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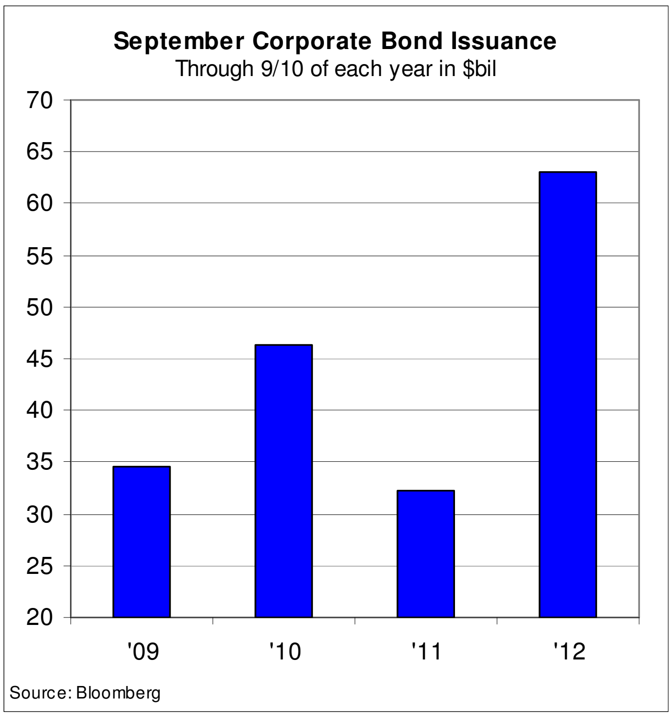
Markets Diverge, So We Look For Credit-Supported Breakouts

- **Flows into the credit market have continued to intensify, and we believe that pensions will put still more money into credit**
- **Yet stocks continue to lag as equity investors don't believe this credit strength can continue**
- **Given that equity skepticism, we look for some stock breakout candidates that are supported by the credit market**

Flows in the credit market continue to intensify. Yesterday morning we detailed the improvement in the credit market since last week, and that market further improved over the course of the day. By the end of the day investors had snapped up more than $18 billion in new corporate bonds, marking the third time in just the first five trading days of the month that has seen issuance top the $17 billion number. Despite this stunning surge in supply, junk yields were again able to hit a new low. At the start of June, the average junk bond was yielding a little over 8%, now it is yielding a little over 6.5%!

While this pace can't be maintained, we continue to believe that we are at the beginning of a wave of pension flows into credit reminiscent of those which followed the panics of 2010 and 2012. Over the summer pension after pension voted to put more money into credit and many of those votes have yet to be implemented.



Our first chart illustrates the intensity of this wave, showing new corporate bond issuance for the first 10 calendar days of each September of this credit boom. This September blows away all the others. We would further highlight that August saw record inflows, and that yields have dropped despite the new supply!

This process is putting waves of cash onto corporate balance sheets, much of which will be used on things such as buybacks to try to boost stock prices. And yet, just as happened at the end of panics of 2010 and 2011, stocks are lagging credit as equity investors seem reluctant to push stocks higher. We would cite as evidence yesterday's late day selloff in stocks, even as credit was improving.

We've written that stocks could thus be subject to a brief pullback, similar to last December (circled in our second chart), as happened on that long, post-panic run from November to March, as the credit boom began to pull stocks up again following last summer's panic.

We do not believe the Fed is ready to launch QE3 at their meeting on Thursday, so that could be the trigger for a brief stock pullback, even though the credit market is unlikely to be impacted by a lack of Fed action.

Of course, if we're wrong about the Fed the markets would most likely rally strongly into next year. Given the underweighting of stocks and the underperformance by equity managers, that would probably be the worst case scenario for many. Nearly as bad would be if the Fed doesn't ease but does come out with such supportive language that stocks don't pull back enough to let people back into the market.

So the S&P broke out last week, but is subject to a possible (brief) pullback, before resuming the type of months-long run supported by credit flows, which usually follows an episode of panic.

A number of our equity friends have asked us for individual ways to participate, so we screened for stocks that are in roughly a similar position to the S&P, either recently having broken out or getting close to one. We then screened those results for evidence that the credit market was indicating support for the bonds of those companies, such that managements of those firms would have the flexibility to engage in buybacks should equity investors create a pullback. Many of these names appear to be coming out of some type of base, and many of them appear to have had low volume for a significant period of time, indicating the potential to get noticed should they gain a little momentum. The list is:

Carnival Corp (CCL)

Leggett & Platt (LEG)

Int'l Flavors & Fragrances (IFF)

Hasbro (HAS)

PPL Corp (PPL)

General Mills (GIS)

Aflac (AFL)

Sysco (SYY)

Becton Dickenson (BDX)

Newell Rubbermaid (NWL)

Gannett (GCI)

Intuit (INTU)

TE Connectivity (TEL)

Int'l Paper (IP)

Hudson City Bancorp (HCBK)

CME Group (CME)

Honeywell (HON)

Moody's (MCO)

IBM (IBM)

Ball Corp (BLL)

Zimmer Holdings (ZMH)

Plum Creek Timber (PCL)

BB&T Corp (BBT)

PNC Financial (PNC)

Keycorp (KEY)

US Bancorp (USB)

Wells Fargo (WFC)

Fifth Third Bancorp (FITB)

M&T Bank Corp (MTB)

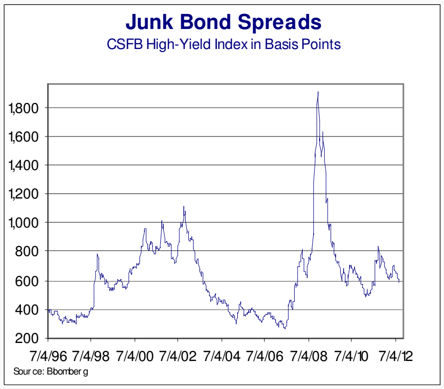
Comerica (CMA)

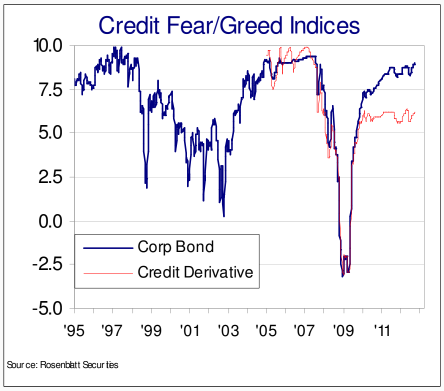
Huntington Bancshares (HBAN)

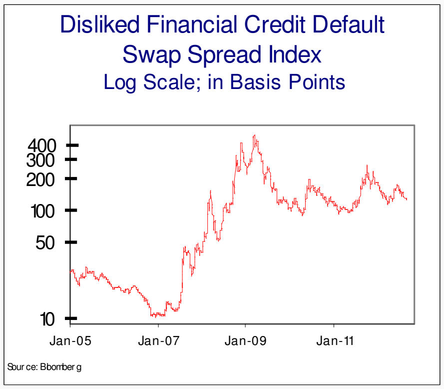
We would underscore that the credit market is indicating support for the bonds of these companies so their managements *would have* the flexibility to engage in buybacks *should* equity investors create a pullback, this does not address the longer-term picture of risk and return potential, and of course past performance is no guarantee of future results.

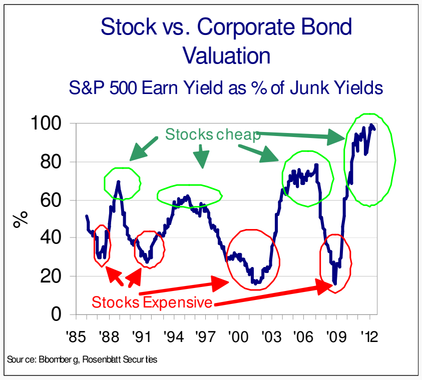
Note: We will be traveling, so our next column will be on Monday.

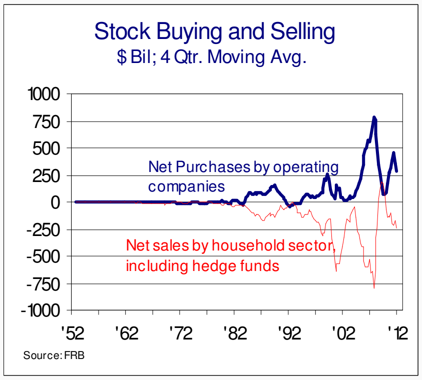
Credit & Stock Dashboard











Appendix A

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Charts: Bloomberg