

Credit Derivatives Navigator

Take advantage of rich vol to sell credit upside

Key takeaways

- While credit spreads have tightened close to historical tights, implied volatility on CDX options remains high.
- Current tight levels imply little room to durably tighten further, we like selling July expiry receivers on CDX IG/HY.
- This strategy allows to bet against a sustained further rally while benefiting from elevated implied vol.

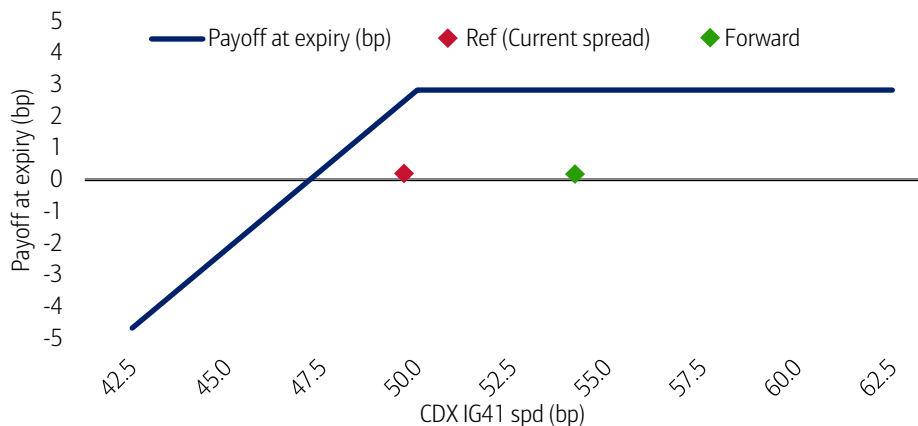
Take advantage of rich vol to sell credit upside

The recent rally in credit has brought CDX IG and CDX HY spreads close to historical tights (5th 10Y percentile for IG, Exhibit 7, Exhibit 8) on the back of stronger-than-expected US data, while the outlook for the Fed remains relatively benign. However, implied volatility on CDX options currently screens rich relative to the level of spreads (Exhibit 3, Exhibit 4) as well as realized vol (Exhibit 5, Exhibit 6).

Risk related to the Fed, the US elections and geopolitical risk could prevent spreads from tightening much past their current levels. CDX IG is currently 6 bp away from 10Y tights, while in HY our colleague Oleg Melentyev highlights the vulnerability of the US HY market to the Fed cycle in “High Yield Strategy: Not So Magnificent”. In this context, we like selling July expiry receivers on CDX IG41 (50 bp strike, 33% delta) and on CDX HY41 (\$106.5 strike, 27% delta). Risks to the strategy are credit spreads tightening further, for example if we continue to see very strong US economic data.

Exhibit 1: Payoff diagram for a July expiry short 50 receiver on CDX IG41

Breakeven spread is 47.2 bp. Shorting a CDX IG41 receiver allows to position against a further IG tightening while benefiting from the currently elevated implied vol levels.



Source: BofA Global Research, Markit, Bloomberg

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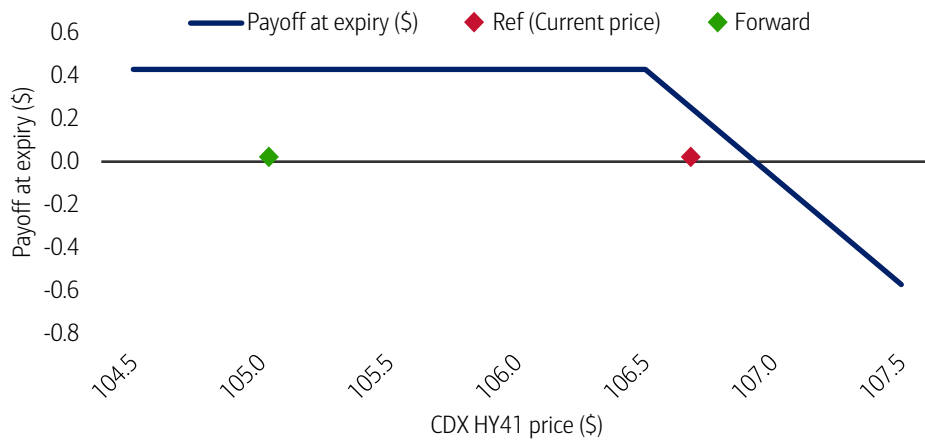
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Refer to important disclosures on page 8 to 10. Analyst Certification on page 7. 12668862

Timestamp: 08 March 2024 04:21PM EST

Exhibit 2: Payoff diagram for a July expiry short 106.5 receiver on CDX HY41 (on price)

Breakeven price is \$106.9. Similarly, shorting a CDX HY41 receiver allows for an attractive bet against a further HY rally.

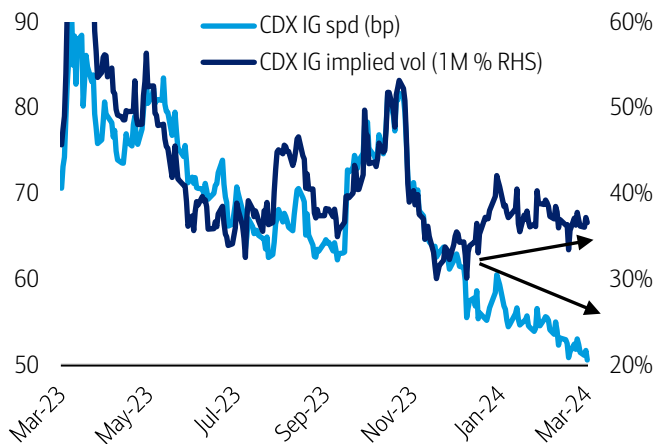


Source: BofA Global Research, Markit, Bloomberg

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Exhibit 3: CDX IG implied vol vs. spreads

CDX IG implied vol currently screens rich relative to spreads...

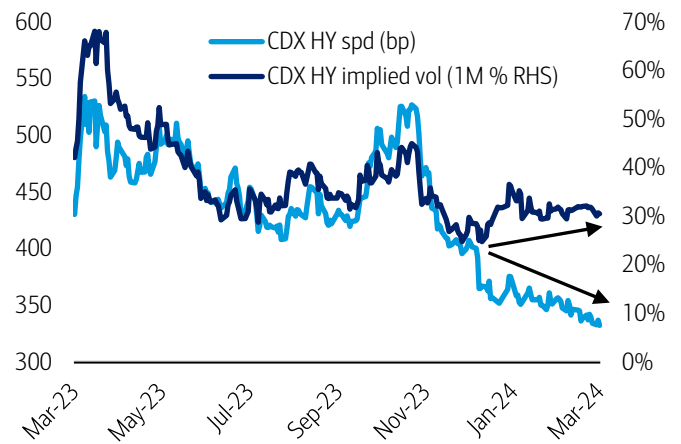


Source: BofA Global Research, Markit, Bloomberg

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Exhibit 4: CDX HY implied vol vs. spreads

...and so does CDX HY implied vol relative to spreads

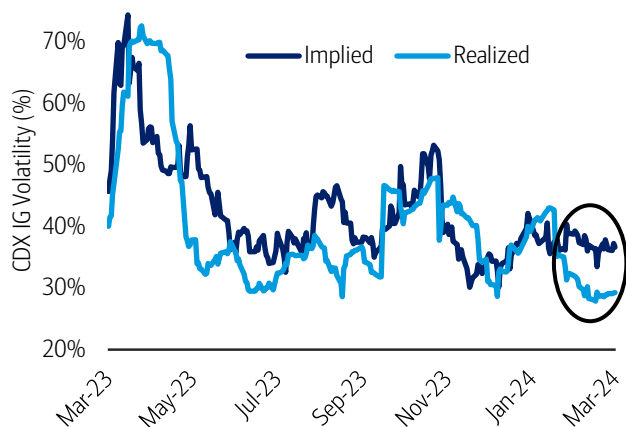


Source: BofA Global Research, Markit, Bloomberg

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Exhibit 5: CDX IG implied vs. realized vol

CDX IG implied vol currently screens rich relative to realized...

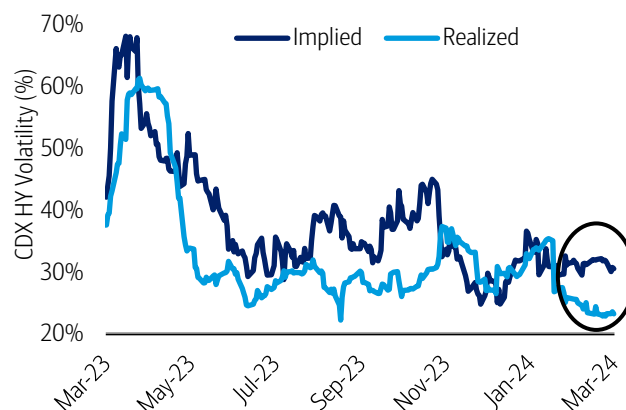


Source: BofA Global Research, Markit, Bloomberg

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Exhibit 6: CDX HY implied vs. realized vol

...and so does CDX HY implied vol relative to realized

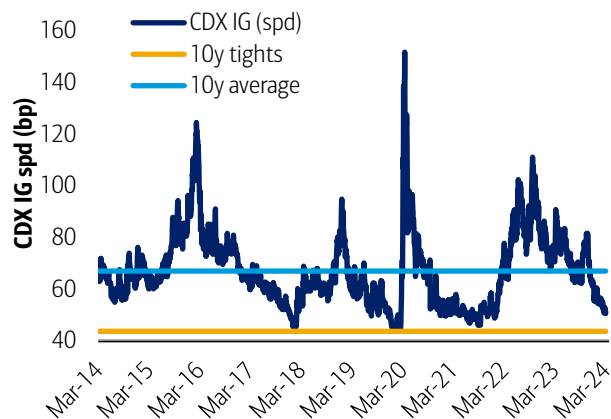


Source: BofA Global Research, Markit, Bloomberg

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Exhibit 7: The recent rally in credit brought CDX IG close to 10Y tights

We see a sustained further tightening as unlikely in the current environment

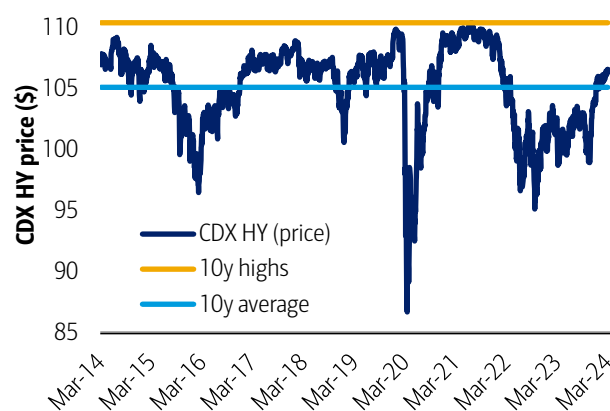


Source: BofA Global Research, Bloomberg

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Exhibit 8: The rally also brought CDX HY price above its historical average

Similar to IG, we find it unlikely that the rally would continue in HY



Source: BofA Global Research, Bloomberg

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Weekly Data and Charts

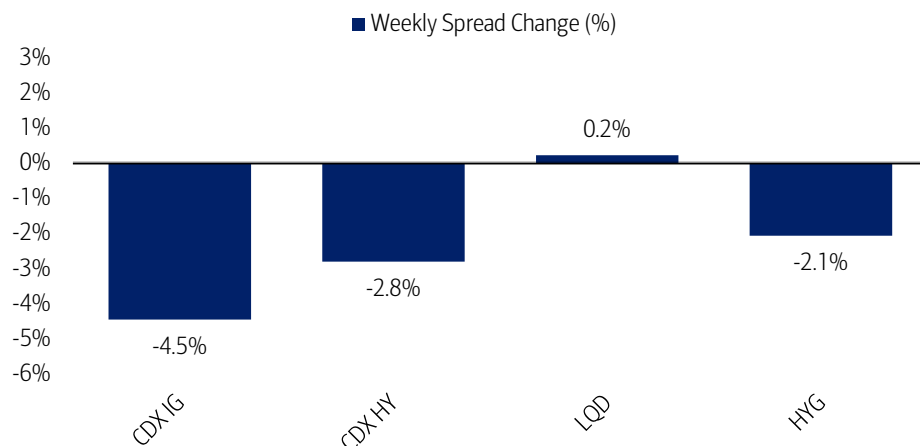
- IG CDS-Cash Basis compressed to -50.6 bp this past week after reaching new 6-month wide of -52.5 bp on Feb 29 (Exhibit 12)
- Synthetics still trade rich to cash, with most value in BBs (Exhibit 16)
- Index skew tightened this past week for CDX IG and CDX HY (Exhibit 21, Exhibit 22)

Performance Dashboard



Exhibit 9: Weekly Spread Change (%), 02/29 to 03/07

CDX IG was the biggest % spread mover this week with a -4.5% move



Source: BofA Global Research, Markit, Bloomberg

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Exhibit 10: Weekly IG snapshot

This week in IG CDX IG 5y spd (bp) sits at a low 3-month %ile while LQD spd (bp) sits at a high 3-month %ile

IG	Level	1W change	3M %ile
Realized Vol CDX IG (1M %)	29.4	2%	28%
Implied Vol CDX IG (1M %)	44.1	-4%	42%
CDX IG 5y spd (bp)	50.1	-4%	0%
IG Cash 5y spd (bp)	90.0	-1%	18%
LQD spd (bp)	113.8	0%	87%
LQD Implied Vol (1M)	7.8	1%	8%
IG CDS-Cash basis (bp)	-50.0	-5%	39%
CDX IG index skew (bp)	-4.2	48%	36%

Source: Bloomberg, Markit, BofA Global Research

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Exhibit 11: Weekly HY snapshot

In HY CDX HY 5y spd (bp) sits at a low 3-month %ile while CDX HY index skew (bp) sits at a high 3-month %ile

HY	Level	1W change	3M %ile
1M Realized Vol CDX HY (1M %)	23.3	2%	15%
Implied Vol CDX HY (1M %)	36.8	-2%	50%
CDX HY 5y spd (bp)	330.2	-3%	0%
HY Cash 5y spd (bp)	347.7	0%	10%
HYG spd (bp)	352.6	-2%	13%
HYG Implied Vol (1M)	5.4	-17%	3%
HY CDS-Cash basis (bp)	-63.1	3%	3%
CDX HY index skew (bp)	-18.3	68%	80%

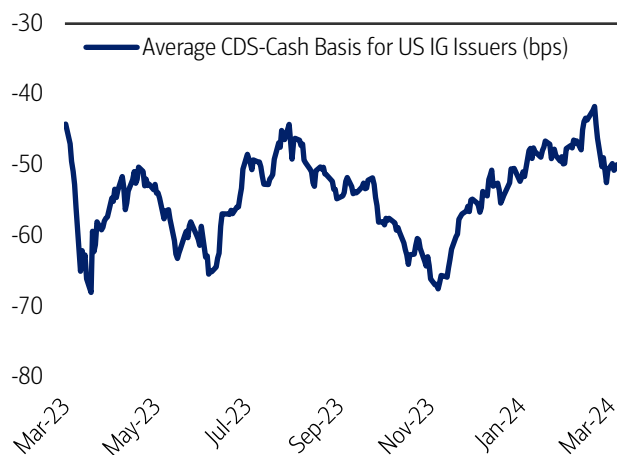
Source: Bloomberg, Markit, BofA Global Research

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CDS-Cash Basis

Exhibit 12: LTM US IG CDS-Cash Basis

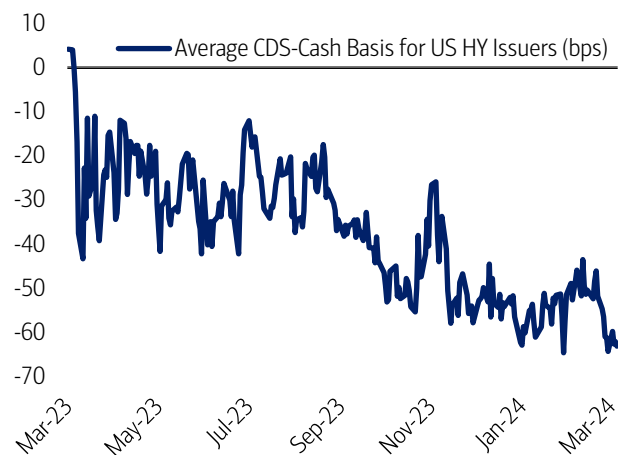
On Mar 07, 2024, spread was 50.1 bps.



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Exhibit 13: LTM US HY CDS-Cash Basis

...versus -63.1bps for US HY Issuers



Note: A more negative basis indicates bonds trading cheap to synthetic cash

Source: BofA Global Research, Markit

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Exhibit 14: CDS-Cash Basis by sector for US IG Issuers

IG Sectors ranked higher have CDS levels currently trading tightest relative to bonds.

Sector	Current Basis (bp)	1W Basis	1M Basis	Current %ile
Utilities	-62	-62	-59	78%
Food, Bev, & Bottling	-61	-65	-61	83%
Aerospace/Defense	-61	-61	-52	32%
REITs	-59	-61	-52	30%
Health Care	-56	-57	-54	31%
Basic Materials	-52	-55	-57	55%
Technology	-51	-57	-51	49%
Finance	-51	-50	-42	88%
Transportation	-50	-53	-47	71%
Retail	-46	-50	-43	38%
Industrial Products	-45	-48	-39	43%
Energy	-44	-47	-46	96%
Banks/Brokers	-42	-46	-45	98%
Other	-42	-45	-38	45%
Media & Entertainment	-40	-44	-44	83%

Note: The Other category includes IG sectors with less than 3 names. It is currently composed of Automobiles, Commercial Services, Consumer Products, Leisure, Telecom, Tobacco

Source: BofA Global Research, Markit

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Exhibit 15: CDS-Cash Basis by sector for US HY Issuers

HY Sectors ranked higher have CDS levels currently trading tightest relative to bonds.

Sector	Current Basis (bp)	1W Basis	1M Basis	Current %ile
Basic Materials	-97	-93	-92	20%
Other	-82	-76	-54	23%
Energy	-73	-54	-62	13%
Commercial Services	-66	-68	-72	38%
Utilities	-65	-68	-61	13%
Media & Entertainment	-63	-74	-62	24%
Leisure	-56	-47	-40	0%
Retail	-7	-10	13	2%
Automobiles	12	5	13	4%

Note: The Other category includes IG sectors with less than 3 names. It is currently composed of Aerospace/Defense, Consumer Products, Finance, Food, Bev, & Bottling, Health Care, Insurance, REITs, Transportation

Source: BofA Global Research, Markit

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Exhibit 16: CDS-Cash Basis by rating

A low basis or low percentile are indicative of synthetic cash trading expensive to cash.

Rating	Current Basis (bp)	1W Basis	1M Basis	Current %ile
A or higher	-44	-46	-41	48%
BBB	-54	-57	-52	76%
BB	-74	-73	-66	4%
B	-38	-36	-25	3%

Source: BofA Global Research, Markit

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Exhibit 17: Top 10 richest US IG synthetic cash to cash

IG Issuers with synthetic cash trading richest to cash currently include HRB (-97bps), WY (-82bps), and DUK (-82bps).

Rank	Ticker	Rating	Sector	Current Basis (bp)	Current %ile	1M %ile
1	HRB	BBB3	Commercial Services	-97	84%	92%
2	WY	BBB2	REITs	-82	61%	80%
3	DUK	BBB2	Utilities	-82	96%	79%
4	AEP	BBB2	Utilities	-81	57%	59%
5	EXC	BBB2	Utilities	-80	100%	n.a.
6	HST	BBB3	REITs	-77	21%	98%
7	AZO	BBB2	Retail	-77	69%	71%
8	MSI	BBB3	Technology	-76	73%	76%
9	NRUC	A2	Finance	-75	100%	n.a.
10	CAH	BBB2	Health Care	-74	60%	n.a.

Note: 94 issuers are included in our analysis

Source: BofA Global Research, Markit

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Exhibit 18: Top 10 richest US HY synthetic cash to cash

HY Issuers with synthetic cash trading richest to cash currently include AVNT (-138bps), VST (-138bps), and DVA (-136bps).

Rank	Ticker	Rating	Sector	Current Basis (bp)	Current %ile	1M %ile
1	AVNT	BB3	Basic Materials	-138	23%	32%
2	VST	BB2	Utilities	-138	40%	60%
3	DVA	B1	Health Care	-136	44%	78%
4	CHK	BB2	Energy	-132	3%	53%
5	BMCAUS	BB3	Basic Materials	-131	54%	91%
6	MTG	BBB3	Insurance	-127	9%	42%
7	LPX	BB1	Basic Materials	-125	55%	74%
8	IRM	BB3	REITs	-117	42%	39%
9	LW	BB2	Food, Bev, & Bottling	-115	23%	38%
10	KBH	BB2	Basic Materials	-114	63%	70%

Note: 55 issuers are included in our analysis

Source: BofA Global Research, Markit

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Exhibit 19: Top 10 cheapest US IG synthetic cash to cash

IG Issuers with synthetic cash trading cheapest to cash currently include WHR (23bps), LNC (5bps), and PARA (-3bps).

Rank	Ticker	Rating	Sector	Current Basis (bp)	Current %ile	1M %ile
1	WHR	BBB2	Consumer Products	23	71%	62%
2	LNC	BBB1	Insurance	5	100%	n.a.
3	PARA	BBB3	Media & Entertainment	-3	25%	n.a.
4	WMT	AA2	Retail	-14	58%	57%
5	DXC	BBB2	Technology	-20	61%	40%
6	PG	AA3	Consumer Products	-24	80%	12%
7	AES	BBB3	Utilities	-26	87%	96%
8	BBY	BBB1	Retail	-28	62%	62%
9	GM	BBB2	Automobiles	-31	2%	17%
10	UPS	A2	Transportation	-32	31%	53%

Note: 94 issuers are included in our analysis

Source: BofA Global Research, Markit

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Exhibit 20: Top 10 cheapest US HY synthetic cash to cash

HY Issuers with synthetic cash trading cheapest to cash currently include JWN (151bps), M (141bps), and NBR (56bps).

Rank	Ticker	Rating	Sector	Current Basis (bp)	Current %ile	1M %ile
1	JWN	BB1	Retail	151	18%	77%
2	M	BB1	Retail	141	95%	99%
3	NBR	B1	Energy	56	20%	35%
4	AXL	B2	Automobiles	45	16%	20%
5	CAR	B1	Commercial Services	41	51%	29%
6	GT	B1	Automobiles	23	21%	5%
7	CCL	B2	Leisure	12	14%	n.a.
8	DAL	BB1	Transportation	0	5%	36%
9	CPN	B1	Utilities	-10	8%	18%
10	NWL	BB3	Consumer Products	-21	0%	35%

Note: 55 issuers are included in our analysis

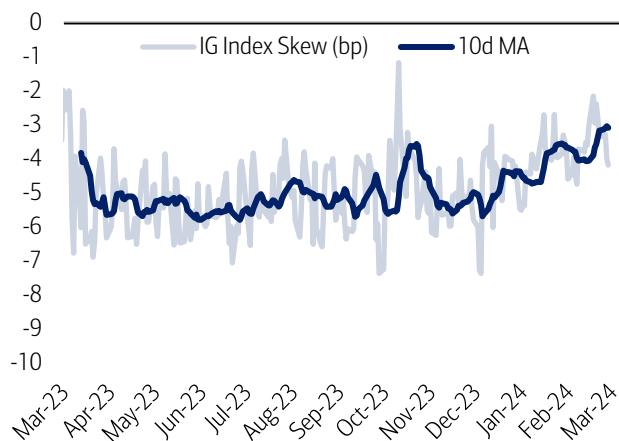
Source: BofA Global Research, Markit

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CDX Index Skew

Exhibit 21: CDX HY Index Skew (bp)

CDX IG spread skew has on average compressed over the last year. On Mar 07, 2024, skew was -4.2 bps.



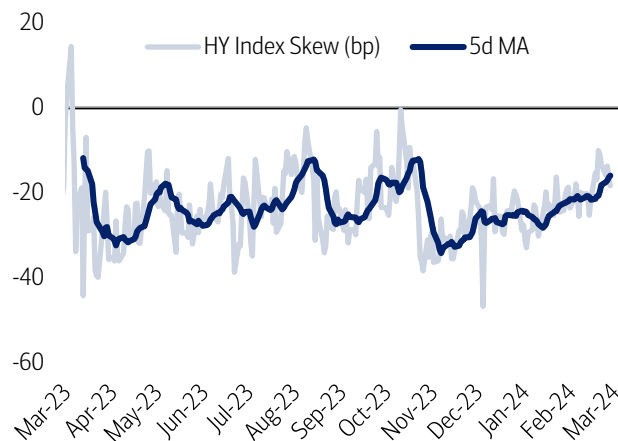
Note: Skew = Traded index - Fair value of the constituents. Negative skew (in spread) points to the index trading rich to FV.

Source: BofA Global Research, Markit

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Exhibit 22: CDX HY Index Skew (bp)

CDX HY spread skew has also on average compressed over the last year. On Mar 07, 2024, skew was -18.3 bps.



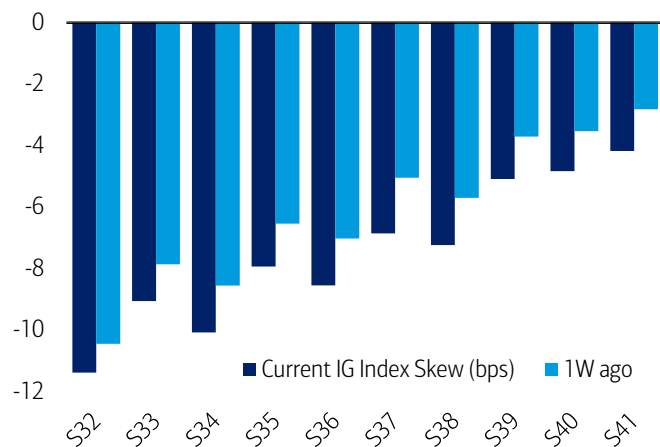
Note: Skew = Traded index - Fair value of the constituents. Negative skew (in spread) points to the index trading rich to FV.

Source: BofA Global Research, Markit

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Exhibit 23: CDX IG Roll Skew

IG Roll Skew is the difference between each series' skew and IG41 skew

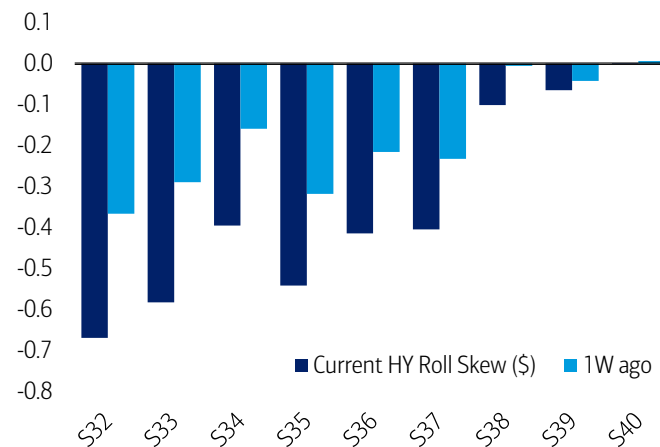


Source: BofA Global Research, Markit

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Exhibit 24: CDX HY Roll Skew

HY Roll Skew is the difference between each series' skew and HY41 skew



Source: BofA Global Research, Markit

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