

Credit Derivatives Navigator

CDX HY42 Roll: Early view

Key takeaways

- We expect four removals from HY42: RAD due to a credit event and F, MTG and HWM due to their upgrade to IG.
- The expected replacements are CIVI, RGCARE, CCO and UNSEAM based on bond liquidity and debt outstanding.
- We see 5Y roll fair value at 22bp, and market technicals leading it to trade 3bp flat to fair value on roll day at 19bp.

March 2024 CDX HY Roll: Early view

The CDX HY index is scheduled to roll to the new series 42 on Wednesday March 27th. We outline here our view on potential constituent changes as well as our preliminary fair value and skew estimates. We expect the 5Y index roll to have fair value (FV) of 22bp/\$0.45, with market technicals leading it to trade 3bp/\$0.15 flat to fair value on roll day at 19bp/\$0.30.

HY42 name changes: One credit event, three rising stars

Exhibit 1: CDX HY Series 42 Roll: Provisional constituent changes

The average spread for the four removals is 100bp, while the average spread for the four additions is 573bp.

Name	Ticker	Rating	5y CDS spread (bp)	Reason
Estimated Removals				
Rite Aid Corp	RAD	None	n.a.	Credit Event
Ford Motor Co	F	Ba1, BBB-, BBB-	148	Rising Star
MGIC Investment Corp	MTG	Baa3, BBB-	82	Rising Star
Howmet Aerospace Inc	HWM	Ba1, BBB-, BBB	69	Rising Star
Average			100	
Estimated Additions				
Civitas Resources Inc	CIVI	Ba3, BB-, BB	190 (estimated)	iBoxx HY Ranking
LifePoint Health Inc	RGCARE	B3, B	650 (estimated)	iBoxx HY Ranking
Clear Channel Outdoor Holdings Inc	CCO	B3, CCC+	750 (estimated)	iBoxx HY Ranking
Allied Universal / Atlas LuxCo 4 SARL	UNSEAM	Caa2, CCC+	700 (estimated)	iBoxx HY Ranking
Average			573	
Runner-ups (not added in our base-case)				
1011778 BC ULC / New Red Finance Inc	BCULC	B2, B+ (bond ratings)	200 (estimated)	iBoxx HY Ranking
Spirit AeroSystems Inc	SPR	B2, B	280 (estimated)	iBoxx HY Ranking

Source: Bloomberg, Markit, DTCC weekly data, BofA Global Research

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Timestamp: 26 February 2024 12:55PM EST

We expect four removals from the index, on account of one credit event and three rising stars. Rite Aid Corp (RAD) declared bankruptcy on October 15th, 2023. The other three are Ford Motor Company (F), MGIC Investment Corp (MTG) and Howmet Aerospace Inc (HWM), which were all upgraded to IG in the last four months (upgrade dates are October 30th, 2023, January 8th, 2024 and December 15th, 2023 respectively).

Because there are no suitable replacements with existing CDS, we expect these removals will trigger the addition of names from the iBoxx High Yield index based on bond liquidity and debt outstanding. We believe these names will be Civitas Resources Inc (CIVI), LifePoint Health Inc (RGCARE), Clear Channel Outdoor Holdings Inc (CCO) and Allied Universal (UNSEAM). Due to additions being more uncertain than removals, we include runners-up (BCULC and SPR) that also rank high in bond liquidity and debt outstanding. For the replacements, we use bond spread as a proxy for CDS spread and adjust for current basis and for names with only secured bonds.

Intrinsic roll estimate: FV of 22bp for 5Y

We estimate that the fair value of the HY42 5Y roll will be 22bp/\$0.45, driven by 16bp for constituent changes and 6bp for the six-month maturity extension.

Exhibit 2: CDX HY Series 42 fair value estimates

We estimate a fair value roll of 22bp for 5Y

5Y	FV Spread (bp)	Traded Spd (bp)	Traded Price (\$)
HY41	352	338	106.36
+ Constituents change	16		
+ 6M Extension	6		
HY42	374	360	105.91
Roll	22	22	0.45

Source: Markit, BofA Global Research

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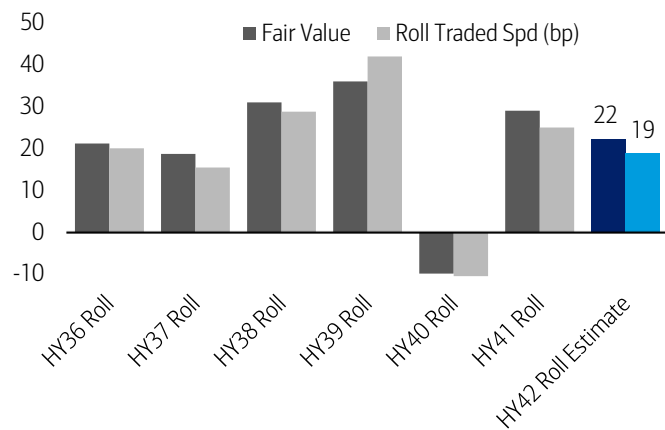
Technical suggest the roll will trade flat to fair value

The roll should trade flat to fair value for two reasons.

First, the index has traded rich to FV (Exhibit 4). This drives considerable index arbitrage activity, leaving net long risk positions to be rolled into the new series as short index positions are “trapped” in index arb packages versus long single-name positions. This happened in the most recent HY41 roll, which traded 4bp flat to FV at inception (Exhibit 3)

Exhibit 3: CDX HY Roll spread at inception (bp)

HY42 Roll is expected to trade flat to fair value at inception

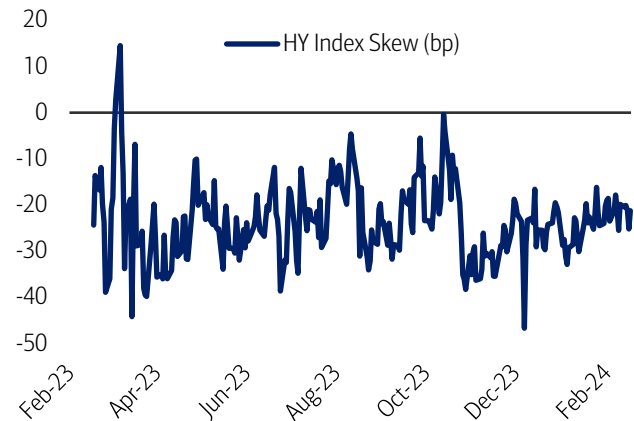


Source: Bloomberg, Markit, BofA Global Research

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Exhibit 4: CDX HY Index Skew (bp)

The index has been trading rich to fair value over the past year



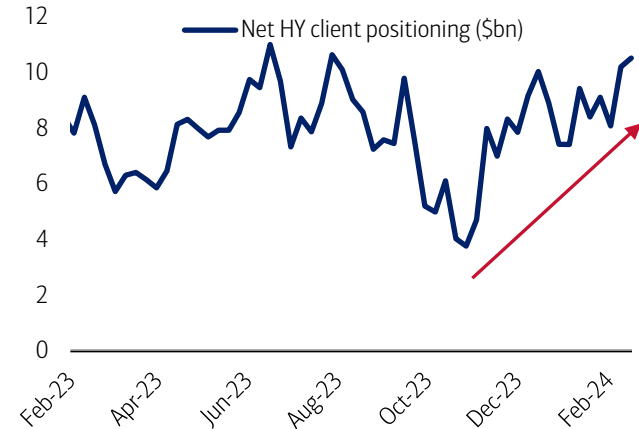
Source: Markit, BofA Global Research

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Second, DTCC data shows an increase in client long risk positioning (Exhibit 5), likely on the back of model-driven risk buying following the substantial recent tightening in CDX HY spreads (Exhibit 6). These long risk positions are likely to roll to the new index series, adding a considerable flattening technical to the HY42 roll.

Exhibit 5: Net long risk client positioning

The increase in risk positioning from clients could lead the HY42 roll to trade flatter to FV at inception

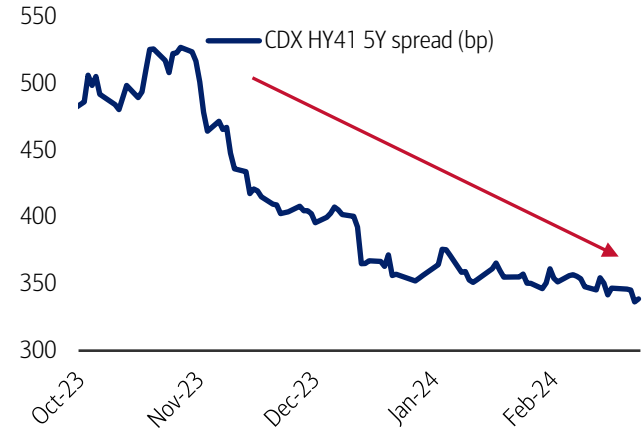


Source: DTCC, BofA Global Research

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Exhibit 6: CDX HY spreads have tightened since October 2023

This recent tightening is likely to lead model-driven investors to increase their long risk positions, adding selling pressure to HY42 protection



Source: Bloomberg, Markit, BofA Global Research

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As a combined effect of these technicals, we estimate HY42 5Y roll to trade 3bp/\$0.15 flat to FV on roll day at 19bp/\$0.30 (Exhibit 3).

Weekly Data and Charts

- IG CDS-Cash Basis reached new LTM tight of -42.3bp over the past week before widening to -46.2bp (Exhibit 9)
- Synthetic cash still trades rich to cash, with most value in BBs (Exhibit 13)



Performance Dashboard

Exhibit 7: Weekly IG snapshot

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

IG	Level	1W change	3M %ile
Realized Vol CDX IG (1M %)	28.6	-5%	5%
Implied Vol CDX IG (1M %)	45.3	5%	67%
CDX IG 5y spd (bp)	51.6	-1%	2%
IG Cash 5y spd (bp)	84.7	-5%	2%
LQD spd (bp)	118.2	-2%	15%
LQD Implied Vol (1M)	7.9	3%	2%
IG CDS-Cash basis (bp)	-46.2	7%	89%
CDX IG index skew (bp)	-3.0	-37%	97%

Source: Bloomberg, Markit, BofA Global Research

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Exhibit 8: Weekly HY snapshot

In HY Cash 5y spd (bp) sits at a low 3-month %ile while HYG Implied Vol (1M) sits at a high 3-month %ile

HY	Level	1W change	3M %ile
1M Realized Vol CDX HY (1M %)	23.3	-7%	3%
Implied Vol CDX HY (1M %)	36.8	1%	61%
CDX HY 5y spd (bp)	338.6	-1%	2%
HY Cash 5y spd (bp)	342.5	-4%	0%
HYG spd (bp)	344.5	-5%	2%
HYG Implied Vol (1M)	11.2	82%	98%
HY CDS-Cash basis (bp)	-51.7	1%	62%
CDX HY index skew (bp)	-21.3	-17%	74%

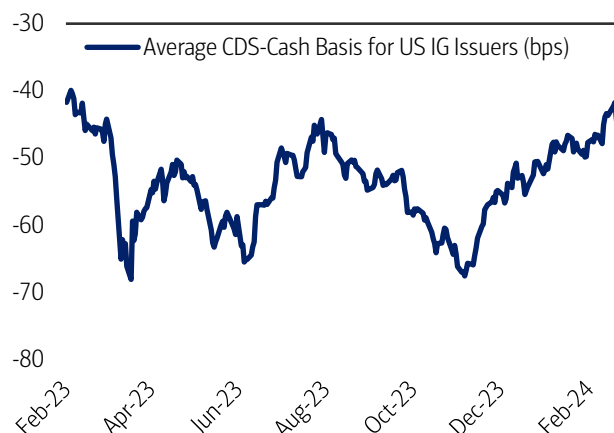
Source: Bloomberg, Markit, BofA Global Research

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CDS-Cash Basis

Exhibit 9: LTM US IG CDS-Cash Basis

On Feb 23, 2024 average CDS-Cash Basis for US IG Issuers was -46.2bp...



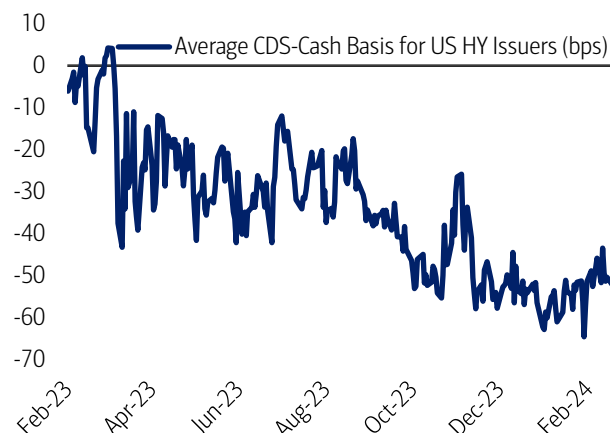
Note: A more negative basis indicates bonds trading cheap to synthetic cash

Source: BofA Global Research, Markit

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Exhibit 10: LTM US HY CDS-Cash Basis

...versus -51.7bp 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 11: 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	-59	-55	-60	89%
Food, Bev, & Bottling	-59	-56	-65	86%
REITs	-57	-51	-51	32%
Basic Materials	-55	-53	-56	40%
Health Care	-54	-52	-54	37%
Technology	-50	-48	-44	48%
Transportation	-49	-43	-46	73%
Retail	-46	-42	-43	35%
Finance	-44	-41	-59	91%
Energy	-42	-39	-47	97%
Other	-41	-39	-39	57%
Industrial Products	-41	-35	-38	58%
Banks/Brokers	-39	-42	-48	99%
Insurance	-29	-26	-24	44%
Media & Entertainment	-15	-23	-47	100%

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

Source: BofA Global Research, Markit

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Exhibit 12: 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	-88	-87	-95	29%
Health Care	-82	-79	-78	16%
Commercial Services	-62	-70	-70	40%
Other	-61	-57	-50	49%
Energy	-55	-55	-57	49%
Media & Entertainment	-53	-50	-64	48%
Utilities	-52	-55	-68	17%
Leisure	-32	-29	-35	52%
Retail	-2	-1	23	1%
Automobiles	16	12	31	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, Insurance, REITs, Transportation

Source: BofA Global Research, Markit

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Exhibit 13: 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	-41	-39	-38	64%
BBB	-50	-47	-52	88%
BB	-64	-64	-70	20%
B	-26	-27	-21	20%

Source: BofA Global Research, Markit

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Exhibit 14: Top 10 richest US IG synthetic cash to cash

IG Issuers with synthetic cash trading richest to cash currently include AZO (-82bp), AEP (-81bp), and DUK (-80bp).

Rank	Ticker	Rating	Sector	Current Basis (bp)	Current %ile	1M %ile
1	AZO	BBB2	Retail	-82	37%	95%
2	AEP	BBB2	Utilities	-81	43%	65%
3	DUK	BBB2	Utilities	-80	95%	81%
4	WY	BBB2	REITs	-80	85%	75%
5	HRB	BBB3	Commercial Services	-77	94%	83%
6	MSI	BBB3	Technology	-77	68%	92%
7	HST	BBB3	REITs	-75	26%	81%
8	PKG	BBB2	Basic Materials	-74	91%	55%
9	SRE	AA3	Utilities	-74	47%	n.a.
10	EXC	BBB2	Utilities	-72	86%	84%

Note: 87 issuers are included in our analysis

Source: BofA Global Research, Markit

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Exhibit 15: Top 10 richest US HY synthetic cash to cash

HY Issuers with synthetic cash trading richest to cash currently include AVNT (-134bp), VST (-116bp), and CHK (-113bp).

Rank	Ticker	Rating	Sector	Current Basis (bp)	Current %ile	1M %ile
1	AVNT	BB3	Basic Materials	-134	27%	12%
2	VST	BB2	Utilities	-116	92%	69%
3	CHK	BB2	Energy	-113	60%	90%
4	DVA	B1	Health Care	-108	72%	75%
5	MTG	BBB3	Insurance	-108	53%	76%
6	CLF	BB3	Basic Materials	-108	13%	40%
7	BMCAUS	BB3	Basic Materials	-104	87%	88%
8	LPX	BB1	Basic Materials	-103	85%	66%
9	LW	BB2	Food, Bev, & Bottling	-102	50%	63%
10	IRM	BB3	REITs	-102	85%	32%

Note: 57 issuers are included in our analysis

Source: BofA Global Research, Markit

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Exhibit 16: Top 10 cheapest US IG synthetic cash to cash

IG Issuers with synthetic cash trading cheapest to cash currently include PARA (91bp), LNC (28bp), and WHR (11bp).

Rank	Ticker	Rating	Sector	Current Basis (bp)	Current %ile	1M %ile
1	PARA	BBB3	Media & Entertainment	91	100%	n.a.
2	LNC	BBB1	Insurance	28	37%	56%
3	WHR	BBB2	Consumer Products	11	14%	87%
4	WMT	AA2	Retail	-17	44%	86%
5	GM	BBB2	Automobiles	-21	65%	78%
6	PG	AA3	Consumer Products	-26	62%	n.a.
7	PRU	AA3	Insurance	-27	39%	31%
8	AES	BBB3	Utilities	-28	85%	76%
9	VZ	BBB1	Telecom	-29	48%	20%
10	DVN	BBB2	Energy	-29	67%	37%

Note: 87 issuers are included in our analysis

Source: BofA Global Research, Markit

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Exhibit 17: Top 10 cheapest US HY synthetic cash to cash

HY Issuers with synthetic cash trading cheapest to cash currently include JWN (175bp), NBR (138bp), and M (100bp).

Rank	Ticker	Rating	Sector	Current Basis (bp)	Current %ile	1M %ile
1	JWN	BB1	Retail	175	35%	74%
2	NBR	B1	Energy	138	72%	64%
3	M	BB1	Retail	100	82%	71%
4	CCL	B2	Leisure	52	38%	41%
5	CAR	B1	Commercial Services	40	49%	45%
6	AXL	B2	Automobiles	34	6%	58%
7	GT	B1	Automobiles	34	40%	10%
8	NWL	BB2	Consumer Products	15	11%	6%
9	DAL	BB1	Transportation	11	15%	55%
10	CPN	B1	Utilities	-3	13%	14%

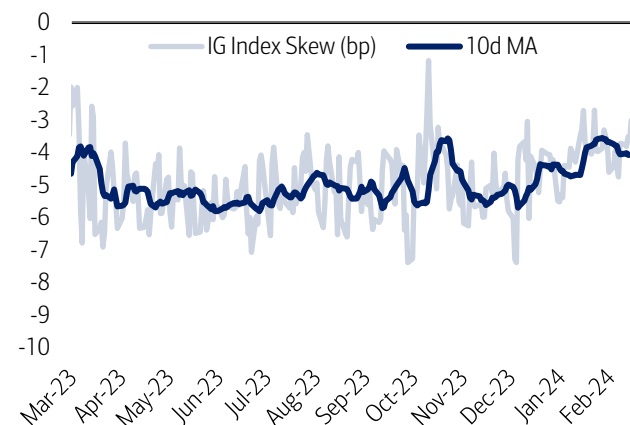
Note: 57 issuers are included in our analysis

Source: BofA Global Research, Markit

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CDX Index Skew**Exhibit 18: CDX IG Index Skew (bp)**

CDX IG spread skew has on average compressed over the last year. On Feb 23, 2024, skew was -3.0bp.



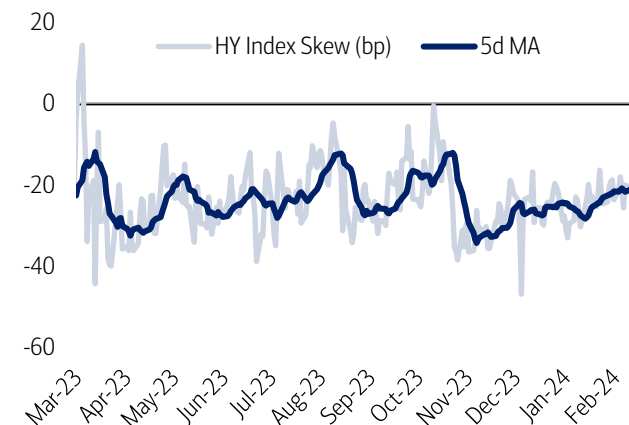
Note: Skew = Traded index - Fair value of the constituents. Negative skew (in spread) points to the index trading rich to FV.

Source: BofA Global Research, Markit

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Exhibit 19: CDX HY Index Skew (bp)

CDX HY spread skew has also on average compressed over the last year. On Feb 23, 2024, skew was -21.3bp.



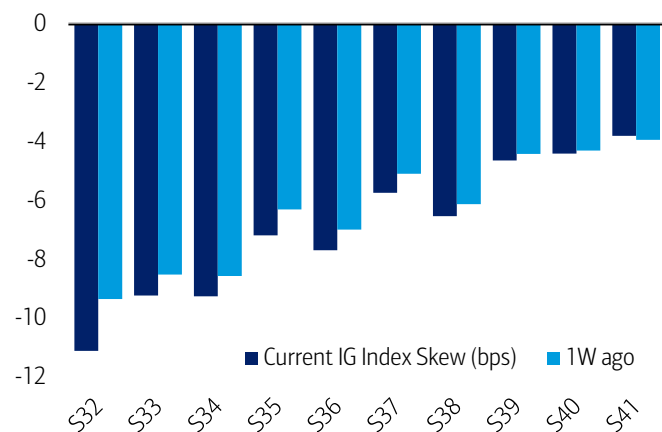
Note: Skew = Traded index - Fair value of the constituents. Negative skew (in spread) points to the index trading rich to FV.

Source: BofA Global Research, Markit

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Exhibit 20: CDX IG Roll Skew

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

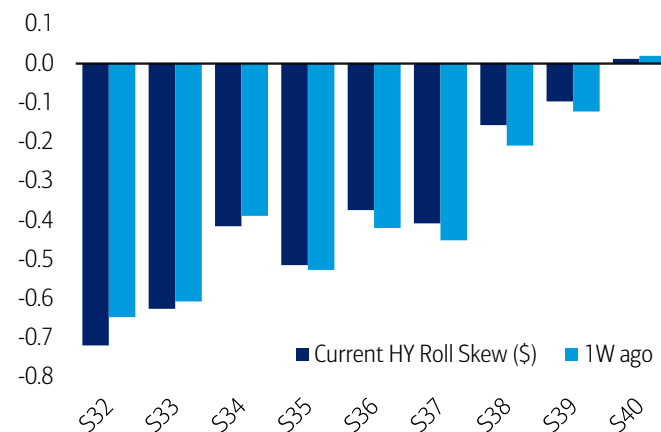


Source: BofA Global Research, Markit

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Exhibit 21: 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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