

# Credit Strategy - The Quick View

## iTraxx indices S41 – what could change

### Getting ready for the new series

In this note we provide our thoughts on the upcoming S41 roll for the European CDS indices of iTraxx Main and Crossover. Note that the below views are based on our analysis of currently available data sets and market information.

### iTraxx Main S41: what could change

Based on the currently available market liquidity and credit ratings data we could see five names changing among the 125 constituents of the current portfolio. Liquidity ranking and also credit rating changes are the drivers of the potential changes for the S41/S40 iTraxx Main roll.

**Lanxess, Alstom** and **ELO** could leave the iTraxx Main index as they do not satisfy the minimum rating criteria for inclusion into the high-grade CDS index (BBB- and negative outlook from at least one of the rating agencies, entails entity does not qualify). We think these names can enter XO (Crossover) S41. We also think that **Rentokil** and **Sky** might not make it in Main S41 and could likely leave the index due to lower rankings across the current S40 names, based on our 6 months top-1000 Liquidity List.

On the flip side, we think that **Lufthansa** and **Accor** do satisfy at the time of writing the minimum credit rating requirement (at least BBB- and stable outlook) and thus likely to move from XO into Main in S41. Additionally, **United Utilities, Adecco** and **Hochtief** could enter the new series as they rank higher in our 6m top-1000 Liquidity List than other names, and also satisfy other inclusion criteria (number of names per sector).

In the Financials sector, we see no name changes.

### Crossover Liquidity List: the ins and the outs

At the time of writing **Lufthansa** and **Accor** are likely to leave the XO index on the back of positive rating actions since the previous index roll. These names ratings currently do not satisfy the ratings criteria for inclusion to XO S41. Both names are likely to make it into the new Main S41, as could potentially satisfy the liquidity rankings rule for inclusion in iTraxx Main S41 index.

In terms of minimum spread requirement, we calculate the minimum spread threshold for XO index inclusion (1.5x iTraxx Main non-Fins) to be ~87p. Lagardere and Galp (both unrated names) still trade at tighter levels, and thus are unlikely to re-enter the new XO S41 index.

**Atos** will no longer be part of the XO index due to wide trading levels as the name's 5y CDS trades above the maximum spread threshold (of 50pts).

**Lanxess, Alstom** and **ELO** are likely to enter the new XO index as they do satisfy at the time of writing the credit rating inclusion criteria.

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The rest of the XO names in the current on-the-run index (S40) are either in the liquidity list we compile (more details later) or because they have been part of the current series are likely to have seen interest in trading due to skew packages and thus, we think that are likely to have enough liquidity to feature in the official DTCC 6m top-1000 Liquidity List (not yet available). The vast majority of the names that do not feature in our liquidity list are the ones that entered into S40 via the Supplementary List.

Thus, on a net basis, and based on the latest available rulebook (the S41 rulebook has not been published by Markit at the time of writing) it seems that there might be no need for any new names to enter the new series via the Supplementary list. **Note though that changes in credit ratings, credit spreads and market liquidity rankings over the rest of the month can affect the ins and outs.**

## Liquidity List: knowns and unknowns

The final ins and outs are dependent on the final liquidity ranking. At this moment there is no clarity on the official liquidity ranking in the Crossover or iTraxx Europe names. The official DTCC 6m top-1000 Liquidity List typically becomes available when data are also available to reflect the entire February month liquidity too. Thus we attempt to compile our own list using the weekly activity DTCC reports since early September 2023.

## Supplementary List

Exhibit 1 below shows the potential top two candidates via the Supplementary List for the new Crossover index, based on our screening analysis. We run this screen in case it is needed based on unforeseen changes over the following weeks and ahead of the roll that would change the net balance of names needed for the new XO S41 index.

We rank the Supplementary List candidates by the largest amount of debt included in the euro, dollar and sterling high yield market. We show the nearest 5yr maturity bond and the bond z-spread. Note again that this list is not reflecting issuance, rating changes and market developments for the rest of February that could affect the eligibility of names for the official Supplementary List.

### Exhibit 1: Potential Supplementary List candidates, based on our screening

Which names could enter the new Crossover S41 index via the Supplementary list if needed

Issuer	Ticker	Country	Total debt (€mn)	z-spread	ISIN	Moody's	S&P	Fitch	~5yr bond
Heimstaden Bostad AB	HEIBOS	SE	2500	312	XS2397239000		BBB- neg	BBB *-	HEIBOS 0 1/4 10/13/24
Lottomatica SpA	GAMENT	IT	1965	155	XS2628390366	Ba3	BB-		GAMENT 7 1/8 06/01/28

**Source:** BofA Global Research, Markit, ICE. Based on screening the constituents of the iBoxx EUR High Yield cum crossover Index, the HLOO index (we use the ICE index as a proxy as we do not have access to the iBoxx GBP High Yield Overall Index) and the HOAO index (we use the ICE index as a proxy as we do not have access to the iBoxx USD High Yield Developed Markets Index)

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## Highlights from the Rulebook

### What's the minimum spread rule for Crossover for unrated entities?

An entity is eligible for inclusion in the new Crossover series if it has an average spread (over the last 10 business days of the month prior to the roll date) of at least 1.5-times the average spread (over the same period) of the non-financial components of the new iTraxx Europe index (S41). In our analysis we use close-of-business data from the 12<sup>th</sup> February 2023). This rule applies only to non-rated entities.

### Notes on the top-1000 liquidity list

While we are waiting for the official DTCC 6m top-1000 Liquidity List (6 Month Analysis Top 1,000 Single Names report), we compile our own list using the weekly DTCC reports since early September 2023. We use the weekly activity notional data.

### Notes on the Supplementary List

Supplementary List entrants are based on the following criteria among others:

- Entities must be incorporated in Europe, where 'Europe' means EU and EFTA member countries, or the UK.
- Entities must have debt outstanding and included (under the same ticker) in the iBoxx EUR High Yield cum crossover Index, the iBoxx GBP High Yield Overall Index, or the iBoxx USD High Yield Developed Markets Index (the "Selection Indices") as published in the Selection Indices on the first business day of the relevant roll month. Furthermore:
  - for this determination all publicly traded debt at all tiers, including senior and subordinated, secured and unsecured included in the Selection Indices will be considered;
  - loans, debt guaranteed (but not issued) by the entity, convertibles and privately placed debt securities will be excluded;
- Entities must have an aggregate minimum of €750mn outstanding in the iBoxx EUR High Yield cum crossover Index or the iBoxx GBP High Yield Overall Index.
- Entities must have at least one bond issued in the three years preceding the first business day of the relevant roll month as per the iBoxx EUR or the GBP Index.
- The entities do not currently trade in CDS market (not appear on the DTCC report).

#### Ranking the Supplementary List:

- The Crossover Supplementary List will consist of those entities which satisfy the above criteria and ranked by the largest amount of debt included in the Selection Indices.

## Caveats

The above analysis is based on a rules-based approach according to the Rulebook (product rules under the Documentation page) published by Markit and news information available in IHS Markit web portal. At the time of writing the latest available rulebook is the one for S40. The final lists of ins and outs will be determined based on datasets that are not currently available on their entirety. The data we used represent only part of the historical data that will ultimately be used to determine the final lists of ins and outs. This note provides some guidance but the final list of names that will enter and leave the CDS indices will be determined by Markit based on a full set of data according to their rulebook.

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