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Featured G

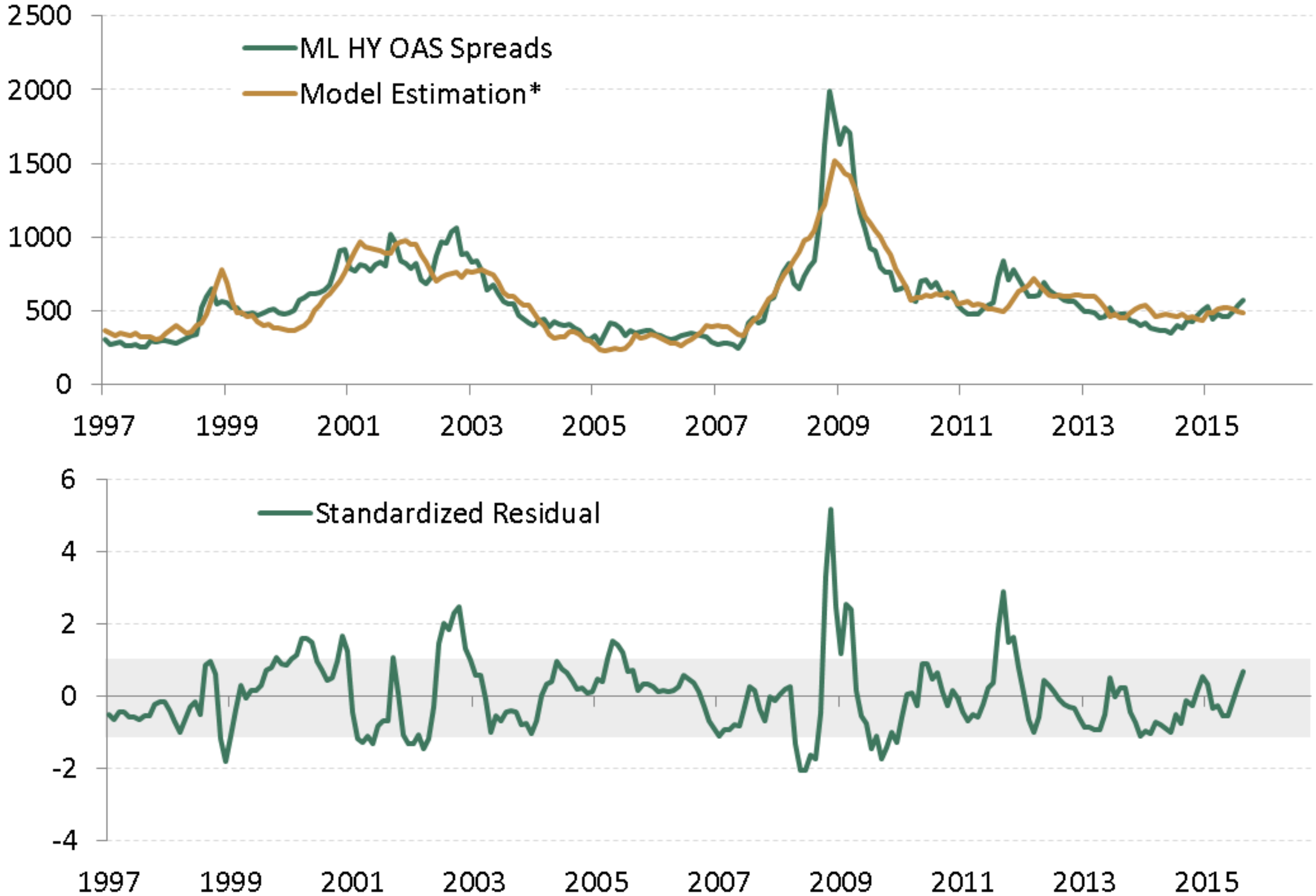
Around THE Curve

Does U.S. Policy Constrain Credit Assets Globally?

Brian L. Kloss, JD, CPA |

Risk asset valuations are generally derived by the market determining the spread (i.e. risk) over a risk- free rate that is appropriate for existing market conditions and the idiosyncratic risk of each credit. Risk-free rates in credit and fixed-income markets are generally determined by “safe-haven” government bonds. For example, German Bunds and U.S. Treasurys respectively determine the risk-free rates for the euro- and U.S. dollar-denominated markets. Markets are currently re-pricing the spread over the risk-free rate as the Federal Reserve (Fed) continues to maintain an accommodative monetary policy through zero-bound short-term rates in light of the headwinds facing the global economy. Our internal research indicates that U.S. credit spreads are approximately one standard deviation cheap to their intrinsic value.

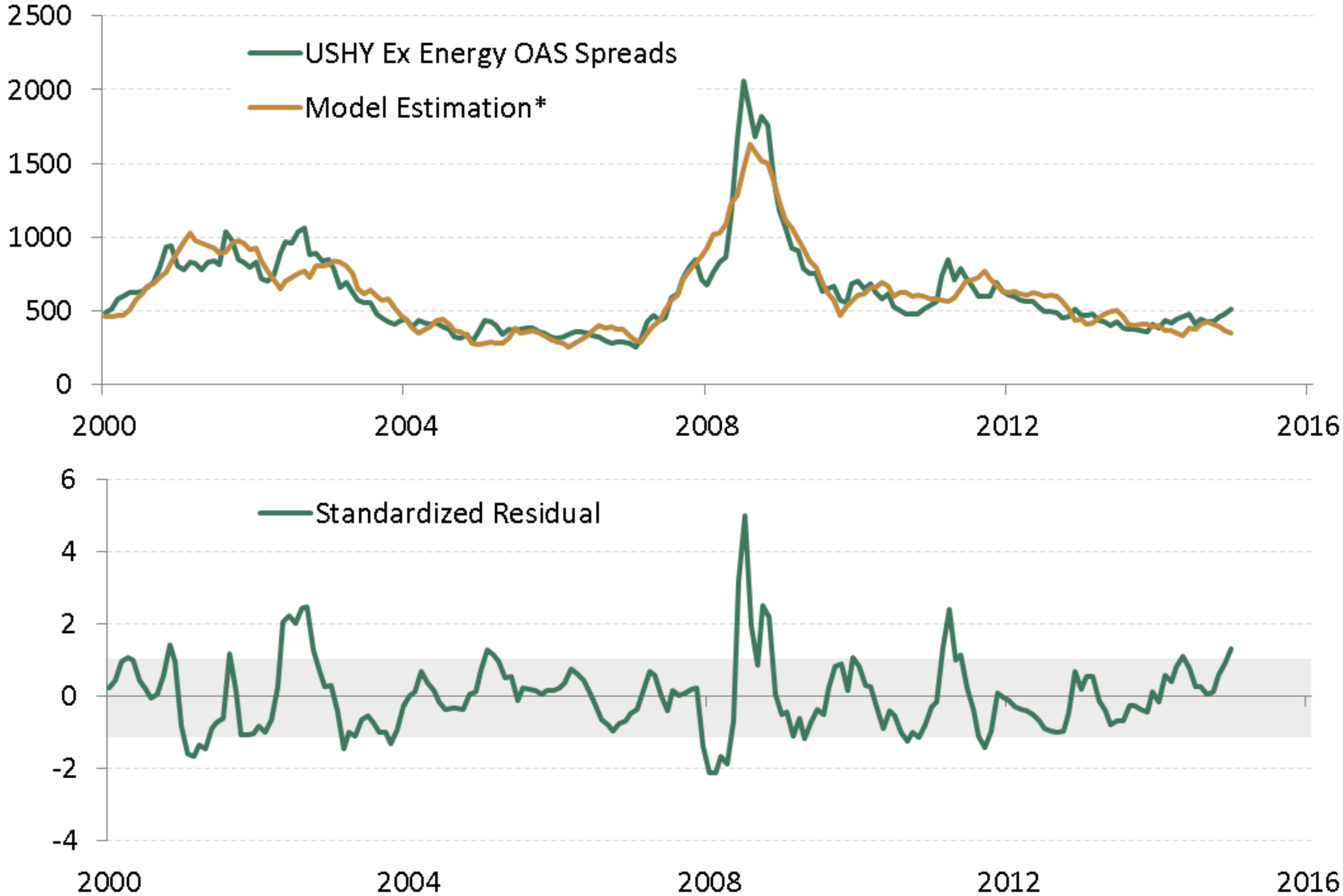
Chart 1: Merrill Lynch High Yield Spreads Model *BPs; As of 8/31/2015*



**Based on Fed loan survey, industrial production, capacity utilization, 12-month trailing default rate, and 5-year treasury*

Source: Thomson Datastream

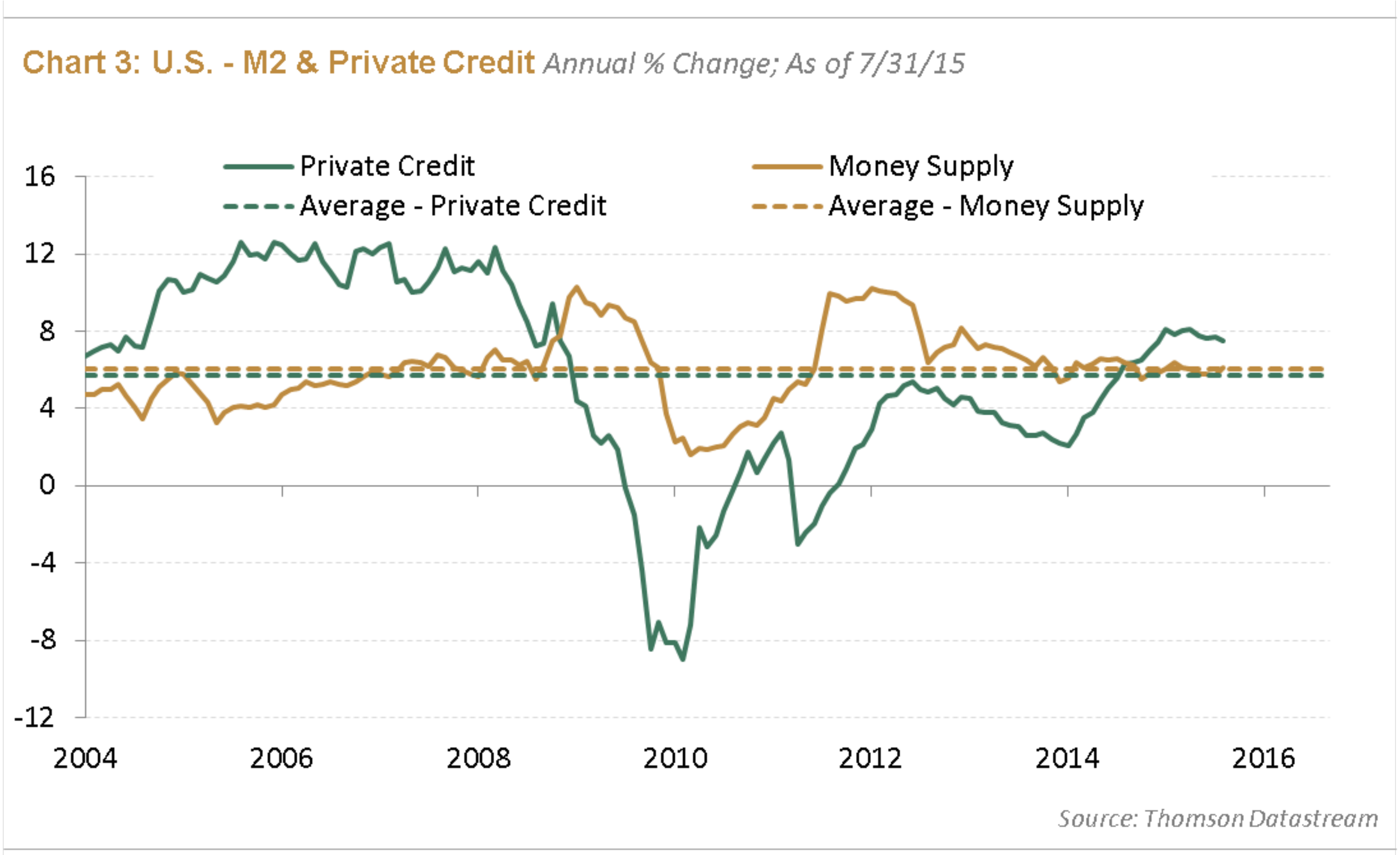
Chart 2: USHY Ex Energy OAS Spreads Model *BPs; As of 8/31/2015*



**Based on Fed loan survey, industrial production, capacity utilization, 12-month trailing default rate, and 5-year treasury*

Source: Thomson Datastream

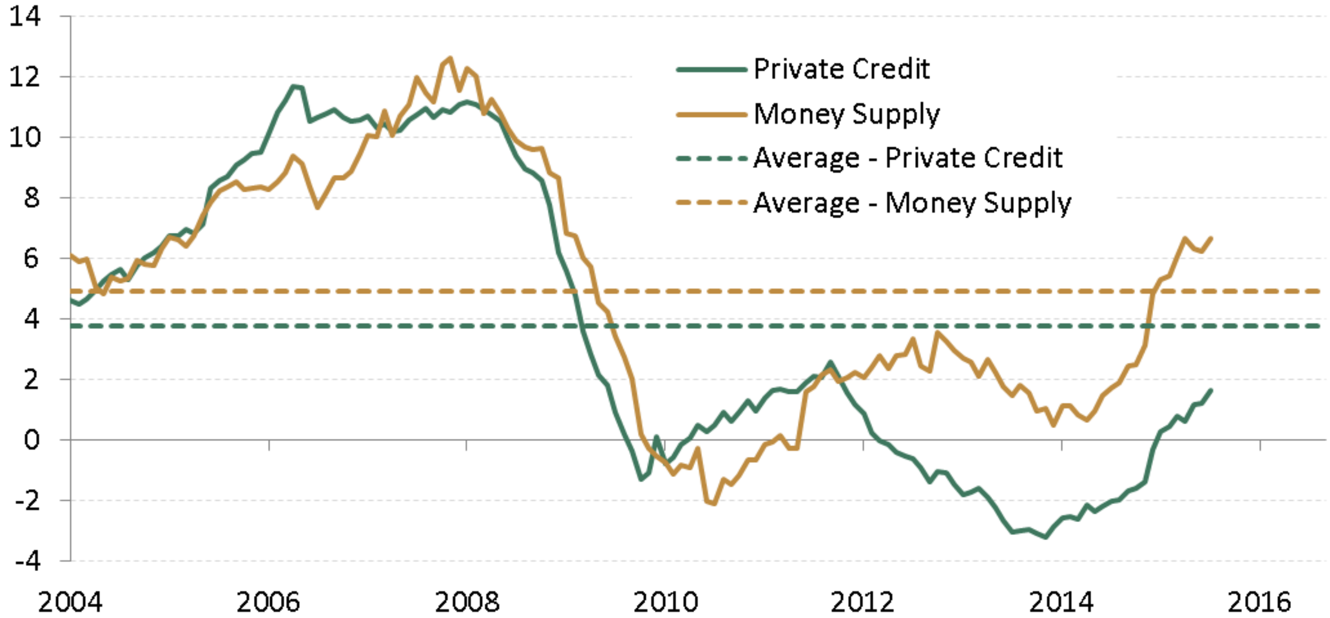
We believe fundamental analysis is critical to determining investors' expectations of current and future valuations of credit instruments. However, in light of current global monetary policy—and more specifically the Fed's decision on September 17—investors must also understand money supply across the globe as any growth or contraction will have a significant impact on risk premia.



Based on the current actions of Chairwoman Yellen and the Federal Open Market Committee at large, we would expect to see money supply growth in the U.S. remain at historical averages going forward given the Fed's accommodative stance.

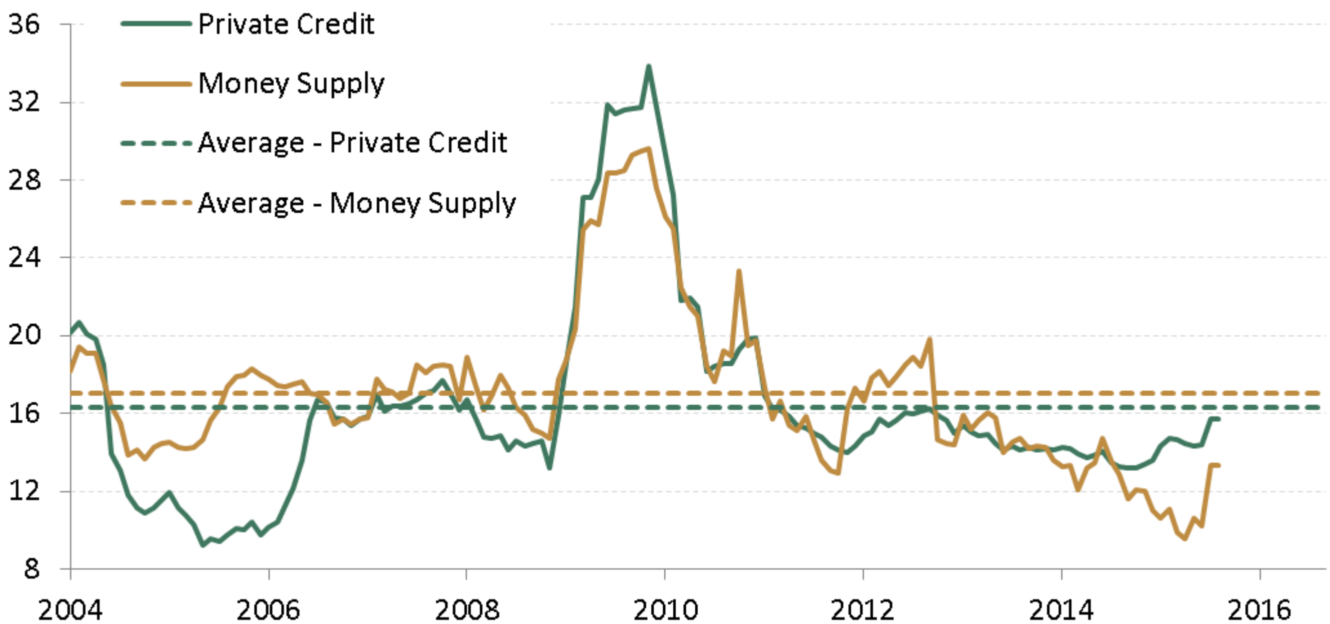
Looking across the globe, money supply growth in the euro zone continues to be accommodative for risk assets based on discussion from the European Central Bank that contemplates extending the scope and/or duration of its quantitative easing program in the event inflation expectations are not met during the remainder of the program. Meanwhile, Chinese money supply is beginning to reaccelerate after a significant period of contraction. Investors will need to determine if this will be a meaningful tailwind for risk assets.

Chart 4: Eurozone - M3 & Private Credit *Annual % Change; As of 7/31/15*



Source: Thomson Datastream

Chart 5: China – M2 & Private Credit *Annual % Change; As of 7/31/15*



Source: Thomson Datastream

In sum, our expectations are that European credit assets—both corporate and structured—with a relatively short duration could perform reasonably well under these global economic conditions.

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