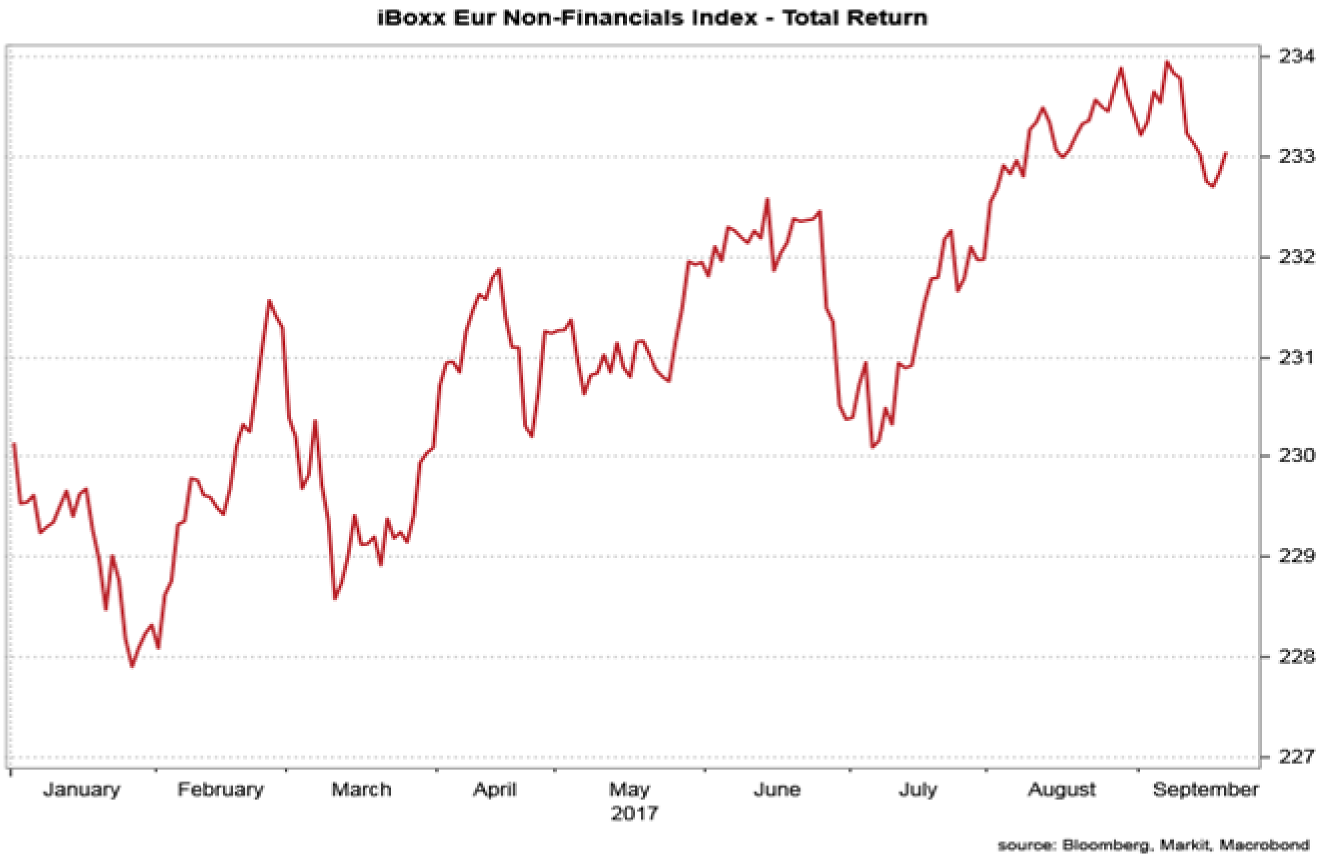
EUR IG CORPORATE BONDS LOOK SET TO REMAIN ON SOLID GROUND

22 September 2017

By Andrew Perrin

The EUR-denominated IG corporate bond market has successfully navigated its way through regular bouts of broader market volatility this year. However, despite suggestions that some valuations are beginning to look overstretched, proprietary analysis produced by **Informa Financial Intelligence (IFI)** shows that issuers are still firmly in the driving seat when it comes to pricing power. This provides an encouraging back drop for other companies planning to visit the market moving forward, although they may not want to sit on their hands too long.

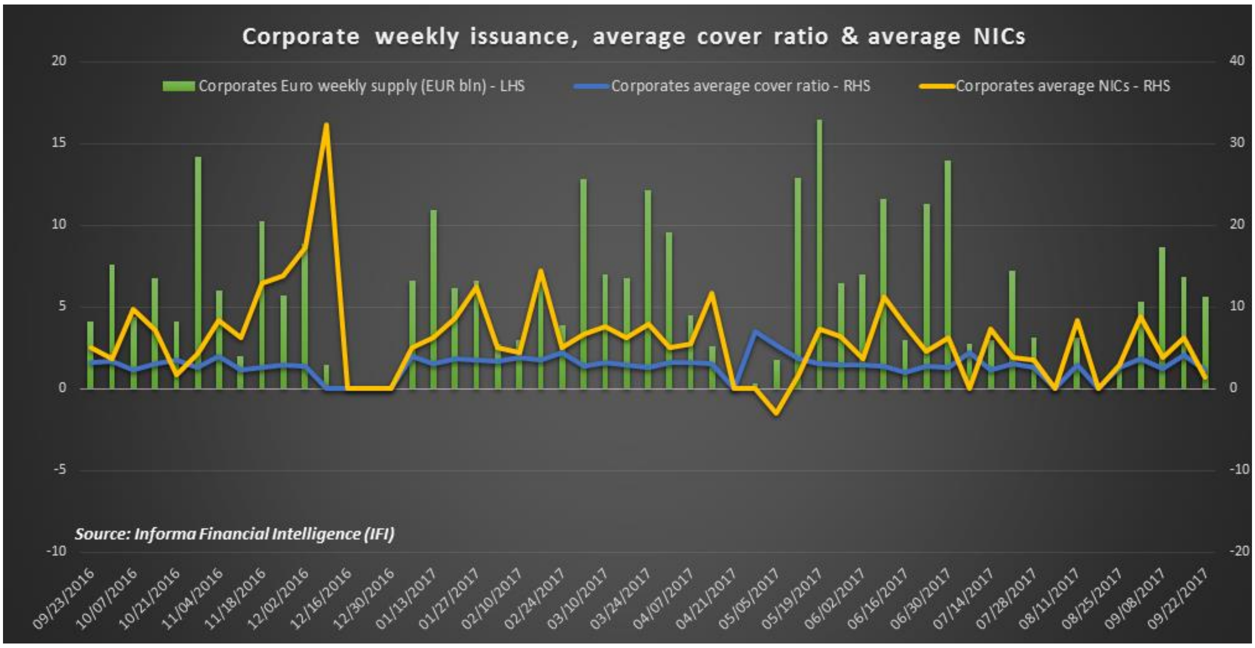
Between North Korean missiles, historically stretched valuations, potential policy shifts among major central banks and the attendant possibility of a rise in volatility, there's been no shortage of events to keep corporate bond investors awake at night. However, as summer tans fade and issuance volumes pick-up, it has become abundantly clear that buyers have lost little of their enthusiasm for Euro corporate debt.



To find out more about Informa Financial intelligence, please visit financialintelligence.informa.com

EPFR Global | IGM | iMoneyNet | Informa Investment Solutions | Informa Research Services | eBenchmarkers

On the contrary, as the following chart shows, this typical post summer rebound in issuance has coincided with consistently well oversubscribed order books and a steady decline in new issue concessions. This has seen a number of corporates manage to secure benchmark funding in line with, or even through, their existing curves.

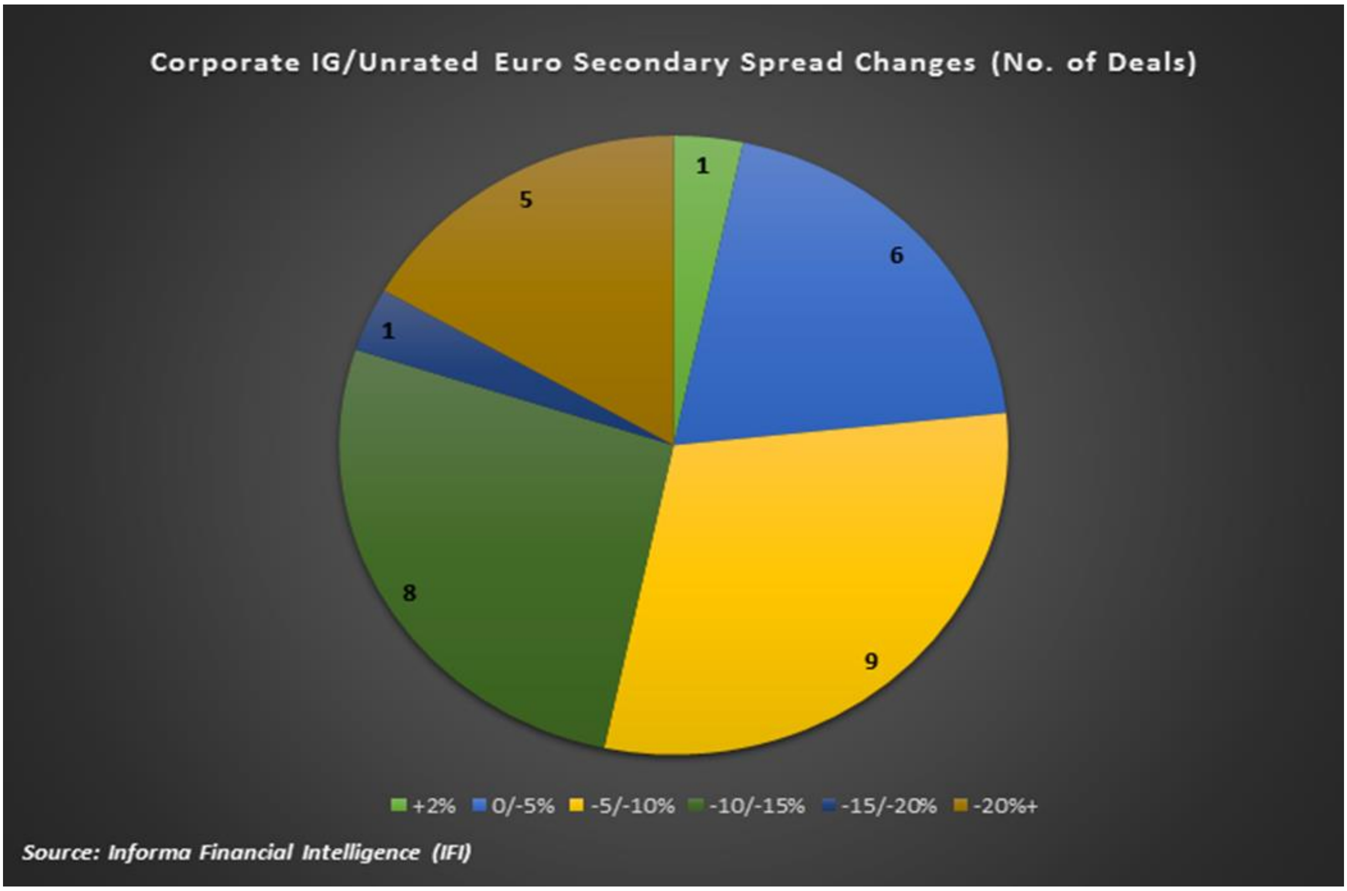


This is clearly illustrated by the average cover ratio on the Euro IG corporate deals which priced in the week ending 22nd September (where the book size was communicated), which came in at a solid 3.08 times.

This positive momentum allowed pricing to be tightened by an average 15.5bps during execution (IPTs to reoffer), which in turn resulted in some very economic funding levels for those issuers which accessed the market. This is reflected by the average final new issue concession of just 1.78bps, which was down notably from a still modest by historical standards 6.22bps the week before.

This bullish momentum has also been replicated in the secondary market where those investors which did stick with deals during execution in recent weeks - despite an often eye watering tightening of spreads from IPTs to reoffer - have been rewarded for their loyalty. This has been accentuated by increasingly high quality order books which contain a larger percentage of buy and hold accounts at the expense of 'flippers'.

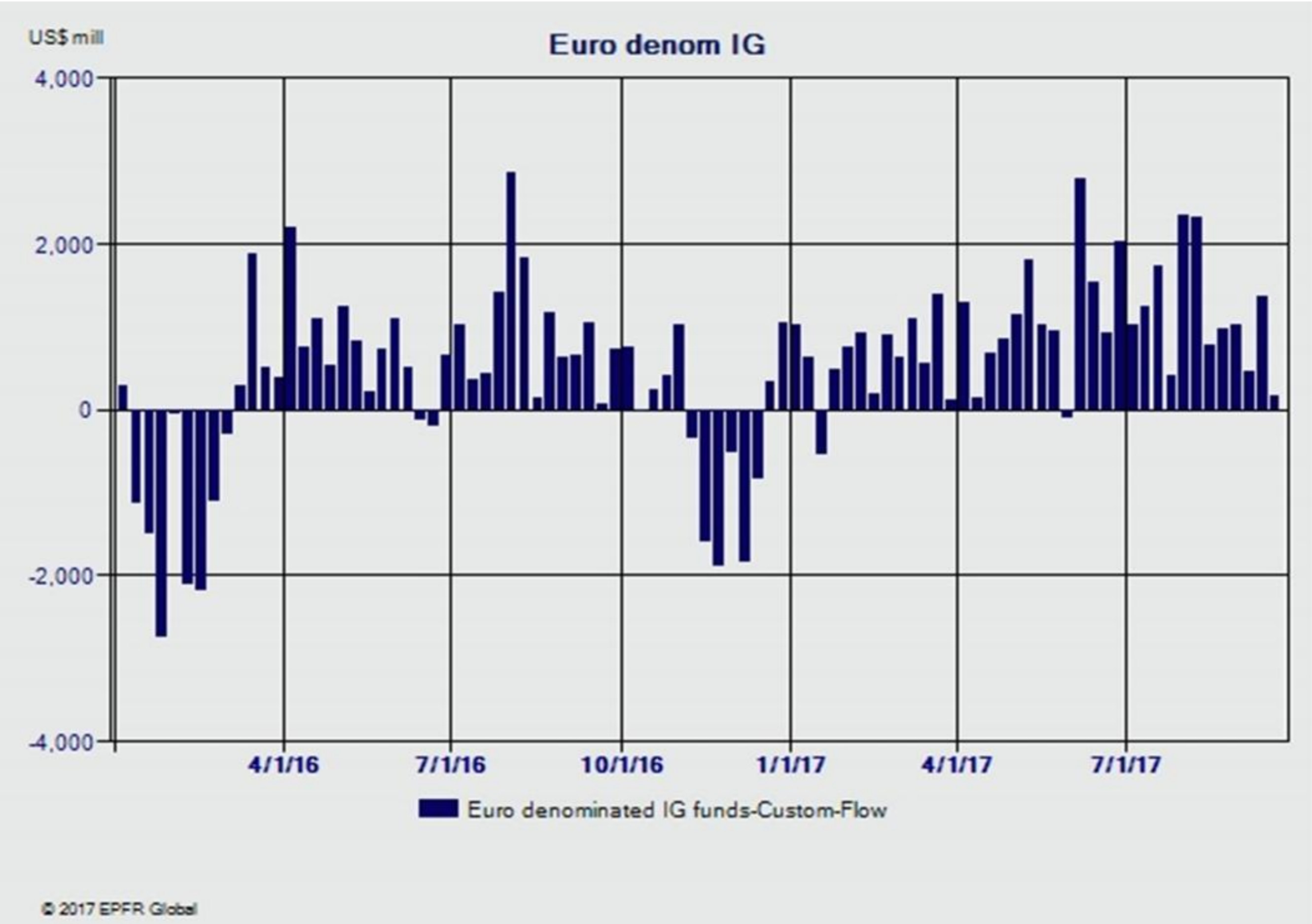
The following graphic illustrates (on a percentage basis) that all but one of the 30 IG or Unrated Euro-denominated fixed rate corporate deals which priced from 1-19th September 2017 are bid inside their respective reoffer levels, by varying degrees. The only exception to this rule is Daimler's EUR500m 0.20% Sep 2021 line which priced on 05th September and even that is broadly flat to reoffer to perhaps a basis point wider at most.



So why the ongoing euphoria?

There are a number of reasons behind the wave of cash that continues to pour into Euro-denominated credit funds, which have been a magnet for investors for a significant part of this year.

The following chart shows investors have put money into Euro-denominated IG bond funds for the past 16 consecutive weeks. This means that year-to-date flows were positive to the tune of an equivalent USD37,611.434m up to 20th September 2017, with 36 out of the 38 weeks so far this year seeing inflows, an impressive statistic in any bull market.

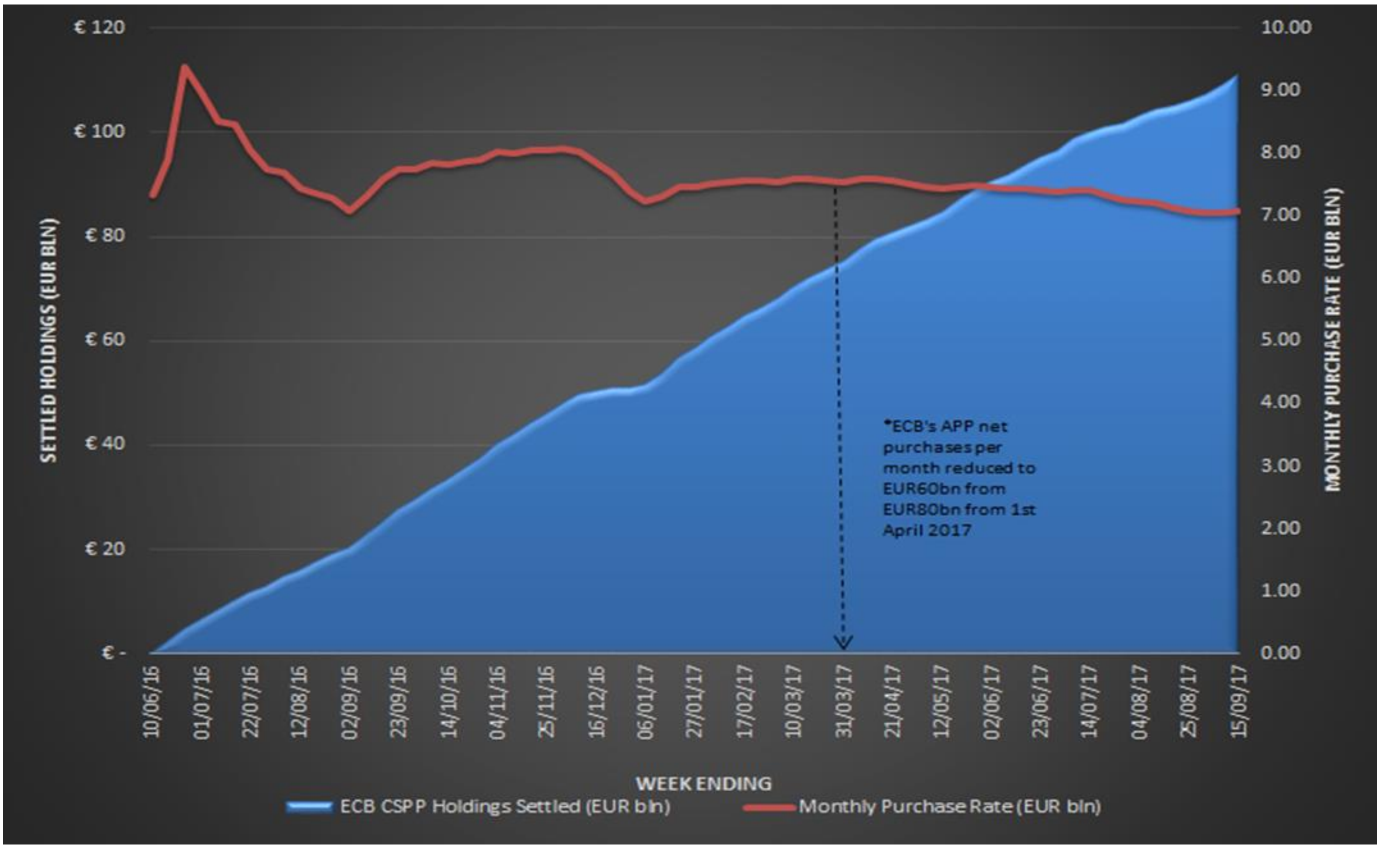


Source: EPFR Global (Informa Financial Intelligence)

ECB has your back, at least for now

Probably helping to underpin the ongoing bullish sentiment towards Euro IG corporate bonds more than anything else has been the massive technical bid provided by the ECB through its Corporate Sector Purchase Programme (CSPP).

Since the ECB began purchases under the programme on 8th June 2016, holdings settled as of 15th September 2017 totaled EUR111.183bn, which points to an implied monthly purchasing rate of EUR7.08bn**.** The ECB also revealed that as of 31st of August 2017, 14.7% of the overall total has been sourced in the primary market.



Source: ECB/Informa Financial Intelligence (IFI)

Apart from the ECB's back stop, other factors which have provided support for Euro corporate spread product this year include:

- Prolonged historically low underlying yields (or close to them)
- Reduced political risk (notably a market friendly outcome in the French Presidential elections)
- Scant liquidity conditions meaning investors are often reluctant to lighten cash positions for fear of not being able to replenish them in what is a primary centric market
- Primary order books reflect a higher participation of quality buy and hold accounts (asset managers, insurance/pension funds etc)
- Relatively contained Euro IG Corporate issuance volumes by historical standards
- Encouraging earnings releases and outlooks for many global blue chip companies that fund in Euros
- Strong inflows into fixed income funds where IG Corps have been viewed as the sweet spot/a safe haven

So where do we go from here?

As the various data points we monitor to gauge sentiment towards the Euro IG Corporate universe highlighted above clearly illustrate, - including cover ratios, NICs and secondary market performance - the Euro Corporate market is in impressive shape. This, coupled with the additional supportive factors outlined above give us little reason to believe issuers can't retain the upper hand when it comes to pricing power in the coming weeks.

Nevertheless, while current market conditions might make it easy for complacency to set in, this is not to say that there aren't potential banana skins further down the road which market participants should definitely be mindful of.

ECB pulls the rug?

The obvious elephant in the room which definitely has the ability to force the market into a sharp rethink is any decision by the ECB to start winding down its CSPP as part of its overall EUR60bn QE programme, more details of which are expected to be revealed at the next central bank meeting on 26th October. Current consensus suggests that the ECB will begin tapering as soon as January, although it is still uncertain as to what extent, if any, CSPP will initially be impacted.

Inflation surprises relative to expectations

We view this as a low risk scenario but it would seem fair to say that central banks have an asymmetric bias to do too much rather than too little given their fears over the destructive and long term impacts of deflation.

Renewed Political risk

Italian elections are due to be held before the end of May 2018 and while Silvio Berlusconi's centre right party is currently ahead in the polls, the populist anti-Euro Five Star Movement (MSS party) remains a potent force. This will undoubtedly be closely monitored by broader markets on the lead up to the elections, particularly given the historical instability of Italian politics.

Escalating geo-political situation

As with potential inflation surprises we also consider this a low risk scenario, particularly in the short to medium-term. While some higher beta investment grade corporate securities could perhaps feel the pinch from a fresh flight-to-quality scenario (hybrids in particular), the broader IG Euro Corporate market has shown recently that it can largely shrug off North Korean missile tests and general sabre rattling that we've encountered to date. And assuming the situation does not deteriorate further, then we wouldn't expect this to evoke any sea change in sentiment towards IG Euro Corporate bonds.

Indeed, on the contrary, we would draw attention to the fact that lower beta blue chip companies, particularly those at the higher end of the IG rating spectrum, have actually often benefitted from demand for safe havens since the onset of the credit crises 10 years ago.

All that said, the Euro IG Corporate bond universe looks like it is going to remain an issuer's market for a little while yet, *ceteris paribus*.

Note to readers:

IGM/EPFR Cheat Sheet provides proprietary intelligence on Euro credit primary market trends using various key data points in an easily digestible Excel spreadsheet.

This includes Euro new issue volumes, average new issue concessions and book cover ratios across asset classes, as well as EPFR fund flow data and other key credit proxies such as ECB CSPP data. This is complemented by related proprietary graphics based on our own observations.

This intelligence enables clients to easily monitor evolving conditions in the primary markets, identify key market correlations and potential forward looking trends, while providing a considerable time saving tool. Please inform sales@informagm.com if you would like to obtain a copy of this report.

This material is provided by Financial Intelligence for the use of the recipient only and is not to be copied or distributed to any other person. No representation, warranty or undertaking (express or implied) is given and no responsibility is accepted by Financial Intelligence or any of its affiliates or by any of their respective partners, officers, employees, advisers or agents for the completeness or accuracy of any information contained in, or of any omissions from, this material or any supplementary information and any liability in respect of such information or omissions is hereby expressly disclaimed. This material is not a comprehensive evaluation of the industry, the companies or the securities mentioned, and does not constitute an offer or a solicitation of an offer or a recommendation to buy or sell securities. All expressions of opinion are subject to change without notice.

© Informa Business Intelligence, Inc (2017). All rights reserved.

London	New York	Tokyo	Hong Kong	Singapore	Shanghai
+44 20 7017 5402	+1 212 907 5802	+81 3 6273 4273	+852 2234 2000	+65 6411 7788	+8621 2326 3766