

Long Time

Opportunities in Long-Dated Credit

- With rates moving lower, companies have looked to issue increasingly longer dated paper. In 2019, the issuance of euro 15y+ paper tripled to €32bn from €11bn the previous year with €7bn of this in the ultra-long 30y+ paper. As issuance has picked up, investors have begun to assess whether there is value in extending duration, especially when it comes to the new 30y tenor.
- We propose a simple method for assessing whether it is worthwhile extending into longer-dated maturities. This involves calculating forward spreads for bonds above 15 years and comparing the calculated forward to the 5y5y forward (Figure 1). In essence, this tells us how much risk premium we are earning for extending into longer-dated credit relative to 10y credit. If this ratio is above the duration ratio, we are additionally being compensated for the increased duration.
- Based on this screening and in conjunction with our sector analysts we suggest seven bonds which appear attractive to us (Table 1).

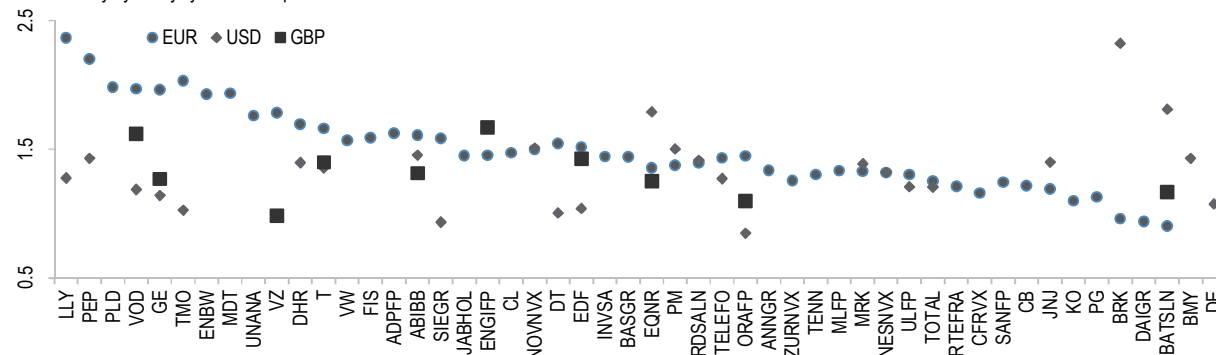
Table 1: Bond Recommendations

| Ticker | Name | Maturity | TtM (Years) | Spread to Govt (bp) | Analyst | Company € Recommendation |
|--------|---------------|------------|-------------|---------------------|-------------------------|--------------------------|
| GE | GE | 01/03/2038 | 18 | 228 | Virginia Chambless | Neutral |
| TMO | Thermo Fisher | 01/10/2039 | 20 | 164 | Danielle Ward | Neutral |
| TMO | Thermo Fisher | 01/10/2049 | 30 | 190 | Danielle Ward | Neutral |
| LLY | Eli Lilly | 01/11/2049 | 30 | 149 | Danielle Ward | Overweight |
| VOD | Vodafone | 20/11/2037 | 18 | 161 | Christian Crosby | Overweight |
| ENBW | EnBW | 07/07/2039 | 19 | 101 | Andres Gonzalez-Puelles | Underweight |
| UNANA | Unilever | 11/06/2039 | 19 | 99 | Ela Kurtoglu | Neutral |

Source: J.P. Morgan.

Figure 1: Long-Dated Issuers

Ratio of 10yXy to 5y5y forward spread



Source: J.P. Morgan.

See page 9 for analyst certification and important disclosures.

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European Credit Strategy and Derivatives Research

Saul Doctor ^{AC}

(44-20) 7134-1539

saul.doctor@jpmorgan.com

J.P. Morgan Securities plc

US Corporate Research

Virginia Chambless, CFA ^{AC}

(1-212) 834-5481

virginia.chambless@jpmorgan.com

J.P. Morgan Securities LLC

European Corporate Research

Danielle Ward, CFA ^{AC}

(44-20) 7742-7344

danielle.x.ward@jpmorgan.com

J.P. Morgan Securities plc

Ela Kurtoglu ^{AC}

(44-20) 7134-0104

ela.n.kurtoglu@jpmorgan.com

J.P. Morgan Securities plc

Andres Gonzalez-Puelles, CFA ^{AC}

(44-20) 7134 0652

andres.gonzalez-puelles@jpmorgan.com

J.P. Morgan Securities plc

Christian Crosby, CFA ^{AC}

(44-20) 7134 2850

christian.d.crosby@jpmchase.com

J.P. Morgan Securities plc

Table 2: Pick up for extending duration

Spread to Govt

| EUR | | | | | | USD | | | | | GBP | | | | |
|--------|----------|----------|-----------|------------|-------|----------|----------|-----------|------------|-------|----------|----------|-----------|------------|-------|
| Ticker | Sprd 10y | 5y5y Fwd | 10yXy Fwd | Difference | Ratio | Sprd 10y | 5y5y Fwd | 10yXy Fwd | Difference | Ratio | Sprd 10y | 5y5y Fwd | 10yXy Fwd | Difference | Ratio |
| LLY | 76 | 88 | 207 | 120 | 2.4 | 72 | 99 | 126 | 27 | 1.3 | | | | | |
| PEP | 66 | 63 | 139 | 76 | 2.2 | 66 | 92 | 132 | 40 | 1.4 | | | | | |
| PLD | 97 | 106 | 209 | 103 | 2.0 | 55 | 52 | | | | | | | | |
| VOD | 107 | 143 | 281 | 138 | 2.0 | 140 | 204 | 242 | 38 | 1.2 | 108 | 141 | 228 | 88 | 1.6 |
| GE | 136 | 167 | 328 | 161 | 2.0 | 150 | 221 | 252 | 31 | 1.1 | 167 | 218 | 278 | 59 | 1.3 |
| TMO | 103 | 123 | 250 | 127 | 2.0 | 95 | 126 | 130 | 4 | 1.0 | | | | | |
| ENBW | 73 | 81 | 156 | 75 | 1.9 | | | | | | | | | | |
| MDT | 88 | 105 | 203 | 98 | 1.9 | 47 | 50 | 147 | 97 | 2.9 | | | | | |
| UNANA | 65 | 82 | 144 | 62 | 1.8 | 67 | 89 | | | | 66 | 80 | | | |
| VZ | 99 | 126 | 226 | 99 | 1.8 | 95 | 130 | 466 | 336 | 3.6 | 106 | 150 | 147 | -2 | 1.0 |
| DHR | 103 | 135 | 229 | 94 | 1.7 | 80 | 106 | 148 | 42 | 1.4 | | | | | |
| T | 134 | 175 | 291 | 116 | 1.7 | 136 | 197 | 267 | 70 | 1.4 | 147 | 193 | 270 | 77 | 1.4 |
| VW | 155 | 204 | 320 | 116 | 1.6 | 124 | 162 | | | | 163 | 208 | | | |
| FIS | 131 | 175 | 278 | 103 | 1.6 | 88 | 106 | | | | 127 | 161 | | | |
| ADPFP | 67 | 72 | 117 | 45 | 1.6 | | | | | | | | | | |
| ABIBB | 96 | 124 | 199 | 75 | 1.6 | 105 | 152 | 221 | 69 | 1.5 | 100 | 128 | 168 | 40 | 1.3 |
| SIEGR | 68 | 86 | 137 | 50 | 1.6 | 89 | 122 | 114 | -8 | 0.9 | | | | | |
| JABHOL | 140 | 190 | 276 | 86 | 1.5 | | | | | | | | | | |
| ENGIFP | 74 | 89 | 130 | 41 | 1.5 | | | | | | 64 | 66 | 110 | 44 | 1.7 |
| CL | 68 | 83 | 122 | 39 | 1.5 | 22 | 25 | 120 | 96 | 4.9 | | | | | |
| NOVNVX | 61 | 72 | 108 | 36 | 1.5 | 63 | 87 | 132 | 44 | 1.5 | | | | | |
| DT | 105 | 143 | 222 | 78 | 1.5 | 135 | 191 | 192 | 1 | 1.0 | 117 | 151 | | | |
| EDF | 95 | 129 | 196 | 67 | 1.5 | 135 | 215 | 223 | 9 | 1.0 | 111 | 154 | 219 | 66 | 1.4 |
| INVSA | 78 | 85 | 122 | 38 | 1.4 | | | | | | | | | | |
| BASGR | 62 | 69 | 100 | 31 | 1.4 | | | | | | 64 | 78 | | | |
| EQNR | 63 | 66 | 89 | 23 | 1.4 | 70 | 92 | 166 | 73 | 1.8 | 69 | 63 | 79 | 16 | 1.3 |
| PM | 131 | 177 | 243 | 66 | 1.4 | 102 | 146 | 219 | 73 | 1.5 | | | | | |
| RDSALN | 75 | 96 | 134 | 38 | 1.4 | 77 | 108 | 153 | 45 | 1.4 | | | | | |
| TELEFO | 111 | 148 | 212 | 64 | 1.4 | 143 | 205 | 261 | 56 | 1.3 | 127 | 157 | | | |
| ORAFP | 98 | 127 | 184 | 57 | 1.4 | 127 | 173 | 146 | -26 | 0.8 | 109 | 149 | 164 | 14 | 1.1 |
| ANNGR | 124 | 161 | 215 | 54 | 1.3 | | | | | | | | | | |
| ZURNVX | 89 | 106 | 133 | 27 | 1.3 | | | | | | | | | | |
| TENN | 77 | 91 | 118 | 28 | 1.3 | | | | | | | | | | |
| MLFP | 67 | 74 | 98 | 25 | 1.3 | | | | | | | | | | |
| MRK | 67 | 74 | 98 | 24 | 1.3 | 60 | 90 | 125 | 35 | 1.4 | | | | | |
| NESNVX | 51 | 53 | 70 | 17 | 1.3 | 68 | 95 | 125 | 31 | 1.3 | 10 | -5 | | | |
| ULFP | 101 | 132 | 172 | 40 | 1.3 | 123 | 158 | 190 | 33 | 1.2 | 119 | 142 | | | |
| TOTAL | 71 | 87 | 109 | 22 | 1.3 | 77 | 103 | 124 | 21 | 1.2 | 69 | 84 | | | |
| RTEFRA | 75 | 84 | 102 | 18 | 1.2 | | | | | | | | | | |
| CFRVX | 81 | 97 | 112 | 15 | 1.2 | | | | | | | | | | |
| SANFP | 58 | 64 | 79 | 16 | 1.2 | 53 | 66 | | | | | | | | |
| CB | 111 | 140 | 171 | 30 | 1.2 | 54 | 62 | 190 | 128 | 3.1 | | | | | |
| JNJ | 66 | 81 | 97 | 16 | 1.2 | 60 | 87 | 121 | 35 | 1.4 | | | | | |
| KO | 72 | 85 | 93 | 8 | 1.1 | 56 | 81 | | | | | | | | |
| PG | 55 | 62 | 70 | 8 | 1.1 | 27 | 31 | 97 | 66 | 3.1 | 55 | 70 | | | |
| BRK | 87 | 103 | 99 | -4 | 1.0 | 58 | 75 | 174 | 99 | 2.3 | | | | | |
| DAIGR | 125 | 168 | 157 | -10 | 0.9 | 121 | 152 | | | | 137 | 169 | | | |
| BATSLN | 193 | 281 | 254 | -27 | 0.9 | 162 | 223 | 404 | 181 | 1.8 | 185 | 252 | 295 | 43 | 1.2 |
| BMJ | | | | | | 80 | 104 | 149 | 45 | 1.4 | | | | | |
| DE | | | | | | 74 | 104 | 112 | 8 | 1.1 | | | | | |

Source: J.P. Morgan.

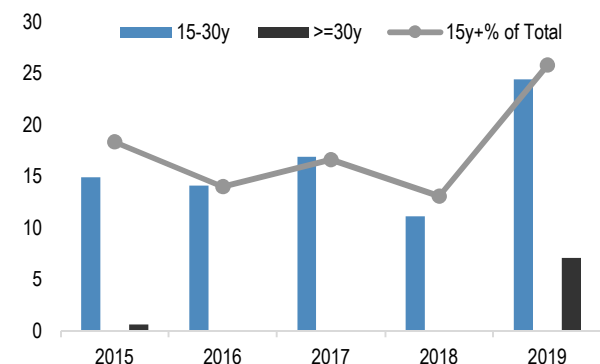
Growing attention

2019 saw a dramatic rise in euro long-dated bond issuance driven, we believe, by low rates allowing companies to issue low-coupon, long-term bonds. This was coupled with a search for yield driving investors to extend duration. In contrast to the US, where long duration issuance has been a persistent feature for many years, issuance of long-dated bonds in euros had been somewhat lacklustre until last year. Our US colleagues have recently written about long-dated USD issuance ([20yr UST issuance and HG corporates](#), Beinstein, 21 Jan).

The spread rally over the past year, along with increasing issuance, has meant that the index spread of longer-dated bonds has increased relative to shorter-dated bonds. The ratio of the iBoxx Eur Corp 10y+ relative to the less than 10y bucket has risen from 1.1x at the start of 2019 to over 1.3x today (Figure 3).

Figure 2: EUR Non-Financial Long Dated Issuance

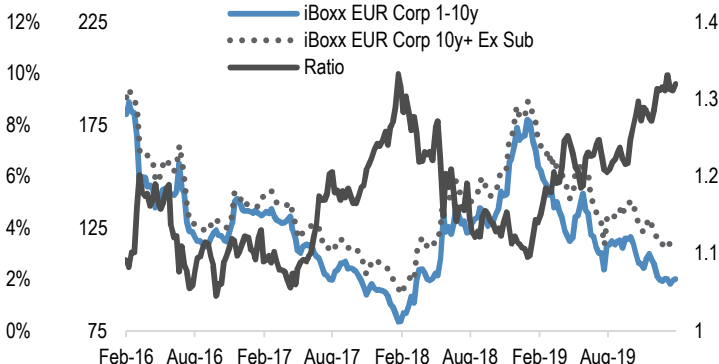
LHS: €bn; RHS: % of total issuance



Source: J.P. Morgan.

Figure 3: Index spreads and Ratio

LHS: Spread (bp); RHS: Ratio



Source: J.P. Morgan.

To extend or not to extend

The rise in issuance and wider spreads in the longer-dated bucket opens the question as to whether investors should extend duration into this increasing active part of the market. We note from Figure 3 that long-dated curves tend to steepen as spreads rally, so investors worried about rising spreads should naturally find the longer bonds more attractive. That said, the longer duration of this paper means that in a spread widening environment losses on an equal notional or spread weighted basis are likely to be higher.

To this end, we prefer to focus on taking a slightly longer-term view and looking at the value that one gets from extending duration. As an investor moves from a 5y bond into a 10y bond, they typically pick up additional spread as curves are upward sloping. The amount of pick-up can be isolated by looking at the 5y5y forward i.e., the annual spread an investor can lock in today for a five-year bond in five years' time by buying the 10y bond rather than the 5y bond (which is subject to reinvestment risk). The 5y5y forward is calculated in Equation 1.

Equation 1: 5y5y Forward Calculation

$$5y5y \text{ Forward} = \frac{\text{Spread}_{10y} \times \text{Duration}_{10y} - \text{Spread}_{5y} \times \text{Duration}_{5y}}{\text{Duration}_{10y} - \text{Duration}_{5y}}$$

Similar to the 5y5 forward, we can calculate the forward between a 10y bond and a longer dated bond. As before, this tells us the pick-up for extending beyond the 10y point. The calculation is shown in Equation 2.

Equation 2: 10yXy Forward Calculation

$$10yXy \text{ Forward} = \frac{\text{Spread}_{(10+X)y} \times \text{Duration}_{(10+X)y} - \text{Spread}_{10y} \times \text{Duration}_{10y}}{\text{Duration}_{(10+X)y} - \text{Duration}_{10y}}$$

Our final step involves calculating the difference between the forward calculated in Equation 2 versus that calculated in Equation 1. We interpret this as the additional pick-up an investor earns for extending beyond 10 years relative to the pick-up for extending from 5y to 10y. Given that the difference is likely to scale with spread – i.e., more risky companies are likely to have a wider forwards – we also look at the forwards as a ratio. The results are shown in Figure 1 and Table 2.

The average ratio of forward for euro bonds with long-dated bonds is around 1.5× higher than in the USD market, where the forward ratio appears to average 1.3×, indicating that there is more value in extending duration in euros than in dollars. Sterling curves also appear flat similarly indicating less value from duration extension.

Time Value and Duration

An alternative way to look at this is to recognise that the forward is linked to the expected time value (carry plus slide) from holding a bond over a one year period (Equation 3). The ratio of forwards is therefore equivalent to calculating the ratio of time value. For investors cautious on duration, a forward ratio that is higher than the duration ratio means that an investor is expected to earn more in time value per unit of duration for extending to longer dated bonds.

Equation 3: Forward and Time Value

$$\begin{aligned} (T-1)y1y\text{Forward} &\approx S_T \times T - S_{T-1} \times (T-1) \\ &\approx S_T + (S_T - S_{T-1}) \times (T-1) \end{aligned}$$

$$\begin{aligned} 1y \text{ Time Value} &\approx \text{Carry} + \text{Slide} \\ &\approx S_T + (S_T - S_{T-1}) \times (T-1) \end{aligned}$$

Below, we highlight seven issuers where we think the pick-up from extending into longer-dated bonds is attractive.

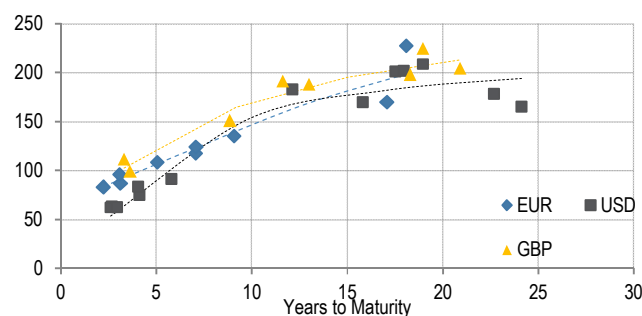
Virginia Chambless

GE 2038

General Electric's credit profile improved in 2019 and we expect further strengthening in 2020. GE has made strides with its multi-year turnaround plan to strengthen the balance sheet and improve business results. A number of asset sales have been completed or are pending which have raised significant cash proceeds for GE to reduce debt and de-risk. GE repaid \$7bn of debt in 2019 and has outlined \$23bn of additional deleveraging actions planned for 2020. Net adjusted leverage improved to 4.2x at 2019 end vs 4.8x at 2018 and GE now expects to achieve its adjusted net leverage target of <2.5x in 2020. While the debt reductions will be achieved with asset sale proceeds, GE also expects improving Industrial free cash flow with guidance of +\$2-4bn for 2020. We expect credit ratings to be stable in 2020. The high cash price of the 2038 bonds may well explain some of its cheapness, but at 60bp versus the 2037 bond this appears overdone. The lower relative duration of high cash price bonds should make this bond more attractive to investors worried curve steepening.

Figure 4: Spread Curve

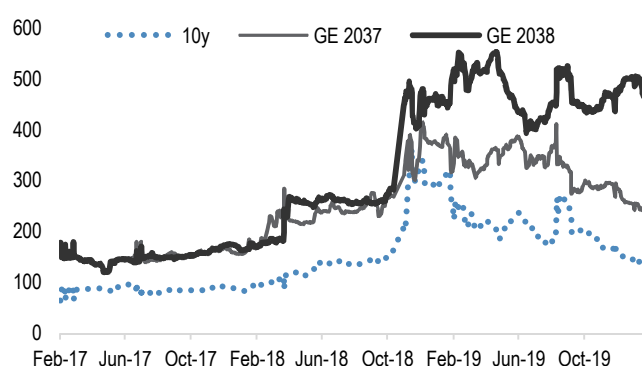
Spread to Govt (bp)



Source: J.P. Morgan.

Figure 5: Spread History

Spread to Govt (bp)



Source: J.P. Morgan.

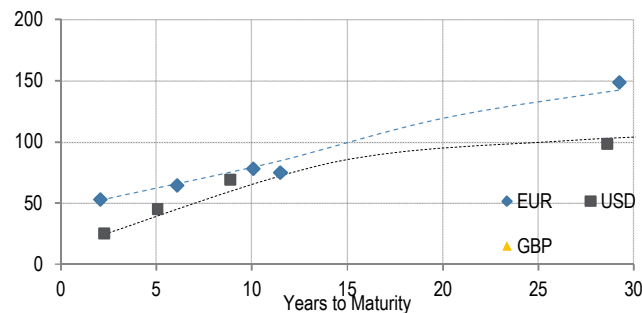
Danielle Ward

LLY 2049

We are constructive on LLY Euro debt given wide trading levels relative to similar or lower-rated pharma credit peers (e.g. MRK, GSK) and our expectation that acquisition activity will be limited to bolt-ons in the coming quarters. LLY recently revisited the Euro market to issue longer-dated notes (2031 and 2049 maturities) with proceeds used to tender for higher-coupon USD bonds. The €49s, in particular, trade with some premium vs. the shorter-end of the curve, which we consider to be an attractive opportunity in a generally stable and high-quality credit story.

Figure 6: Spread Curve

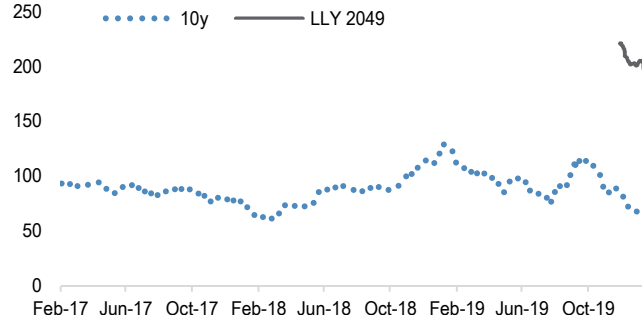
Spread to Govt (bp)



Source: J.P. Morgan.

Figure 7: Spread History

Spread to Govt (bp)



Source: J.P. Morgan.

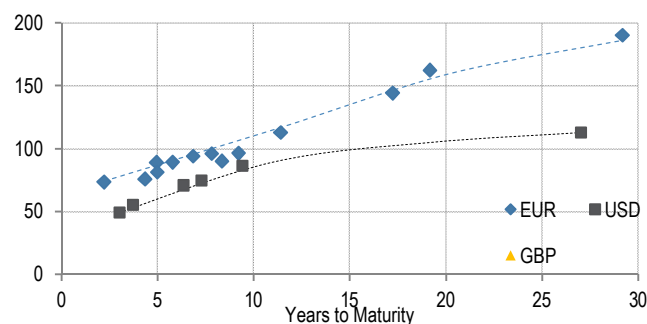
Danielle Ward

TMO 2039 and 2049

TMO's credit profile is solid, with a strong track record of delivering good organic growth rates and deleveraging swiftly after leverage-boosting M&A. We acknowledge that TMO is actively pursuing M&A opportunities in the near-term, which may well require debt funding, but we consider the group's decent ratings headroom (S&P has estimated c. \$11bn debt-funded acquisition capacity within the current BBB+ rating) and willingness to use (partial) equity financing where appropriate. Having recently issued >€4bn EUR notes to term out shorter-dated maturities, TMO may prioritise the USD market for any M&A funding needs, although we cannot rule anything out at this stage. While the mid-part of the TMO curve prices in little premium vs. similar-rated peer DHR (who is set to enter deleveraging mode following the completion of the GE Biopharma acquisition vs. TMO being in a more acquisitive mode), at the longer end the TMO € notes price in the M&A overhang more fully (TMO €39s +12bp vs. DHR €39s; TMO €49s +17bp vs. DHR €49s).

Figure 8: Spread Curve

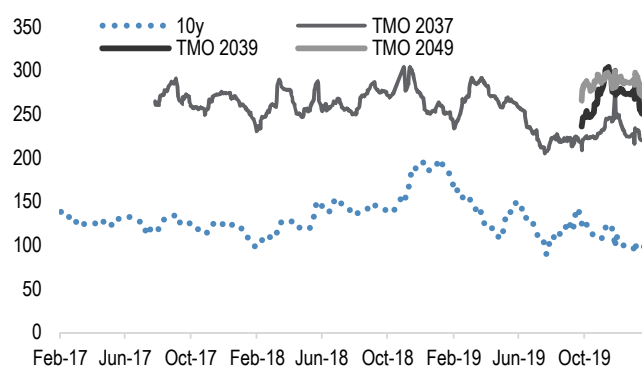
Spread to Govt (bp)



Source: J.P. Morgan.

Figure 9: Spread History

Spread to Govt (bp)



Source: J.P. Morgan.

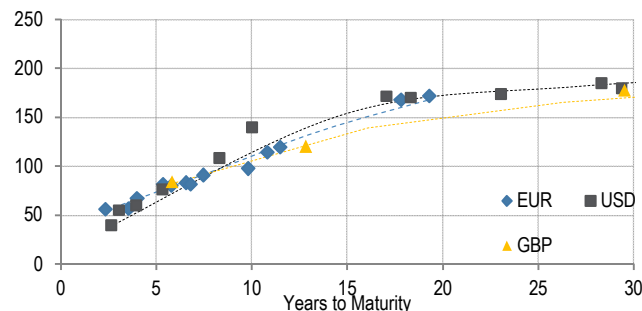
Christian Crosby

VOD €2037 and €2039

We believe the Vodafone (VOD) EUR curve presents an interesting opportunity with '37 and '39 maturities having lagged the performance of the shorter end of the stack. We have an Overweight rating on the issuer with spread catalysts in our view skewed positively via a combination of inbound asset sale proceeds, potential monetizations, a light senior maturity wall, and stabilizing operating performance. We viewed the recent trading update as an affirmation of our views ([see our full note here](#)), and as such remain comfortable with moving out the credit curve or down in the structure to hybrids for investors in need of extra yield. We prefer the '37 notes at just 5bps inside '39s, but acknowledge that price sensitive investors may prefer the '39s given a six point cash price differential.

Figure 10: Spread Curve

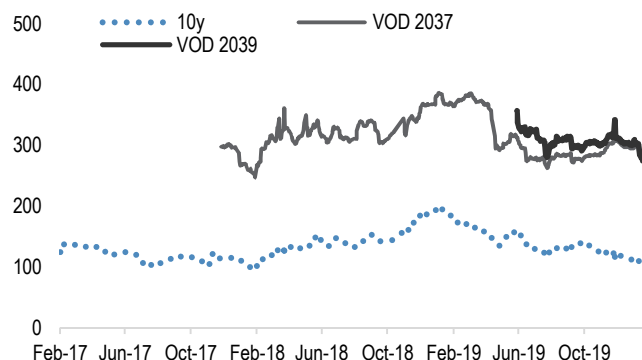
Spread to Govt (bp)



Source: J.P. Morgan.

Figure 11: Spread History

Spread to Govt (bp)



Source: J.P. Morgan.

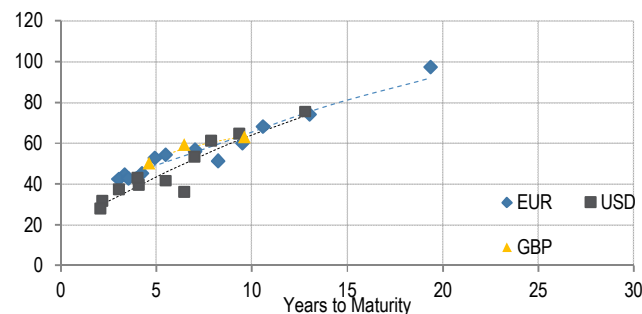
UNANA €2039

Ela Kurtoglu

We have a Neutral [recommendation](#) on Unilever due to stable credit profile with relatively tight trading levels; however, we highlight that the curve is the steepest among consumer names and we think the longer that € bonds (2030s, 2033s and 2039s) are relatively attractive for strong A credit ratings. We therefore suggest the following switches from Nestle (Aa3/S-AA-/S) and Danone (Baa1/S-BBB+/S) into Unilever (A1/S-A+/S): (1) 1.25% Nestle Nov'29s (€111.9pts/1bps z-sprd) into 1.375% Unilever Sep'30s (€111.4pts/27bps z-sprd) for 26bps spread pick-up, (2) 1.75% Nestle Nov'37s (€122.0pts/14bps z-sprd) into 1.5% Unilever Jun'39s (€111pts/55bps z-sprd) for 41bps spread pick-up and (3) 1.2% Danone Nov'28s (€110pts/7bps z-sprd) into 1.125% Unilever Jul'29s (€111.4pts/18bps z-sprd) for 11bps spread pick-up.

Figure 12: Spread Curve

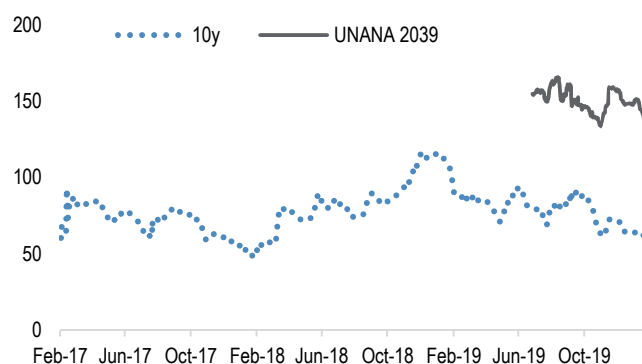
Spread to Govt (bp)



Source: J.P. Morgan.

Figure 13: Spread History

Spread to Govt (bp)



Source: J.P. Morgan.

ENBW €2039

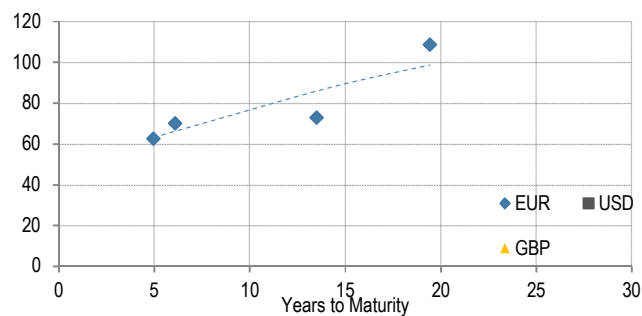
Andres Gonzalez-Puelles

In 2Q19, we downgraded EnBW to Underweight (prev. Neutral). As a result of the challenging outlook for conventional generation (German 1 Yr Baseload ~€41/MWh), intensifying competition in the renewable arena (onshore wind, offshore wind), an elevated investment programme (~€12bn over the period 2021-25) and deteriorated credit quality (increased leverage, M&A), we believe credit spreads will come under pressure, particularly given they rank amongst the most expensive in the sector. However, we currently find an interesting opportunity

extending duration across its rather steep curve, buying its long dated 6.125% 2039 bonds and selling the short end 4.875% 2025 bonds for a ~40bps pickup.

Figure 14: Spread Curve

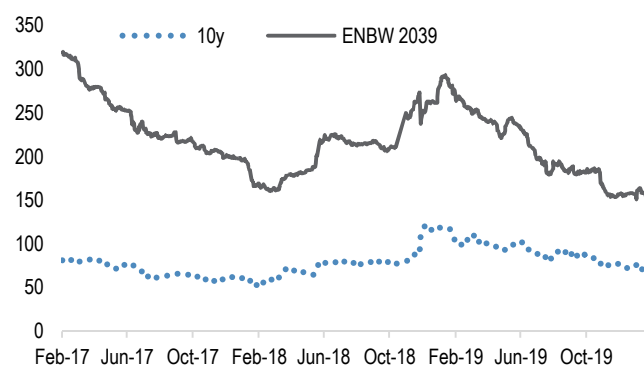
Spread to Govt (bp)



Source: J.P. Morgan.

Figure 15: Spread History

Spread to Govt (bp)



Source: J.P. Morgan.

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We use the following ratings for bonds (issues) and issuers: Overweight (over the next three months, the recommended risk position is expected to outperform the relevant index, sector, or benchmark); Neutral (over the next three months, the recommended risk position is expected to perform in line with the relevant index, sector, or benchmark); and Underweight (over the next three months, the recommended risk position is expected to underperform the relevant index, sector, or benchmark). J.P. Morgan Emerging Markets Sovereign Research uses Marketweight, which is equivalent to Neutral. NR is Not Rated. In this case, J.P. Morgan has removed the rating for this particular security or issuer because of either a lack of a sufficient fundamental basis or for legal, regulatory or policy reasons. The previous rating no longer should be relied upon. An NR designation is not a recommendation or a rating. NC is Not Covered. An NC designation is not a rating or a recommendation.

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|---------------------------------|------------|---------|-------------|
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| IB clients* | 66% | 63% | 60% |

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