

Weekly Credit Update

Summary

- CDS indices have moved sideways while cash bonds continue to perform
- In the EUR market we have seen the first non-investment grade benchmark issuance
- We move from overweight to neutral on credit following the strong rally we have seen in the last few months

Headlines from the credit market this week

CDS indices are more or less unchanged compared to last week. The investment grade index, iTraxx Europe, currently trades at 122bp compared to 123bp last week, while the high yield index, iTraxx Crossover trades at 727bp down from 750bp. The cash market continues to perform strongly and it remains difficult to find offers.

During the week it was announced that Bradford & Bingley will defer on coupon payments for its LT2 issues. The move was not a total surprise after the UK authorities in February decided to amend the bond documentation on the subordinated bonds (for info on the change in the bond documentation please refer to the *Weekly Credit Update from 27 February 2009*). Back then this caused an extremely negative reaction in the Tier 2 due to general fears that bond documentation could not be relied upon. This time around the reaction has been more muted.

Despite the somewhat lukewarm sentiment in the secondary market during the week we have continued to see high activity in the primary market. Worth noticing is that Pernod-Ricard issued a benchmark non-investment grade bond, which was massively oversubscribed. Therefore it is safe to say that the EUR high yield market is now officially open after a few smaller issues lately. In the US the high yield market has already been open for some time.

Table 1. Selected new issues during the week

Name	Rating	Coupon	Maturity	Currency	Size	Bond spread on issue date, ASW (bp)*
Danske Bank	Aa3/A+	Fixed	5Y	EUR	1.5bn	195
Credit Agricole (LT2)	Aa2/A+	Fixed	10 NC 5Y	EUR	1.0bn	220
Pfizer	Aa2/AAA	Fixed	4-12Y	EUR	5.85bn	Gov +137-224
Arcelor Mittal	Baa3/BBB+	Fixed	4 & 7Y	EUR	2.5bn	Gov +598-637
Pernod-Ricard	Ba1/BB+	Fixed	6Y	EUR	0.8bn	Gov +414

Note: Ratings are Moody's and S&P. * Mid-Swaps for Fixed, Discount Margin for floating

Source: Danske Markets

We move from overweight to neutral on credit

During the past couple of months credit has enjoyed a very strong spell across the sectors and capital structure and spreads have tightened significantly. At the same time the activity in the primary market continues to be at a record-high as more and more companies (are able to) turn to the capital markets instead of the banks for funding. The strong sentiment has largely come as a consequence of a significant improvement in the conditions in the money market and lower volatility.

iTraxx Europe (5Y CDS)



Source: Markit

iTraxx Crossover (5Y CDS)



Source: Markit

VIX volatility index



Source: Bloomberg

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We question the sustainability of this massive rally and the pace at which it has occurred is simply too fast in our view. The macroeconomic outlook is still extremely challenging and defaults are currently increasing sharply. A while ago we moved to overweight based on the large liquidity and risk premiums for credit. Both these premiums have been reduced substantially in the past few months and consequently we go from overweight to neutral. At the same time name selection in the primary market is becoming increasingly important. Our preferred sector is the Utility & Energy sector. On Banks we go from overweight to neutral following the massive tightening we have seen in spreads. Within banks, we recommend to overweight LT2 capital from the strong names. On Telecoms we prefer the non-Nordic companies. Finally, we have an underweight on general industrials and Pulp & Paper.

For further insights into this change in recommendation as well as an update on the sectors please refer to *Credit Strategy Update and Q1 09 sector Wrap Up*.

Fixed Income Credit Research

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TMT, Utilities & Energy

Financials

Pulp & Paper

Industrial

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