



STANSBERRY'S CREDIT OPPORTUNITIES

Seven Credit-Market 'Bombs' Waiting to Explode Right Now

On a quiet Tuesday night in Germany, a 1,100-pound bomb exploded... killing three men.

The unexpected blast happened at 9:36 p.m. on June 1, 2010, at a construction site in Göttingen, a city on the River Leine with about 115,000 residents. Six others were injured.

The casualties weren't just bystanders, though. They were three experts who were hired to defuse an unexploded bomb found by workers building a new sports arena on the site.

But as the experts prepared to begin removing the bomb from the property, it suddenly detonated about 22 feet underground... sending shrapnel hundreds of yards away.

The bomb had a delayed-action chemical fuse and was highly unstable. It was one of three bombs found at the site. The team had just removed a similar bomb the week before.

This wasn't a terrorist attack. *The active bomb had been buried for nearly seven decades.*

You see, the three victims were experts on disposing of World War II-era bombs. They spent years – decades, in the case of two of the victims – removing bombs like this one...

Reports said they had defused more than 600 bombs in their careers. But as Peter Bodes, head of the Hamburg Ordnance Disposal Unit, told German public television at the time...

Accidents happen, of course. But you always go out there thinking, "It won't be me."
So it's just dreadful when something tragic like this happens.

A decade after this accident – and nearing the 75th anniversary of the end of World War II – old, unexploded bombs remain a major problem throughout Europe. In Germany, hardly a week goes by without a street being closed and evacuated due to unexploded ordnance.

The Allied Powers dropped almost 2 million tons of ordnance on Germany during the war. But the bombs were notoriously unreliable... Estimates show up to 15% never exploded.

Today, up to 300,000 metric tons of undetonated bombs remain under Germany... Even after American and British officials handed over air-reconnaissance photos in the 1990s of their bombing runs, it's still impossible for experts to pinpoint the locations of all the bombs.

INSIDE THIS ISSUE:

- Breaking Down the Current Craze in the Bond Market
- Don't Follow the Herd Into These Investments
- These Five Steps Will Help You Build an Ideal Bond Portfolio

STANSBERRY RESEARCH

1125 N. Charles Street
Baltimore, MD 21201
1-888-261-2693
www.stansberryresearch.com

Editor

Mike DiBiase

Analyst

Bill McGilton

Many of the bombs pierced a layer of soft soil and bounced off the gravel layer below the surface. And to this day, they're resting underneath the top layer – with the TNT intact – waiting for their chemical detonators to corrode and explode... like the one did in 2010.

Working near such danger is a risky proposition, even for the best-trained experts. They know most of the bombs will eventually explode... They just don't know exactly *when*.

We see similar dynamics in the corporate-bond market today...

We know hidden dangers – devastating "bombs" – lurk just below the surface... waiting to go off. These bombs are getting ready to explode. It's not a matter of if... but *when*.

Fueled by a decade of record-low interest rates, U.S. companies have now amassed more than \$10 trillion in corporate debt. They've long blown past the \$6.6 trillion peak from the last financial crisis. And the credit quality of much of this debt is the worst ever... To survive, many companies need the world's central banks to keep the monetary spigot open.

Central banks – like the German bomb-disposal experts – are frantically exhausting all their resources to defuse the bombs. They're keeping interest rates at record lows and injecting liquidity into the markets. But like the bomb experts, they can't control all the variables.

Eventually, a recession or geopolitical shock will hit... *It always does*. Credit will suddenly tighten. And the debt bombs will begin to detonate – the weakest and most volatile first.

Yet right now, the bond market continues to ignore all these risks. Far too many investors are currently thinking, "It won't be me." We don't want you to be one of the victims...

So instead of making a new recommendation this month, we want to help you learn about all the dangers lying beneath the surface. And we want to prepare you for what's coming.

Let's get started...

BREAKING DOWN THE CURRENT CRAZINESS IN THE BOND MARKET

This month, we went through our normal process to identify a potential recommendation...

We scoured through roughly 40,000 U.S. corporate bonds searching for "outliers" – safe bonds yielding far more than they should, given the level of risk we would be taking on.

Normally, we find a handful of bonds that look promising. After investigating further, we identify the most attractive opportunity... and recommend putting your money to work.

But the thing is, *few corporate bonds look interesting at today's inflated prices*.

Most distressed bonds – those trading at significant discounts to their par value of \$1,000 per bond – are far too risky to invest in right now. And the few opportunities that seemed interesting on our initial scan didn't meet our standards after we took a closer look.

To give you an example of the current craziness, look at this list of corporate bonds...

Issuer	CUSIP No.	Coupon	Maturity Date	Bond Price	Yield to Maturity	Stansberry Rating
Macy's	55616XAH0	2.875%	2/15/23	\$988	3.26%	7 - Moderate
AT&T	00206RUL7	4.850%	7/15/45	\$1,142	3.96%	7 - Moderate
Netflix	64110LAV8	4.875%	6/15/30	\$1,026	4.54%	5 - Distressed
Hertz	428040CZ0	6.000%	1/15/28	\$1,000	6.00%	5 - Distressed
Community Health	12543DAY6	6.250%	3/31/23	\$983	6.83%	5 - Distressed
McClatchy	579489AL9	9.000%	7/15/26	\$928	10.55%	5 - Distressed
WeWork	96208LAA9	7.875%	5/1/25	\$805	13.00%	4 - Distressed

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Source: Bloomberg

We'd never recommend any of these bonds at these prices and yields.

All these businesses have large amounts of debt. The yields on these bonds don't come close to compensating investors for the default risk.

For example, telecom AT&T (T) owes a total of \$165 billion in debt. Yet investors are paying well above par value right now for an AT&T bond with just a 4.85% coupon... and that isn't due until 25 years from today. More than \$127 billion in debt comes due ahead of this bond.

Video streamer Netflix (NFLX) has never generated any free cash flow. In fact, it's burning through more cash than ever to produce its own content. And yet, investors are paying more than par for a bond due in more than a decade with a 4.875% coupon.

This shows that investors are getting desperate in their chase for yield...

Yields on government bonds are negative in parts of Asia and Europe. And here in the U.S., 10-year U.S. Treasury bonds only yield 1.85% today. Looking for any kind of meaningful fixed-income returns, investors have turned their attention to the corporate-bond market.

They've chased up bond prices, causing yields to fall. (Remember, prices and yields move inversely... So when the prices of bonds go up, their yields – or returns – go down.)

Whether you've been with us since we launched *Stansberry's Credit Opportunities* or you're a new subscriber, please know this... **We'll never recommend that you buy a bond if we don't believe you'll be more than compensated for the risk you're taking on.**

We refuse to follow the herd... ignoring risk and chasing yield. That will result in disaster.

And that brings us to the main point of this month's issue...

We've identified seven "bombs" hidden from the view of most bond investors today. If just one of them explodes, it could set off a chain reaction that brings down the financial markets.

That's why you must prepare now for what's coming...

To help you do so, we're taking a deep dive into the corporate debt market this month. As we'll explain, unlike the last financial crisis that was set off in the subprime mortgage market, we believe the next financial crisis will begin in the corporate-bond market.

Armed with this knowledge, you'll be ahead of 99% of investors when disaster strikes.

DON'T FOLLOW THE HERD INTO THESE INVESTMENTS

Before we tell you about the hidden dangers in the corporate-bond market, let's look at how most investors view this market today. In short, *they're completely oblivious to the risks.*

Our favorite metric to "take the temperature" of investor sentiment in the bond market is the "high-yield credit spread." It's the difference between the average yield of high-yield – or "junk" rated – corporate bonds and the yield of similar-duration U.S. Treasury notes.

As we go to press this month, the high-yield credit spread equals about 350 basis points ("bps"). That's down from 400 bps last month, and it's well below its historical average of around 600 bps... More important, *the spread hasn't been this low since October 2008.*

That tells us investors aren't worried at all. They're gobbling up junk-rated debt.

When the high-yield credit spread is below normal, it means investors aren't getting properly compensated for the default risk of these bonds. That's true today, too... The average junk bond only yields about 5%, compared with 1.85% for 10-year Treasuries.

We can measure investor sentiment toward junk bonds in another way, too... inflows and outflows of exchange-traded funds ("ETFs") that focus on high-yield bonds.

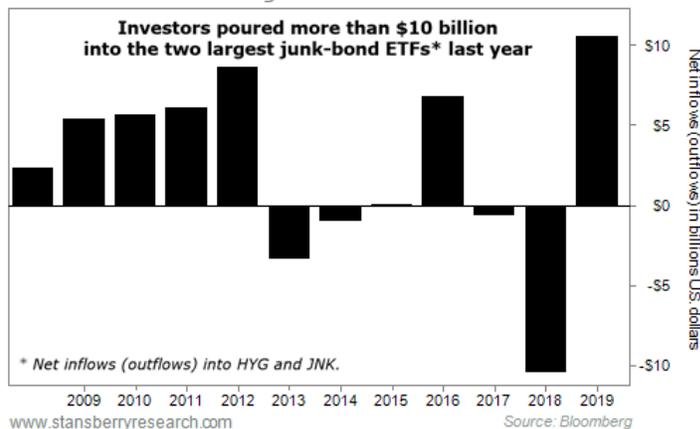
We use the two largest ETFs in this category – the iShares iBoxx High Yield Corporate Bond Fund (HYG) and the SPDR Bloomberg Barclays High Yield Bond Fund (JNK).

These types of ETFs give retail investors much easier access to junk bonds than ever before. You can buy them in your brokerage account with a click of a mouse... just like any stock.

If investors are piling money into these ETFs, we know they love junk bonds. And if money is flowing out, it means investors view junk bonds as more risky than other investments.

Right now, investors can't get enough of junk bonds... They piled a record \$10.6 billion into HYG and JNK last year. That's a big change in sentiment from 2018, too. Take a look...

Record Inflows Into High-Yield ETFs



And as the following chart shows, the gamble paid off last year...

ANNUAL RETURNS OF TWO LARGEST JUNK-BOND ETFs

Year	HYG	JNK
2019	14.1%	14.9%
2018	-2.2%	-3.5%
2017	6.1%	6.5%
2016	13.4%	14.4%
2015	-5.0%	-6.8%
2014	2.2%	1.3%
2013	5.7%	5.7%
2012	10.8%	12.4%
2011	6.8%	5.1%
2010	11.9%	13.7%
2009	29.2%	44.3%
2008	-18.1%	-28.1%
2007	1.6%	0.7%

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Source: Bloomberg

JNK and HYG returned 14.9% and 14.1%, respectively, in 2019. It was second-best annual return in history for both ETFs... trailing only 2009, the year after the last financial crisis.

The historically low high-yield credit spread and massive inflows into high-yield ETFs throughout the past year tell us that investors' appetites for junk debt is far from satisfied today. But the thing is, we don't believe you should join the crowd. *Don't make this bet.*

In fact, if you're invested in any junk-bond ETFs today, we think you should exit the position immediately. Including JNK and HYG, here are some of the largest junk-bond ETFs...

Ticker	Junk-Debt ETF Name
HYG	iShares iBoxx High Yield Corporate Bond Fund
JNK	SPDR Bloomberg Barclays High Yield Bond Fund
BKLN	Invesco Senior Loan Fund
SJNK	SPDR Bloomberg Barclays Short Term High Yield Bond Fund
SHYG	iShares 0-5 Year High Yield Corporate Bond Fund
HYS	PIMCO 0-5 Year High Yield Corporate Bond Index Fund
SRLN	SPDR Blackstone GSO Senior Loan Fund
FTSL	First Trust Senior Loan Fund
HYLS	First Trust Tactical High Yield Fund
PHB	Invesco Fundamental High Yield Corporate Bond Fund

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Each of these ETFs owns a large basket of corporate bonds issued by companies with junk-rated credit. But the fund managers don't tell you about their enormous problem...

These ETFs can't choose to hold their bonds until maturity like we can.

When other investors want to get out – and when defaults rise, they will in large numbers – the ETFs will be forced to sell their bonds to meet customers' redemptions. They have no choice. They must repay the ETFs' investors. And to do so, they'll sell anything they can.

The fund managers will likely sell their best bonds first... the ones with the most liquidity that can raise the most cash in a short period. Then, the ETFs will be left with a portfolio of ever-riskier bonds whose prices have collapsed. There won't be nearly enough liquidity to handle all the sales. Investors in these high-yield ETFs will be wiped out quickly...

For example, during the last financial crisis, the ICE Bank of America Merrill Lynch U.S. High Yield Bond Index collapsed... losing nearly a third of its value in three months. And with much lower credit protections today, *the next collapse will be much worse.*

When you own individual bonds, you don't have to worry about other investors exiting their positions and ETFs being forced to sell their bond holdings. As long as you know you'll be paid all of your interest and principal in full at maturity, you have nothing to worry about.

Let's now look below the surface at the hidden bombs that could set off the next crisis...

STAY CLEAR OF THESE SEVEN DANGERS

Most investors in junk bonds aren't scared right now. But we are...

We see a lot of hidden dangers in the corporate credit market. And any one of these bombs could detonate as soon as later this year... causing the junk-bond market to collapse.

As distressed-debt investors, we must be aware of what could happen...

While a sell-off in the junk-bond market would likely cause prices of our current holdings to dip in the short term, it's important to remember that we locked in our expected returns at the time of purchase – as long as our companies don't default. And when the next crisis hits,

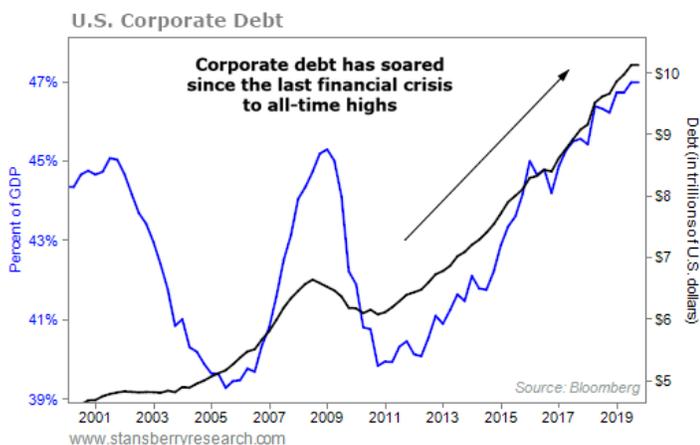
we expect to have plenty of opportunities to make safe, significant annual returns.

With that said, we'll start with the first bomb that's lurking in the corporate credit markets...

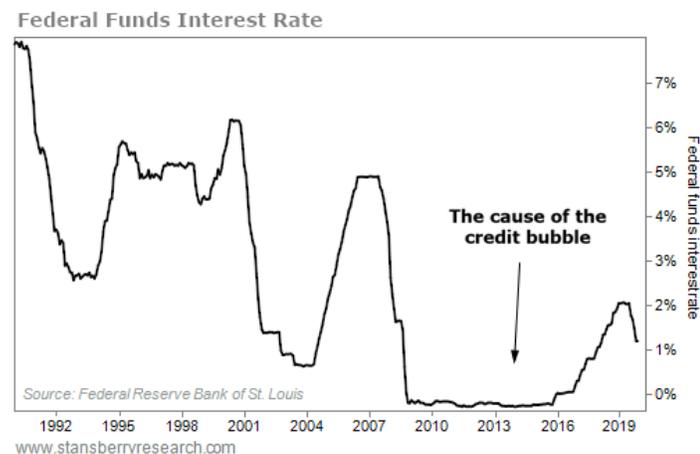
Bomb No. 1 – Record Corporate Debt

As we mentioned earlier in this month's issue, corporate debt in the U.S. is now at unprecedented levels... U.S. corporations owe a record \$10.1 trillion. That enormous amount of debt represents 47% of the annual U.S. gross domestic product ("GDP").

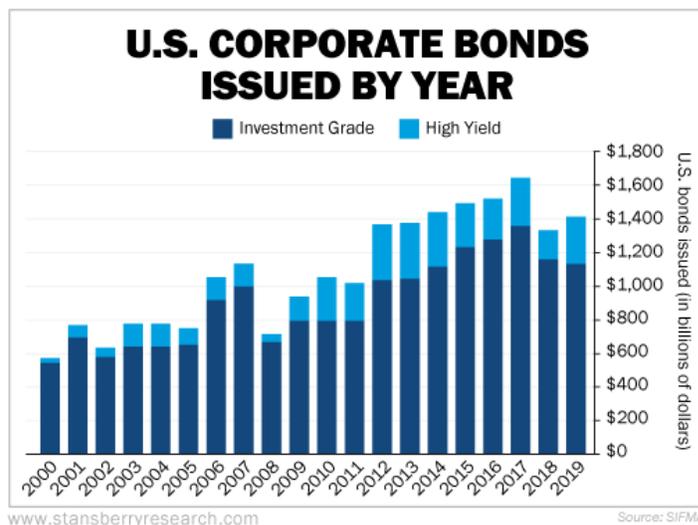
It's an all-time high... both nominally and as a percentage of GDP. Corporations have never owed this much money in history. This is what a bubble looks like...



The Federal Reserve's fingerprints are all over this credit bubble. Its "easy money" policies since the last financial crisis have forced interest rates lower and lower. Take a look...



U.S. corporations took advantage of the Fed's generosity and borrowed like never before. The following chart shows the amount of new bonds issued over the past 20 years...



Almost \$11 trillion of new bonds were issued over the past decade by investment-grade companies, compared with \$7 trillion during the previous decade... an increase of about 53%.

Meanwhile, junk-rated companies issued \$2.7 trillion in new bonds over the past 10 years, compared with \$1 trillion during the previous decade. *That's an increase of about 170%.*

And it doesn't just stop with bonds... Highly leveraged companies have increasingly turned to another source for their borrowing needs. It's another high-yield market that is just as risky as – and now even bigger than – the junk-bond market... leveraged loans.

Like junk bonds, leveraged loans are made to companies with poor credit.

But leveraged loans have floating interest rates. So when rates rise, these loans pay more interest. That's why investors love them... They could potentially pay a lot of interest.

The leveraged-loan market has doubled since the end of the last financial crisis. The Bank for International Settlements ("BIS") – a collection of 60 global central banks – estimates that the size of the U.S. leveraged-loan market is now \$1.4 trillion.

Banks typically make these risky loans. But they don't hold on to them for long... They use the same financial trickery they used with subprime mortgages in the 2000s, packing them up and selling to institutional investors – like pension funds, hedge funds, and mutual funds.

Once bundled together, these loans are called "collateralized loan obligations" ("CLOs").

Private-equity firms have even joined the party...

They're lending directly to smaller, high-risk borrowers, packaging the loans, and selling them. The private-equity firms making these types of loans are known as "shadow banks"... because they aren't regulated like actual banks. So they can take on even more risk.

Leveraged loans might even be riskier than high-yield bonds. As demand for high-yield debt has soared since the last crisis, the quality of these loans has deteriorated... The loan covenants – the rules that govern what a borrower can and can't do – have grown weaker.

Meanwhile, the number of "covenant lite" leveraged loans (loans with weak creditor protections) has soared... Today, more than 85% of leveraged loans are considered covenant lite – up from just 17% in 2007.

With weaker protections, investors will recover far less in bankruptcies than in past credit cycles. Former Fed Chair Janet Yellen sounded the alarm on leveraged loans in October 2018, when she cautioned about "the systemic risk associated with these loans."

The size of corporate debt today is unsustainable. It has grown 67% since the last financial crisis. And debt issued by the most dubious borrowers has grown even faster in that span.

This has set the stage for a massive explosion in the credit markets. When this debt starts going bad – as it always does in credit cycles – many investors will get wiped out.

Bomb No. 2 – Low Credit Quality

It's not just the *size* of the corporate debt markets that's troubling...

The *quality* of this debt is at an all-time low, too.

A 2019 study from investment bank JPMorgan Chase showed the ratio of debt to earnings before interest, taxes, depreciation, and amortization ("EBITDA") for U.S. companies was 2.24 times. That's near the same levels as before the past three recessions.

The Fed noted in a November report that the debt-to-asset ratio of publicly traded U.S. companies – another important leverage ratio – is at its highest level in two decades. And according to the Fed's report, the ratio for debt-heavy firms is near a historic high.

The Fed's artificially low interest rates have kept many companies alive for much longer than in the past. As a result, more "zombie" companies exist today than ever before.

Zombies are companies whose profits can't even pay for the interest on their debt. These companies are like the walking dead... They have no hope of ever paying off their debt.

According to a 2018 study from the BIS, the number of zombie firms has increased sixfold since the mid-1980s. The BIS estimates that one in six U.S. companies is now a zombie.

The only reason these zombies keep breathing is that banks with low lending standards keep extending them credit. Without banks continuously rolling over (or refinancing) their debts, these companies wouldn't exist. This situation likely won't last forever...

If banks suddenly denied credit to these zombies, a tidal wave of American companies would go bankrupt. The result would be skyrocketing default rates... massive credit losses... bond investors rushing for the exits... and the global economy grinding to a halt.

Bomb No. 3 – Record-High BBB-Rated Debt

In addition to leverage ratios, you can assess the credit quality of U.S. companies through their credit ratings. And today, the ratings of U.S. debt are the worst they've ever been...

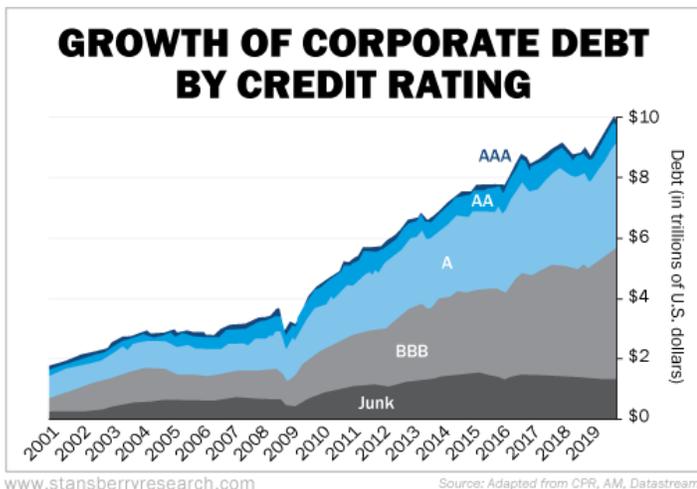
Three major agencies – Standard & Poor's ("S&P"), Moody's, and Fitch Ratings – continually assess the credit of most U.S. borrowers and assign credit ratings. With S&P, they range from AAA to CCC. Longtime subscribers know that AAA, AA, A, and BBB ratings are known as "investment grade"... and ratings of BB, B, CCC, CC, and C are "noninvestment grade."

In the 1990s, more than 60 U.S. companies had the highest credit rating – AAA. Today, just two U.S. companies – consumer-products behemoth Johnson & Johnson (JNJ) and technology giant Microsoft (MSFT) – maintain perfect AAA ratings.

The credit quality of corporate debt in America has steadily worsened since the last financial crisis. According to Bloomberg, the largest portion of U.S. corporate bonds outstanding today is rated BBB. BBB-rated debt totals \$3

trillion – or 40% of all outstanding corporate-bond debt in the U.S. That's the largest percentage ever. It's four times higher than in 2008.

The following chart shows the growth of U.S. corporate debt by credit rating since 2001...



BBB-rated debt has grown the most... And it now accounts for the largest share of U.S. corporate debt. In other words, **nearly half of U.S. corporate debt is only one level above junk.**

This is important... *Downgrades to BBB-rated companies will send them into junk territory.*

Regular readers know newly minted junk-rated companies are known as "fallen angels"...

Many large institutional investors – like pension funds, hedge funds, and mutual funds – have policies specifying that they can only hold investment-grade debt. So when they hold the debt of a company that's downgraded to junk, they must sell. They have no choice.

Downgrades to large numbers of BBB-rated companies will trigger massive selling...

Remember, the investment-grade debt market is much larger than the high-yield market. Demand in the high-yield market can't absorb this debt. It will send prices crashing.

The Fed is also concerned about BBB-rated debt. As it wrote in the November report...

"In an economic downturn, widespread downgrades of bonds to speculative-grade [junk] ratings could lead investors to sell the downgraded bonds rapidly, increasing market illiquidity and down-

ward price pressures in a segment of the corporate bond market known already to exhibit relatively low liquidity."

Bomb No. 4 – Downgrades on the Rise

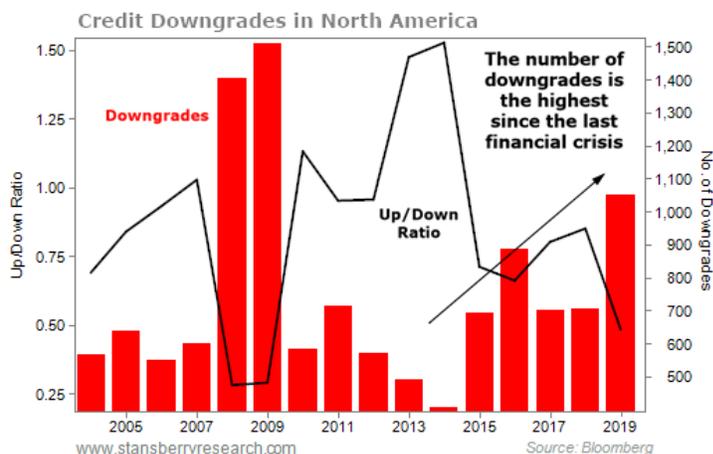
Credit quality is not only low today... *It's getting worse.*

The best way to look at the direction of credit quality is through the number of credit downgrades and upgrades. Regular readers know it's another one of our favorite metrics...

S&P downgraded the credit of 1,053 companies in North America at some point last year. That's the most downgrades since 2009... and it's up nearly 50% from the 705 downgrades in 2018. Almost two-thirds of these downgrades occurred with junk-rated companies.

Meanwhile, S&P only upgraded the credit ratings of 510 companies last year.

The "up/down ratio" is the number of upgrades divided by the number of downgrades. A ratio above 1 indicates improving credit in general. And a ratio below 1 means conditions are worsening. Last year, the up/down ratio fell to 0.48, its lowest level since 2009...



Companies don't normally default without warning. We can often spot trouble ahead of time... S&P and other agencies typically cut their credit ratings before a default. As a result, the number of downgrades is a good predictor of how the default rate will change.

On the surface today, everything looks calm if you just look at the default rate...

The number of companies defaulting on their debt is still relatively low. The high-yield default rate – the percentage of companies with junk-rated credit that missed interest or

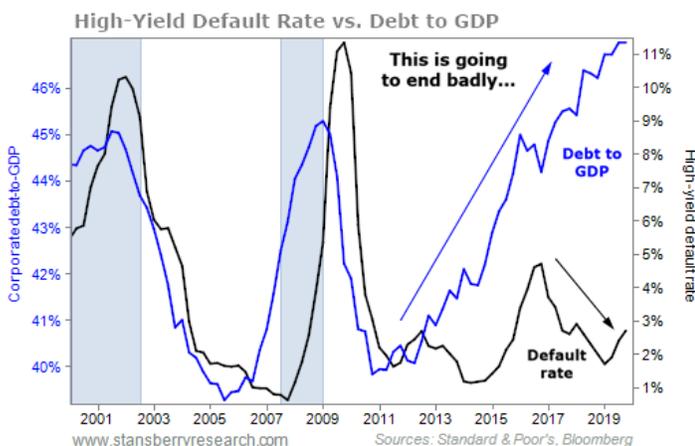
principal payments – is about 3.1%. Ultra-low interest rates have kept defaults at bay.

But again, this situation simply can't last.

Given the record level of corporate debt in the country today, this is highly abnormal. Notice in the following chart how the default rate normally rises and falls in a similar pattern to the level of corporate debt in the economy... but on a slight lag. That makes sense...

As debt levels balloon, interest costs rise and many companies struggle to repay their loans. The most leveraged companies default. Debt rises, then the default rate follows. In credit crises, the default rate spikes higher than 10% and triggers recessions and bear markets.

But that normal relationship has broken down in the years after the last financial crisis...



Since 2010, corporate debt has ballooned to all-time highs. However, the default rate hasn't followed it higher. It's still near historic lows. Except for a brief spike back in 2016 when oil and gas prices cratered, it has held steady in the 1.5% to 3% range for nearly a decade.

With its easy-money policies, the Fed has only delayed the day of reckoning for corporate America. It can only end in two ways... Corporate debt must fall, or defaults must rise.

And except for a few tech giants, corporate America doesn't have the cash to pay down its debt. So the only logical way this will end is with defaults rising. *That won't be pretty.*

Edward Altman, professor emeritus at New York University's Stern School of Business, believes more money will be lost than normal through defaults in the next downturn. As he warned during an interview with *Fortune* magazine early last month... "The magnitude of the next spike in default rates, whenever it occurs, will be severe."

Bomb No. 5 – A 'Wall of Maturities'

U.S. companies face a mountain of maturing debt over the next few years...

According to Bloomberg data, \$3.8 trillion of bonds are set to mature over the next five years – including \$1 trillion this year. As we've explained before, U.S. Secretary of Commerce Wilbur Ross refers to this phenomenon as a "wall of maturities."

Most companies completely depend on banks to refinance their debt as it comes due...

Soon, lenders will need to decide if they want to keep kicking the can further down the road for these companies. Will they extend these companies' debts for another five to 10 years, knowing that interest rates are likely to rise and a recession is right around the corner?

With leverage ratios worsening, we believe banks will start saying "no" more often. And starting this year, banks must consider another critical factor in making these decisions...

Bomb No. 6 – A New Accounting Rule in 2020

At the beginning of the year, a new accounting rule went into effect that will radically change the way banks account for their loan losses...

Under the previous accounting rules, banks only recorded credit losses after it looked likely that the loans would go bad. But now, banks must record all projected future credit losses on their loans at the time they're made. They can no longer wait for the loans to actually start running into trouble.

This is a big deal... It will force many banks to *significantly increase their loan loss reserves*. One major accounting firm called it "the biggest change to bank accounting – ever."

As a result, banks will soon begin cutting off credit to the least creditworthy companies – those most in need of their credit lifelines. Many companies will be hung out to dry.

In fact, U.S. banks are already tightening credit...

The best way to gauge whether banks are loosening or tightening credit is to look at their lending standards. Every quarter, the Fed surveys a collection of U.S. banks and asks how their credit standards have changed over the previous three months. The Fed wants to know if the banks have tightened standards, eased them, or kept them the same.

The information is all boiled down into a single number...

It's the difference between the percentage of banks tightening credit and the percentage easing credit. If the percentage of banks tightening is higher than the percentage easing, the net score is positive. If the number of banks easing is greater, the score is negative.

In the latest available survey, the net score was about 5%. The survey shows that despite the Fed's interest rate cuts, banks are worried again. That spells trouble... If banks are tightening when the Fed is dovish and lowering interest rates, that's a bad sign.

When banks tighten, defaults rise. And when defaults rise, investors start selling bonds and the credit spread widens. This is an important trend to keep a close eye on...

The next Fed survey should be published in early February. If the tightening from the banks continues into 2020, it could become the ignitor to set off the next credit crisis.

Bomb No. 7 – Threat of a Recession

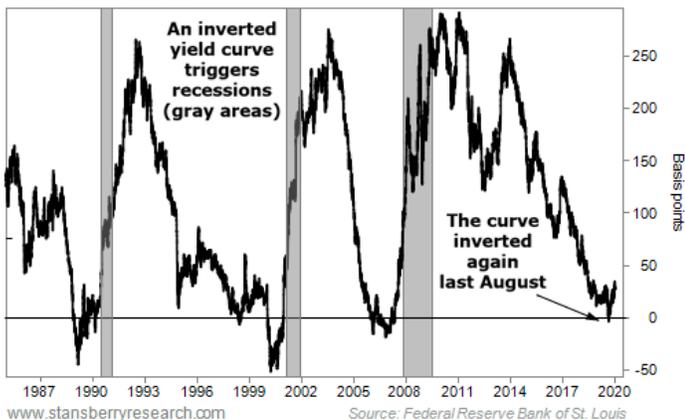
By now, you should see that the majority of U.S. companies are in a perilous situation...

Overall, they're leveraged like never before. They're dependent on low interest rates and creditors willing to lend them money. And they're also dependent on the economy humming along... *But the next recession could detonate the entire credit market.*

If corporate profits fall, companies' debt-to-earnings ratios will rise. In turn, their credit ratings would be downgraded... and as riskier businesses, their interest costs would soar.

In that scenario, access to credit would dry up... and a wave of companies would default.

2-10 Yield Curve



The best "recession warning sign" already flashed last August, when the so-called "2-10 yield curve" inverted. In other words, the interest rate on the 10-year U.S. Treasury note fell below the rate on the two-year Treasuries. You can see that doesn't normally happen.

Dating back six decades, an inversion of the 2-10 yield curve has preceded every recession.

From studying the past occurrences, we know that a 2-10 yield curve inversion doesn't lead to an immediate recession. On average, recessions usually follow around 18 months later.

Sometimes, recessions come much sooner... Back in 1980, the stock market peaked less than three months after the 2-10 yield curve inverted. And other times, they happen much later... The 2-10 yield curve inverted around 22 months before the dot-com crash of 2000.

We can't say exactly when the next recession will start. But based on the inversion of the 2-10 yield curve last summer, we know it isn't far off. The clock is now officially ticking...

To sum up, many unexploded "bombs" lurk beneath the surface of the corporate-bond market... including unsustainable debt levels and rising leverage for many companies.

These companies face a wall of maturities, and many must depend on creditors to refinance their massive debt loads. Plus, it's all happening in an environment with credit downgrades on the rise, an impending global recession, and a new accounting rule for banks' loan losses.

And remember, the largest portion of corporate debt is one notch away from being downgraded to junk. It's a recipe for disaster... and we want to make sure you're prepared.

THESE FIVE STEPS WILL HELP YOU BUILD AN IDEAL BOND PORTFOLIO

So now, let's discuss what you should do with everything we've discussed today...

First, **stay away from corporate-bond mutual funds and corporate-bond ETFs.** Investing in these funds is not like investing in individual bonds. As we explained, these investments don't have any specific maturity dates... so the market price matters.

Second, **build your cash stockpile**. It's OK to sit on the sidelines and wait for the best opportunities to emerge. Let other investors assume the risk today. After the next collapse, you'll be able to pick up bonds for pennies on the dollar that currently trade near par value.

Third, **only put your money to work today in safe distressed debt with attractive returns given the level of risk you're taking on**. You won't find many bargains today... That's why we call them outliers. In today's market, finding them is like spotting "Bigfoot."

That's where we come in... We do all the work for you in *Stansberry's Credit Opportunities*.

We look for businesses that most investors have given up on... but that still produce solid cash flows. The businesses might not be great, but we consider their bonds to be safe.

Fourth, **diversify your bond portfolio across at least 10 positions**. Understand that investing in distressed debt is risky. Despite all the homework we do, in the end, these companies and banks are run by people operating in a competitive, fluctuating economy.

We can't avoid the human element... Management teams can act in their own best interests in ways we may not anticipate. We can't predict the future or control every single variable.

In the long run, some of the bonds we recommend will default. But if you're well-diversified, the large gains in

your other positions will more than offset the few losses you endure.

And in the end, you'll still vastly outperform the market...

Since launching our newsletter, we've closed 23 bond positions. Only one recommendation has defaulted... and we've booked 20 winners. Our average annualized returns across all 23 closed positions is 20%. That's nearly three times higher than the return of our benchmark – the HYG junk-bond fund – in the same holding period.

For the fifth and final step, **try not to be too exposed to any single market sector**. In our portfolio, we're most exposed to the energy sector. So going forward, we plan to focus on attractive opportunities in other sectors until we exit some energy-related positions.

As we begin 2020, it promises to be a tumultuous year... Any one of the seven bombs we've highlighted today could trigger the next credit crisis, beginning as early as this year.

The world's central banks will continue doing their best to defuse these bombs. But like the three brave men who lost their lives trying to defuse the bomb in Germany a decade ago... the central banks can't always control *when* they detonate.

You're now warned... and you'll be ahead of most investors when disaster strikes.



CREDIT OPPORTUNITIES DASHBOARD

With *Stansberry's Credit Opportunities*, you get much more than just a monthly recommendation. You get insight into what we're seeing in every part of the bond market. We rate thousands of bonds and assign each into "Safe," "Moderate," or "Distressed" categories. You can find a more detailed explanation of our process [right here](#).

As we've shown throughout this month's issue, it's tough to find attractive opportunities today. Our usual analysis of our bond-rating categories and Watch Lists shows you why...

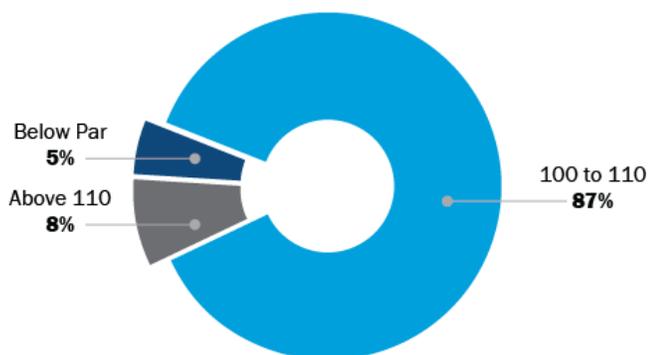
SAFE

This month, only 5% of the roughly 300 bonds that earned our "Safe" rating trade for less than par value. That's down from 8% last month. It's the fewest number of Safe bonds trading for less than par since we launched this newsletter. These bonds yield an average of only 2.05% today... down from 2.16% a month ago.

We removed the Costco Wholesale (COST) 1.7% December 2019 bond from our Safe Bond Watch List since it matured last month. The prices of the remaining 11 bonds on this watch list rose an average of 0.3% since last month. As a result, their average yield fell slightly... These 11 bonds now yield 2.16%, on average, compared with 2.21% in December.

~300 SAFE BONDS

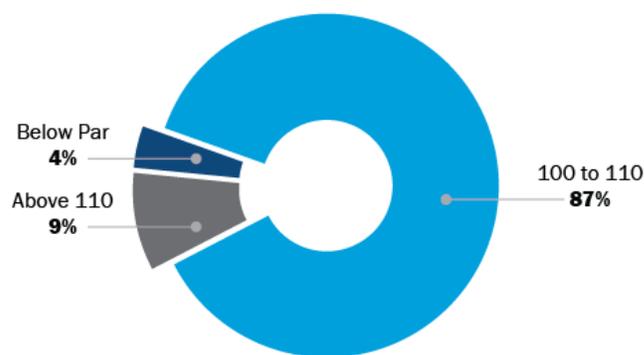
■ Priced Below Par ■ Priced 100 to 110 ■ Priced Above 110



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~2,100 MODERATE BONDS

■ Priced Below Par ■ Priced 100 to 110 ■ Priced Above 110



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You'll notice that only one bond on this Watch List trades for less than par value – the Under Armour (UAA) 3.25% June 2026 bond. It trades for around \$99 and yields 3.4% today.

The prices of the 10 bonds on our Moderate Bond Watch List increased an average of 1.1% this month. The average YTM for these bonds fell from 6.07% in December to 5.63% today.

SAFE BOND WATCH LIST

Issuer Name	CUSIP No.	Coupon %	Maturity Date	Last Price	Yield to Maturity %	S&P Rating	Stansberry Rating
Activision Blizzard	00507VAH2	2.300%	9/15/2021	\$100.51	2.0%	BBB+	10
Alphabet	02079KAC1	1.998%	8/15/2026	\$100.00	2.0%	AA+	10
Amazon	023135AT3	1.900%	8/21/2020	\$100.08	1.8%	AA-	9
Biogen	09062XAC7	2.900%	9/15/2020	\$100.61	2.0%	A-	9
Chevron	166764AU4	2.436%	3/3/2022	\$100.74	2.0%	AA	9
Johnson & Johnson	478160BY9	2.450%	3/1/2026	\$102.20	2.1%	AAA	9
Nike	654106AF0	2.375%	11/1/2026	\$101.88	2.1%	AA-	10
Nvidia	67066GAE4	3.200%	9/16/2026	\$106.00	2.2%	A-	10
Southwest Airlines	844741BC1	3.000%	11/15/2026	\$103.33	2.5%	BBB+	9
Texas Instruments	882508BA1	1.850%	5/15/2022	\$100.12	1.8%	A+	10
Under Armour	904311AA5	3.250%	6/15/2026	\$99.27	3.4%	BB	9

Prices as of January 13, 2020

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Source: Bloomberg

MODERATE BOND WATCH LIST

Issuer Name	CUSIP No.	Coupon %	Maturity Date	Last Price	Yield to Maturity %	S&P Rating	Stansberry Rating
Altria	02209SAU7	2.625%	9/16/2026	\$99.33	2.7%	BBB	7
Diamond Offshore	25271CAM4	3.450%	11/1/2023	\$85.52	7.9%	CCC+	7
Genworth Financial	372491AF7	4.900%	8/15/2023	\$100.81	4.7%	B/*	8
Liberty Media	530715AG6	4.000%	11/15/2029	\$69.32	8.7%	B+	7
National CineMedia	63530QAH2	5.750%	8/15/2026	\$98.90	6.0%	B-	7
New Home	645370AB3	7.250%	4/1/2022	\$101.00	6.7%	B-	7
NGL Energy Partners	62913TAJ1	7.500%	11/1/2023	\$102.10	6.9%	B+	7
Owens & Minor	690732AD4	3.875%	9/15/2021	\$96.43	6.2%	B	7
Pitney Bowes	724479AK6	4.125%	10/1/2021	\$102.02	3.3%	BB	7
SunPower	867652AJ8	0.875%	6/1/2021	\$96.80	3.2%	N/R	7

Prices as of January 13, 2020

The symbol "/*" next to a credit rating means the company is under credit watch by Standard & Poor's.

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Source: Bloomberg

MODERATE

Of the approximately 2,100 bonds that earned our "Moderate" rating this month, only 4% are priced below par... down from 8% last month. Similar to the Safe category, it's the lowest percentage of Moderate bonds trading below par since we began this newsletter. On average, these Moderate bonds yield just 2.52% today... down from 2.66% last month.

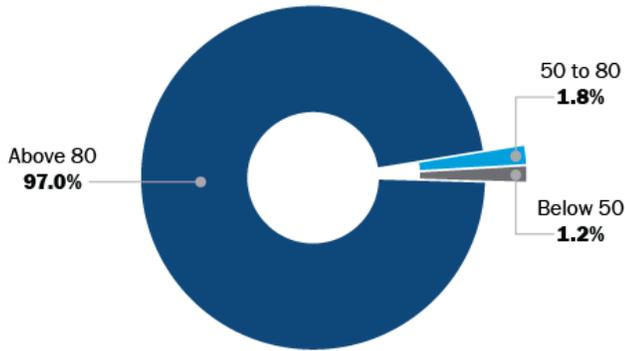
DISTRESSED

We rated about 1,900 bonds as "Distressed" this month. Only 3% trade for less than \$80... down from 3.3% last month. Meanwhile, the average YTM of these bonds increased to 4.89% from 4.78% a month ago.

The prices of the 15 bonds on our Distressed Bond Watch List increased 1% over the past month. Their average YTM soared from 44% in December to 61% this month.

~1,900 DISTRESSED BONDS

■ Priced Above 80 ■ Priced 50 to 80 ■ Priced Below 50



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The average YTM of the Distressed bonds on our Watch List increased mostly because of one bond... The YTM of the Frontier Communications (FTR) 8.5% April 2020 bond skyrocketed from 236% to 366% over the past month.

Please remember... We don't advise buying any bonds in these Watch Lists – including this Frontier bond – until we officially recommend them in *Stansberry's Credit Opportunities*. If you buy them, you're doing so at your own risk.

DISTRESSED BOND WATCH LIST

Issuer Name	CUSIP No.	Coupon %	Maturity Date	Last Price	Yield to Maturity %	S&P Rating	Stansberry Rating
Antero Resources	03674XAF3	5.625%	6/1/2023	\$76.88	14.5%	BB	6
Comstock Resources	205677AB3	9.750%	8/15/2026	\$90.93	11.8%	B	6
Denbury Resources	247916AC3	6.375%	8/15/2021	\$86.50	16.4%	CCC-	6
Diebold Nixdorf	253651AC7	8.500%	4/15/2024	\$97.31	9.3%	CCC+	6
Ferrellgas Partners	315295AE5	8.625%	6/15/2020	\$42.77	335.7%	C	5
Frontier	35906AAH1	8.500%	4/15/2020	\$52.28	366.5%	CCC-	5
FTS International	30283WAB0	6.250%	5/1/2022	\$68.70	24.9%	CCC+	6
Mallinckrodt	561234AE5	4.750%	4/15/2023	\$40.09	38.6%	C/*	5
Martin Midstream Partners	573334AD1	7.250%	2/15/2021	\$91.25	16.4%	B-	6
Mattel	577081AY8	3.150%	3/15/2023	\$100.00	3.1%	B	6
Quorum Health	74909EAC0	11.625%	4/15/2023	\$81.48	19.5%	C	5
EnSCO Rowan	779382AR1	4.750%	1/15/2024	\$65.75	16.9%	B-	5
Superior Energy Services	78412FAP9	7.125%	12/15/2021	\$85.00	16.6%	CC	6
Uniti	20341WAD7	8.250%	10/15/2023	\$88.10	12.3%	C	5
Whiting Petroleum	966387AP7	6.250%	4/1/2023	\$85.25	11.9%	BB-	6

Prices as of January 13, 2020

The symbol "/" next to a credit rating means the company is under credit watch by Standard & Poor's. The symbol "/*" means the credit watch is negative and the credit rating will be lowered if it is changed.

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Source: Bloomberg

Regards,

Mike DiBiase and Bill McGilton

January 15, 2020

We welcome comments or suggestions at feedback@stansberryresearch.com. This address is for feedback only, and you will not receive a reply. To speak with customer service, e-mail info@stansberrycustomerservice.com or call 888-261-2693 (U.S.) or 443-839-0986 (international) Monday-Friday, 9 a.m.-5 p.m. Eastern time. Please note: The law prohibits us from giving personalized financial advice.

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