their salaries. If the company lays off 10 employees, it would need to pay only 50% of its previous wage bill. Given the financial pressure and the very real prospect of further restrictions being imposed, most companies would have no choice but to let people go.

This means the government's new Job Support Scheme is unlikely to result in significant revisions to our baseline forecast. We still think that unemployment will continue to mount in coming months, especially in light of the resurgence of coronavirus cases across Europe. We might revise our unemployment rate forecasts slightly down in coming weeks—we are currently expecting it to peak at 8.4% in the first quarter of 2021—but any changes should be minor.

The good news is that the winter economic plan was not limited to the Job Support Scheme, with the government also extending the support to struggling companies. First, there was the "pay as you grow" package, which allows firms to extend their state-backed business loans from six to 10 years; this will almost halve repayments. Firms in real trouble will have the option of paying only the interest and not the principal. Adding to that, the government will allow businesses to spread their value-added tax bills over 11 separate payments.

The fraught hospitality sector also got some help. The chancellor said that the increase in the sector's VAT rate scheduled for January will be canceled, and that the VAT will remain at 5% (instead of 20%) at least until the end of March 2021.

However, we don't think these measures represent a lifeline for struggling companies. The postponement of the VAT increase for the hospitality sector is more symbolic than anything else. Cash flows for businesses in the sector have slumped despite the VAT cut, and this extension will do little to help firms that are on the brink of collapse and won't survive any further COVID-19 restrictions. This is especially so given the end of the Coronavirus Job Retention Scheme. In all, these measures will help cushion the blow from the crisis but won't prevent job losses from mounting in coming months or the economy from stalling as new restrictive measures are put in place.

EURO ZONE

Wednesday's flash composite PMIs for the European countries were grim, showing that business sentiment declined across all major countries in September. We can't say this was unexpected, though, given the sharp rise in new daily infections in Europe over the past month, and the increased prospects of renewed restrictions over the

The Long View

coming weeks. They are casting a shadow over the strength of the post-COVID-19 recovery, raising fears that activity will falter again in the fourth quarter and that the rebound will go into reverse.

The details of the PMIs confirmed our view that the services sector is already feeling the pain from the resurgence in cases. The euro zone's services PMI plunged to 47.6 from 50.5, the worst result since May, as consumer-facing firms struggled with new social distancing measures and as travel and tourism remained depressed. This led to an acceleration in the rate of job losses in the sector, which is worrying especially because it builds on already-bad numbers for the previous months. By contrast, manufacturing gathered some momentum in September, led mainly by an increase in new orders—the highest in 2½ years.

Across the euro zone's two biggest economies, the main downside came from France. Business activity in the country suffered the first decline since May—the PMI was down to 48.5 from 51.6—as the sharp rise in cases in the country has led to fresh restrictions being imposed. It's no surprise that the services sector was dealt the largest blow, with the PMI tumbling to 47.5 from 51.5 in August. By contrast, manufacturing returned to growth, with the sector's index rebounding to 50.9 from 49.8. In Germany, the flash composite PMI was stronger at 53.7, though still down from 54.4 in August. This strong performance was due mainly to the manufacturing sector, which grew at its fastest pace in more than two years in September. A jump in new export orders drove most of the increase, as external demand continued to recover from the historic lows it reached in previous months.

Outside the euro zone, the U.K.'s flash composite PMI fell to 55.7 from 59.1. Manufacturing and services both eased in September, with the slowdown particularly acute in the restaurant sector, as the Eat Out to Help Out scheme was withdrawn. The bad news is that confidence continues to lose momentum in October given the fresh restrictions put in place by the U.K. government over the past week.

The Long View

ASIA PACIFIC

By Shahana Mukherjee of Moody's Analytics
September 24, 2020

NEW ZEALAND

The Reserve Bank of New Zealand kept its monetary settings unchanged at its September meeting, holding the official cash rate steady at 0.25%. The central bank also agreed to continue with its Large Scale Asset Purchase Programme of up to NZ\$100 billion, which was announced last month. Echoing the sentiment of the Federal Reserve and other leading central banks, the RBNZ highlighted the need for prolonged support to combat the fallout from the COVID-19 crisis.

The latest decision was in line with our expectations and follows the dramatic rate cut worth 75 basis points delivered in March in response to the COVID-19 outbreak. The central bank this week kept alive the possibility of taking interest rates into negative territory. It signalled the possible need for additional monetary stimulus, which could be mobilized through a negative official cash rate, a Funding for Lending Program (a low-interest loan programme for banks), or the purchase of foreign assets.

Backing the need to deploy additional monetary instruments is the economy's significant weakness. Despite the relatively lower intensity of the outbreak during both the first and second waves, the stringent restrictions have weighed heavily on all aspects, hitting domestic consumption and investment the hardest. A testament to the severity of the containment efforts was the June quarter performance, when domestic output contracted by a significant 12.4% in yearly terms, led by a 12.1% fall in consumption and a 29.1% collapse in gross fixed investment.

Most restrictions eased

On the brighter side, the localized health crisis is under control and authorities eased most restrictions across the country this week, except in Auckland, where stronger restrictions remain for another two weeks. However, the aftershocks in the form of another setback in consumer spending, as electronic card transactions slipped 7.6% in August; and industrial activity, as manufacturing PMI fell to 50 in August from 59 in July, are expected to at least partially reverse some of the revival seen following the easing of restrictions since May, soon after the first wave. For New Zealand, an equally pertinent concern is the pause on tourism and its ramifications for the highly tourism-reliant services industries, which generate 15% of domestic income, as they are expected to see a prolonged slump in demand through the rest of 2020.

Considering the unprecedented economic strain and the dire need for low-cost funding, the RBNZ has signalled that a Funding for Lending Program is likely to be ready for deployment by the end of the year. While this will be welcome, the translation into lower costs will be slow, and the uncomfortable decision of lowering the official cash rate below zero will still need to be contended with. Concerns surrounding negative interest rates include their potential impact on the functioning of the banking system and the supply of credit, as they depend on deposit funding; the stickiness of a negative rate regime; and possible distortions induced in the financial system. Yet, prolonged weakness in domestic demand could well lead to the adoption of this instrument, and markets have already priced in such a move, expected at the latest by the first half of 2021. Moody's Analytics expects the official cash rate to hold steady at 0.25% until December.

For now, a strong rebound in consumer spending will be key to initiating a revival in New Zealand. Thus, fiscal measures are expected to continue driving policy efforts, while an ultra-accommodative monetary policy stance complements this position.

Ratings Round-Up

Ratings Round-Up

U.S. Upgrades Account for Three-Fourths of Affected Debt in the Latest Period

By Steven Shields

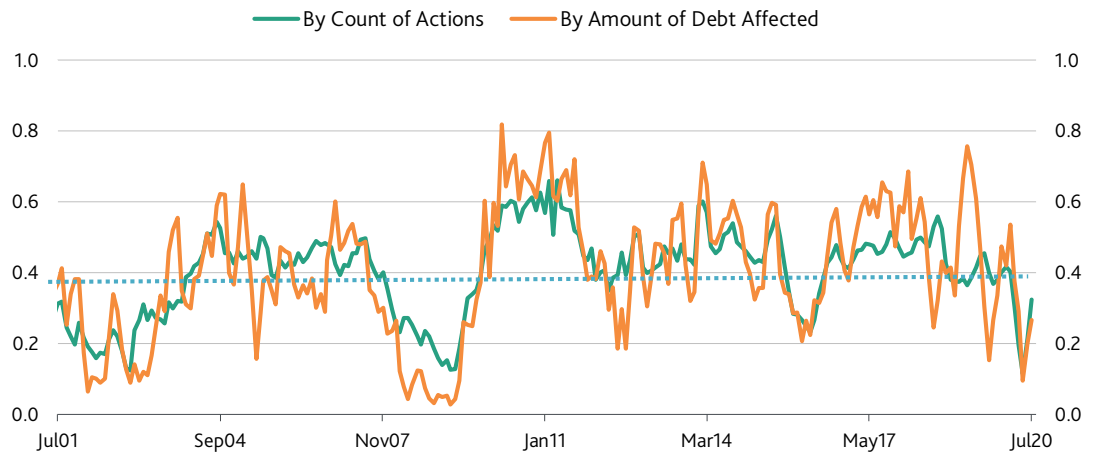
U.S. rating changes were credit positive for the period ending September 22. Upgrades accounted for four of the eight rating changes but accounted for more than three-fourths of debt affected in the period. Antero Resources Corp. received the largest upgrade in terms of debt affected at nearly \$3.2 billion. Moody's Investors Service upgraded Antero's Corporate Family Rating to B2 from B3 and its senior unsecured notes to B3 from Caa. The change reflects Antero's reduced refinancing risk, debt reduction, and improved cost structure. Additionally, Antero Midstream Partners LP's senior unsecured notes were raised to B3 from Caa. According to Moody's Investors Service, North American natural gas producers will continue to benefit from the swoon in oil prices, but gas prices still face increasing risks of rising gas supply in 2021 if oil production continues to rebound. On September 21, TPC Group Inc. senior secured notes were downgraded to Caa1 from B2. The downgrade of TPC's ratings reflects its poor financial performance in 2020 as a result of the coronavirus pandemic and costs stemming from a December 2019 explosion and fire at its Port Neches facility. Moody's Investors Service also downgraded the rating GTT Communication's senior secured facilities to B3 from B2 and the rating on the company's senior unsecured notes to Caa2 from Caa1. The ratings are on review for further downgrade. These rating actions follow the company's announcement that it expected further material delays in the filing of its Q2 financials, which may, if unresolved by debt holders, result in default.

European ratings activity was limited to one upgrade and one downgrade in the period. The upgrade was made to Premier Foods PLC, with its senior secured notes raised to B1 from B2. The ratings change reflects Premier's strengthening of its key credit ratios over the last two years as a result of improving profitability and decreasing debt. Premier Foods, together with other UK-based food manufacturers, is exposed to the uncertainty associated with U.K. consumer spending in the context of an economic slowdown or the potential failure of the U.K. and EU to agree a trade deal or extend the Brexit transition arrangement. The rating is constrained by the company's high geographical and customer concentration, its exposure to volatility in raw material prices, and foreign exchange risk. Meanwhile, Unibail-Rodamco-Westfield SE's senior unsecured notes were downgraded one notch from A3 to Baa1 reflecting increased leverage expectations and weaker operating outlook for the company and broader retail real estate sector. The downgrade impacts nearly \$18.9 billion in outstanding debt.

Ratings Round-Up

FIGURE 1

Rating Changes - US Corporate & Financial Institutions: Favorable as % of Total Actions



* Trailing 3-month average

Source: Moody's

FIGURE 2

Rating Key

BCF	Bank Credit Facility Rating	MM	Money-Market
CFR	Corporate Family Rating	MTN	MTN Program Rating
CP	Commercial Paper Rating	Notes	Notes
FSR	Bank Financial Strength Rating	PDR	Probability of Default Rating
IFS	Insurance Financial Strength Rating	PS	Preferred Stock Rating
IR	Issuer Rating	SGLR	Speculative-Grade Liquidity Rating
JrSub	Junior Subordinated Rating	SLTD	Short- and Long-Term Deposit Rating
LGD	Loss Given Default Rating	SrSec	Senior Secured Rating
LTCF	Long-Term Corporate Family Rating	SrUnsec	Senior Unsecured Rating
LTD	Long-Term Deposit Rating	SrSub	Senior Subordinated
LTIR	Long-Term Issuer Rating	STD	Short-Term Deposit Rating

Ratings Round-Up

FIGURE 3

Rating Changes: Corporate & Financial Institutions – US

Date	Company	Sector	Rating	Amount (\$ Million)	Up/ Down	Old LTD Rating	New LTD Rating	IG/SG
9/16/20	IQOR HOLDINGS INC. -IQOR US, INC.	Industrial	PDR		D	Ca	D	SG
9/16/20	NFP INTERMEDIATE HOLDINGS A CORP.-NFP CORP.	Financial	SrSec/BCF		U	B2	B1	SG
9/16/20	GTT COMMUNICATIONS, INC.	Industrial	SrUnsec/SrSec /BCF/LTCFR/PDR	575	D	Caa1	Caa2	SG
9/16/20	AIMBRIDGE HOSPITALITY HOLDINGS, LLC	Industrial	SrSec/BCF		D	B2	B3	SG
9/18/20	ALKU HOLDINGS, LLC-ALKU, LLC	Industrial	SrSec/BCF /LTCFR/PDR		U	B3	B2	SG
9/21/20	TPC GROUP INC.	Industrial	SrSec/LTCFR/PDR	930	D	B2	Caa1	SG
9/22/20	ANTERO RESOURCES CORPORATION	Industrial	SrUnsec/LTCFR/PDR	3,179	U	Caa1	B3	SG
9/22/20	ANTERO MIDSTREAM PARTNERS LP	Industrial	SrUnsec	1,950	U	Caa1	B3	SG

Source: Moody's

FIGURE 4

Rating Changes: Corporate & Financial Institutions – Europe

Date	Company	Sector	Rating	Amount (\$ Million)	Up/ Down	Old LTD Rating	New LTD Rating	IG/SG	Country
9/16/20	UNIBAIL-RODAMCO-WESTFIELD SE	Industrial	SrUnsec/LTIR /JrSub/MTN	18,871	D	A3	Baa1	IG	FRANCE
9/22/20	PREMIER FOODS PLC	Industrial	SrSec/LTCFR/PDR	661	U	B2	B1	SG	UNITED KINGDOM

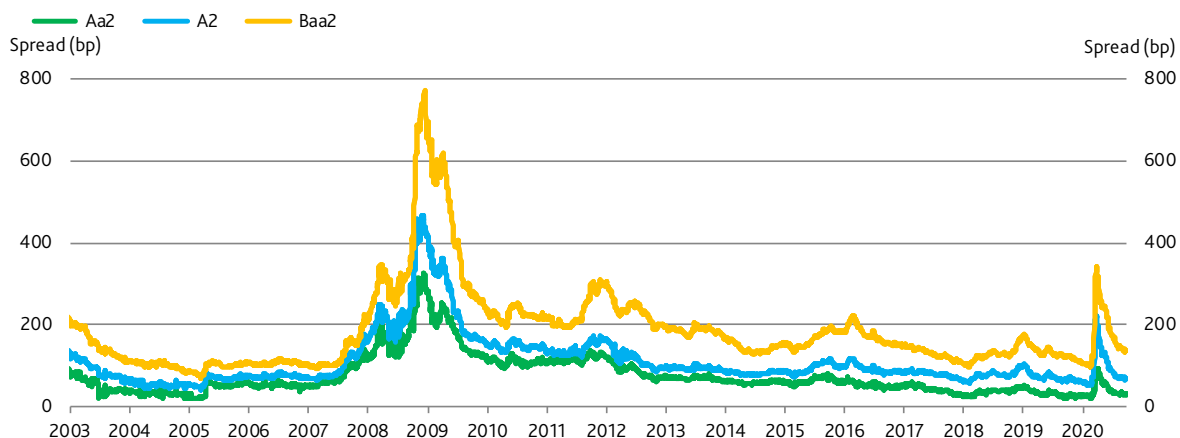
Source: Moody's

Market Data

Market Data

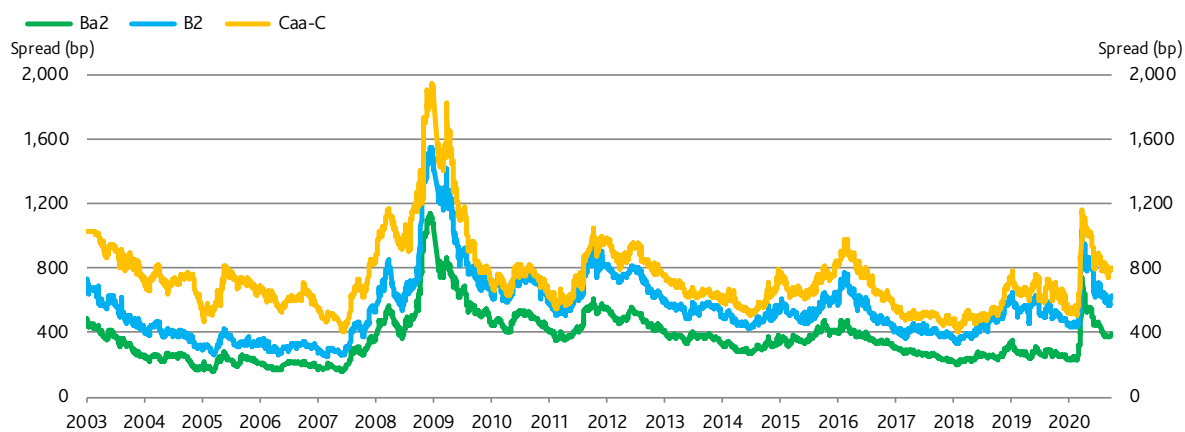
Spreads

Figure 1: 5-Year Median Spreads-Global Data (High Grade)



Source: Moody's

Figure 2: 5-Year Median Spreads-Global Data (High Yield)



Source: Moody's

Market Data

CDS Movers

Figure 3. CDS Movers - US (September 16, 2020 – September 23, 2020)

CDS Implied Rating Rises		CDS Implied Ratings		
Issuer		Sep. 23	Sep. 16	Senior Ratings
Kimberly-Clark Corporation		A2	Baa1	A2
Ford Motor Credit Company LLC		B1	B2	Ba2
Microsoft Corporation		Aa2	Aa3	Aaa
Boeing Company (The)		B1	B2	Baa2
Enterprise Products Operating, LLC		Baa1	Baa2	Baa1
Consolidated Edison Company of New York, Inc.		Baa1	Baa2	Baa1
Charles Schwab Corporation (The)		A1	A2	A2
Waste Management, Inc.		A2	A3	Baa1
DTE Energy Company		A3	Baa1	Baa2
Constellation Brands, Inc.		Ba1	Ba2	Baa3

CDS Implied Rating Declines		CDS Implied Ratings		
Issuer		Sep. 23	Sep. 16	Senior Ratings
CVS Health		A1	Aa2	Baa2
Carnival Corporation		Caa3	Caa1	B2
Conagra Brands, Inc.		A1	Aa2	Baa3
Kroger Co. (The)		A1	Aa2	Baa1
Sherwin-Williams Company (The)		A1	Aa2	Baa2
Eastman Chemical Company		Baa1	A2	Baa3
Cardinal Health, Inc.		A3	A1	Baa2
ERP Operating Limited Partnership		A1	Aa2	A3
Campbell Soup Company		A2	Aa3	Baa2
Whirlpool Corporation		A2	Aa3	Baa1

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Sep. 23	Sep. 16	Spread Diff
Nabors Industries, Inc.	B3	5,208	4,592	616
Royal Caribbean Cruises Ltd.	B2	1,192	907	285
Carnival Corporation	B2	897	646	251
Occidental Petroleum Corporation	Ba2	807	618	189
Macy's Retail Holdings, Inc.	B1	1,147	959	188
Tenet Healthcare Corporation	Caa1	534	357	177
Avis Budget Car Rental, LLC	B3	624	481	142
American Axle & Manufacturing, Inc.	B2	564	422	142
American Airlines Group Inc.	Caa1	2,652	2,511	141
Staples, Inc.	B3	1,296	1,175	121

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Sep. 23	Sep. 16	Spread Diff
K. Hovnanian Enterprises, Inc.	Caa3	1,133	1,349	-217
Avon Products, Inc.	B3	328	345	-18
Healthcare Realty Trust Incorporated	Baa2	90	107	-17
YRC Worldwide Inc.	Caa2	929	946	-17
JetBlue Airways Corp.	Ba3	701	706	-5
Mohawk Industries, Inc.	Baa1	114	118	-5
Levi Strauss & Co.	Ba2	133	137	-4
Nissan Motor Acceptance Corporation	Baa3	439	441	-3
Louisiana-Pacific Corporation	Ba2	229	232	-3
Constellation Brands, Inc.	Baa3	173	174	-1

Source: Moody's, CMA

Market Data

Figure 4. CDS Movers - Europe (September 16, 2020 – September 23, 2020)

CDS Implied Rating Rises		CDS Implied Ratings		
Issuer	Sep. 23	Sep. 16	Senior Ratings	
Landesbank Baden-Wuerttemberg	A2	Baa1	Aa3	
Bankinter, S.A.	Baa2	Ba1	Baa1	
Spain, Government of	A2	A3	Baa1	
Portugal, Government of	A1	A2	Baa3	
Banque Federative du Credit Mutuel	A2	A3	Aa3	
Nordea Bank Abp	Aa1	Aa2	Aa3	
UniCredit Bank AG	A2	A3	A2	
Bayerische Landesbank	A3	Baa1	Aa3	
RCI Banque	Ba2	Ba3	Baa2	
Alpha Bank AE	B3	Caa1	Caa1	

CDS Implied Rating Declines		CDS Implied Ratings		
Issuer	Sep. 23	Sep. 16	Senior Ratings	
BNP Paribas	Aa3	Aa2	Aa3	
Societe Generale	Aa3	Aa2	A1	
Banco Bilbao Vizcaya Argentaria, S.A.	A2	A1	A3	
Intesa Sanpaolo S.p.A.	Baa3	Baa2	Baa1	
Credit Agricole S.A.	Aa2	Aa1	Aa3	
Natixis	Aa3	Aa2	A1	
Credit Agricole Corporate and Investment Bank	Aa2	Aa1	Aa3	
Danske Bank A/S	Aa3	Aa2	A3	
Electricite de France	A2	A1	A3	
Orange	Aa3	Aa2	Baa1	

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Sep. 23	Sep. 16	Spread Diff
TUI AG	Caa1	822	553	269
Deutsche Lufthansa Aktiengesellschaft	Ba2	372	298	74
Altice Finco S.A.	Caa1	426	359	67
Stena AB	Caa1	676	609	67
CMA CGM S.A.	Caa1	582	518	64
Jaguar Land Rover Automotive Plc	B1	799	736	63
thyssenkrupp AG	B1	365	305	60
Novafives S.A.S.	Caa2	966	909	57
Vue International Bidco plc	Caa2	1,136	1,080	56
Ineos Group Holdings S.A.	B2	332	282	50

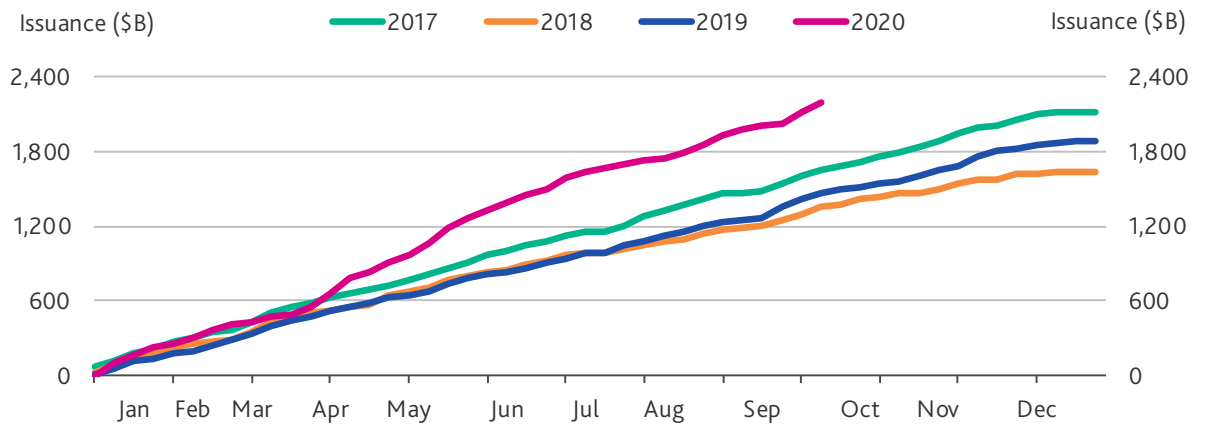
CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Sep. 23	Sep. 16	Spread Diff
Selecta Group B.V.	Caa3	2,453	2,496	-43
Bankinter, S.A.	Baa1	77	110	-33
Italy, Government of	Baa3	123	126	-3
Alpha Bank AE	Caa1	494	497	-2
Vedanta Resources Limited	B3	1,147	1,149	-2
Spain, Government of	Baa1	51	52	0
Piraeus Bank S.A.	Caa2	792	792	0
National Bank of Greece S.A.	Caa1	422	422	0
Novo Banco, S.A.	Caa2	339	339	0
Iceland Bondco plc	Caa2	603	603	0

Source: Moody's, CMA

Market Data

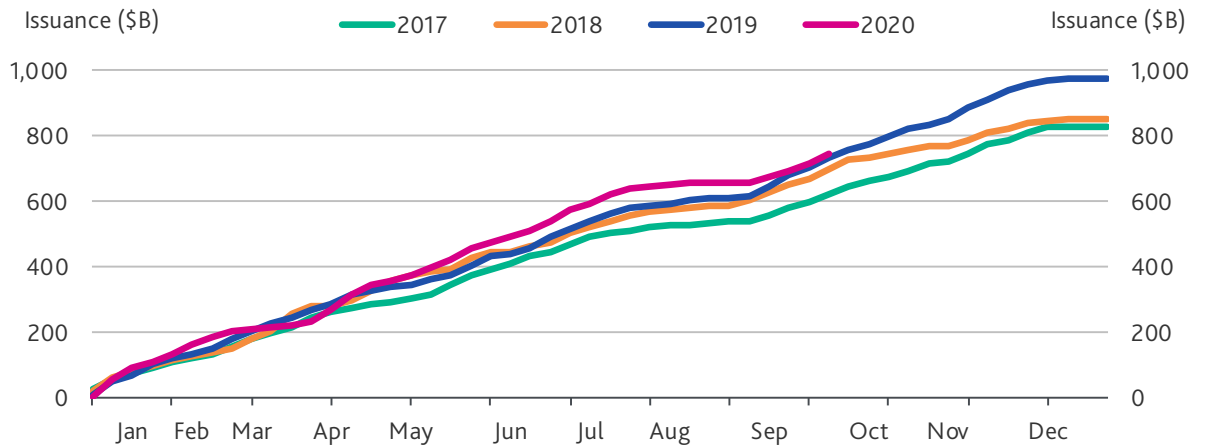
Issuance

Figure 5. Market Cumulative Issuance - Corporate & Financial Institutions: USD Denominated



Source: Moody's / Dealogic

Figure 6. Market Cumulative Issuance - Corporate & Financial Institutions: Euro Denominated



Source: Moody's / Dealogic

Market Data

Figure 7. Issuance: Corporate & Financial Institutions

	USD Denominated		
	Investment-Grade	High-Yield	Total*
	Amount \$B	Amount \$B	Amount \$B
Weekly	49.385	22.505	74.822
Year-to-Date	1,688.337	421.964	2,181.533

	Euro Denominated		
	Investment-Grade	High-Yield	Total*
	Amount \$B	Amount \$B	Amount \$B
Weekly	22.583	3.285	28.443
Year-to-Date	626.846	88.753	743.790

* Difference represents issuance with pending ratings.

Source: Moody's/ Dealogic

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Editor
Reid Kanaley
help@economy.com

Contact Us

Americas:	1.212.553.4399
Europe:	+44 (0) 20.7772.5588
Asia:	813.5408.4131

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