

## Credit and Macro Insights

Economics & Strategy | Industry Analysis | Company Analysis

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Credit

North America

Trading Companies

## Economics & Strategy

### U.S. Economics — Thematic Perspectives: Fed Policy and the Outlook

Global

Presentation on US Outlook and Fed policy post-September FOMC

William Lee

### The Citi Income Report — A Good Year for Income Strategies...

Western Europe

Equity high yield has outperformed European equity, bunds, BBB credit, IG credit and cash (in that order) over the past 12 months. Income investors across asset classes have been well rewarded.

ECB vs Fed — Policy divergence = ECB QE to support income (DY) vs Fed to support growth (G); we suggest DY\*G therefore a more attractive income strategy (see page 18, 23), eg AXA, Rio, SocGen, Siemens, HSBC, Michelin, Allianz.

Income opportunities — Beyond DY\*G, look at: 1) UK value/DY opportunity in £20bn+mkt cap stocks yielding > 3%, almost 2x DY pick-up vs median DY, 2) CDS-adjusted DYs for multi-asset and total return strategies (see page 20 and our global CDS-DY strategy here ), 3) Tech & Resources for surplus FCF (Figure 37), 4) Banks & Resources top our European Dividend Model, 5) Rio Tinto, Siemens, Sanofi head the “screen of screens” (page 3).

Jonathan Stubbs | Ayush Tambi

### China Macro View — Cyclical Policy Not Lessening Property-Sector Drag; Trimming Growth Forecasts

Asia

Distinguishing between cyclical easing and stimulus – The property sector correction has complicated Chinese authorities’ efforts to balance between growth and reform. Policy choices are tied up to both quantitative and qualitative targets. Cyclical easing which is necessary to smooth out growth is perceived as stimulus by policy-makers, and thus avoided.

The Aug data suggests that targeted easing is unable to even partially neutralize the property drag, and if it continues, may result in a back-loaded stimulus. We cut our GDP growth forecasts to 7.3% this year (from 7.5%) and 6.9% next year (from 7.1%) to reflect the policy reluctance, and now expect three policy rate cuts from now into 1H15.

Minggao Shen | Shuang Ding

### How sticky is the money in credit? — Why the ECB is the all-

## US Key Economic Data

| Monday                  | Consensus |
|-------------------------|-----------|
| Existing Home Sales     | 5.2mm     |
| Existing Home Sales MoM | 1.0%      |

| Tuesday                      |      |
|------------------------------|------|
| Markit US Manufacturing PMI  | 58.0 |
| FHA House Price Index MoM    | 0.5% |
| Richmond Fed Manufact. Index | 10   |

| Wednesday          |      |
|--------------------|------|
| New Home Sales     | 430k |
| New Home Sales MoM | 4.4% |

| Thursday                   |      |
|----------------------------|------|
| Durable Goods Orders       | 17%  |
| Durables Ex Transportation | 0.5% |

| Friday                       |      |
|------------------------------|------|
| GDP Annualized QoQ           | 4.6% |
| Univ. of Michigan Confidence | 85   |

## International Data

| Monday                       | Consensus |
|------------------------------|-----------|
| Eurozone Consumer Confidence | 10.5      |

| Tuesday                        |      |
|--------------------------------|------|
| Markit/BME Germ. Composite PMI | 53.5 |
| Markit/BME Germ Manufact. PMI  | 51.2 |
| Markit Germany Services PMI    | 54.6 |

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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### **EMEA**

Diversification is now what it seems – While ownership of both US and European credit looks nicely diversified at first glance, the reality is that in both most of the inflows have come from what the market regards as 'non-dedicated investors'. A backstop is needed – With strong indications that those flows are waning, or about to, another source of demand is needed. Pension and insurance money is unlikely to make up the difference. To make matters worse, without Fed QE the net supply...

Hans Lorenzen

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## **Industry Analysis**

### **Consumer Watchdog — August Mattress Data**

#### **North America | Household/Personal Care Products**

This edition of the Consumer Watchdog report includes August mattress data.

Kevin Ziets | Kelly Hallinan

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## **Company Analysis**

### **CenturyLink (CTL) — RAX Plans to Remain Independent**

#### **North America | Telecommunications Operators**

What's New — Rackspace (RAX), "the #1 managed cloud company", announced it ended its evaluation of alternatives that would result in RAX being acquired. On May 15th, RAX disclosed in an 8-K that RAX had been approached by "multiple parties who expressed interest in exploring a strategic relationship".

David Phipps | Ashish Nair

### **Christmas Is Early!! — TOY Announces Cost Savings Plan of \$150mm-\$200mm**

#### **North America | Retailing - Department Stores, Retailing - Specialty Softlines, Retailing - Specialty**

Christmas Is Early — In conjunction with the filing of its Delaware financials, TOY announced that they expect to realize annualized cost savings of approximately \$150mm-\$200mm by the end of 2016. The company noted the estimates are "preliminary" and expected savings could change as the plan progresses. Recall that in our February 2014 initiation, we highlighted we thought the company could achieve at least \$200mm of savings longer term based on our analysis of how SG&A per store has trended in recent years.

Jenna Giannelli

### **Crane Weakness Hits Terex (Again) — Downgrading TEX & MTW to Marketweight**

#### **North America | Diversified Industrials**

What's New — Earlier today (9/15), Terex issued a press release announcing the reduction of its full year 2014 guidance owing to weaker than expected demand in Crane end markets. The company noted FY14 EPS is now expected to be between \$2.35 and \$2.50 (vs. previous guidance of \$2.50 and \$2.80 and consensus expectations of \$2.56). TEX also introduced 3Q14 EPS guidance of \$0.55-\$0.65, well below market expectations of \$0.80. Terex 6.00% & 6.50% senior notes were down ¼ to ½ points following the announcement.

We are downgrading our issuer weighting on both Terex & Mainitowoc from Overweight to Marketweight following the news. We also highlight relative value

|                               |      |
|-------------------------------|------|
| Markit Eurozone PMI Manufact. | 50.6 |
| Markit Eurozone Services PMI  | 53.0 |
| Markit Eurozone Composite     | 52.5 |

### **Wednesday**

|                                |       |
|--------------------------------|-------|
| Germany IFO Business Climate   | 105.8 |
| Jap. Markit/JMMA Manufact. PMI | 52.32 |

### **Thursday**

|                         |      |
|-------------------------|------|
| Japan CPI Ex-Fresh Food | 2.6% |
| Japan CPI YoY           | 3.3% |

### **Relative Value**

- September 17

### **Outlook Publication**

- High Yield & Leveraged Loan Outlook & Top Ideas

### **PM Weekly**

- September 12

### **Citi's Most Read – High Yield**

- September 10 – September 16

opportunities within our high yield industrials coverage universe.

Manish A. Somaiya | Ishan Singh | Sapan Shah

### **DynCorp International (DCP) — Continuing Uncertainty Keeps us on Sidelines; Updating Forecasts**

North America | Aerospace & Defense

What's New? — Over the past two months, DynCorp 10.375% senior notes have sold off 14+ points from their pre-earnings level of \$105. At current mid-market price of \$90.5, the paper yields 14.6% to its 2017 maturity date (575bp incremental yield vs. CCC-rated Index). In addition to weak 2Q results reported on Aug 11, CEO departure(s), and a downgrade from Moody's on Aug 15, negative headlines relating to lost contracts and a DoD investigation into overcharges for an prior contract (2007-2013) have negatively impacted trading levels. We see potential for continued volatility and prefer to remain Neutral on the 10.375% senior notes, despite tempting yields.

Manish A. Somaiya | Ishan Singh | Sapan Shah

### **Guidance Cut but Not So RADical — Higher Generic Costs, Lower Reimbursements Impact Margin Outlook but FCF Story Still Intact**

North America | Retailing - Department Stores, Retailing - Specialty Softlines, Retailing - Specialty

Citi's Take — Rite Aid Corp. (RAD) reported 2Q results that were ahead of our expectations, but that were overshadowed by the lowering of guidance for the 2H of the year. SSS increased 4.1% YoY, led by pharmacy SSS growth of 5.6% and front end SSS growth of 1.1%. Script count was up 3.7% reflecting higher utilization, particularly in Medicaid expansion states. Adjusted EBITDA came in \$364.2mm, beating our estimate of \$308mm and consensus of \$294mm. The increase was primarily driven by front-end & pharmacy gross profit, but also benefitted from a positive \$40mm impact on inventory valuation from a McKesson purchasing agreement that should be offset in the next two quarters.

Jenna Giannelli

### **Results: Lennar (LEN) 3Q14 — Solid Beat by LEN; Reiterate Buy on 2022s**

North America | Homebuilding

Citi's Take: LEN reported a better than expected quarter on most fronts with order growth of +23% YoY and continued gross margin improvement (QoQ & YoY). This strong result is a positive data point for the industry given LEN's diverse geographic and end market footprint. In the press release LEN's CEO stated he expects a continued gradual housing recovery driven by limited supply, improved demand which will continue to be restrained by reduced credit availability for buyers.

James P Finnerty | Maneesha Shrivastava

### **U.S. Steel — Restructuring Canadian Ops, Stopped Blast Furnace Expansion, Strong 3Q Guidance**

North America | Steel

We view better than expected 3Q guidance, the restructuring and deconsolidation of its Canadian operations and capex reductions related to blast furnace production positively.

Richard C Yu

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# Appendix A-1

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|---|---------------|-------------|-------------|
|   | <i>Buy</i>    | <i>Hold</i> | <i>Sell</i> |
| Citi Research US High Yield Issuer Coverage                                       | 31%           | 58%         | 10%         |
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