

Investment Grade

The Highs and Lows of High Price Bonds

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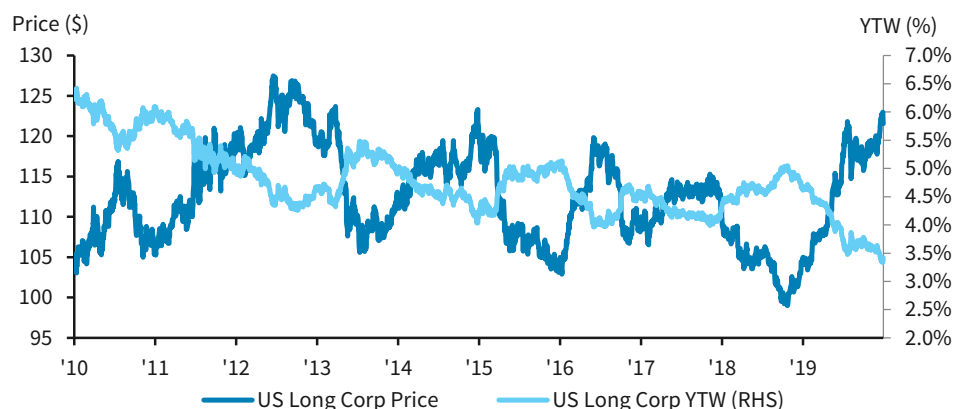
With the Long Index price exceeding \$121, the preponderance of high dollar price debt is a potential concern for investors. High coupon debt of BAA3 credits screens rich, but similar BAA1/BAA2 paper appears more compelling. We highlight long and short opportunities in high coupon BBB debt.

US corporate yields reached all-time lows last Friday as concerns about the spread of the coronavirus spurred a flight to quality. 30y Treasury yields briefly dipped below 2% and are still nearly 25bp lower for the year despite bouncing off the lows in the past few days. The decline has been especially significant in the long end, with the Bloomberg Barclays US Corporate Long Index now yielding less than 3.5%. This has driven a sharp increase in its price, which now exceeds \$121.5 (Figure 1). The preponderance of high dollar price debt is a potential concern for investors. Given the elevated price of the Long Index, dollar price adjusted spreads are meaningfully tighter than nominal levels suggest (see [Low Yields Heighten Concern for Long Bonds](#)).

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FIGURE 1. US Corporate Long Index Yields Are Near All-time Lows, Driving Prices Higher



Source: Bloomberg, Barclays Research

It also raises the question of how much compensation (if any) investors are receiving for high coupon bonds (trading at an elevated price). To get a better understanding of the relative value of bonds with different prices, we construct a universe of matched bond pairs from the same issuers and with similar maturities, but at least a \$5 difference in price. Figure 2 shows the

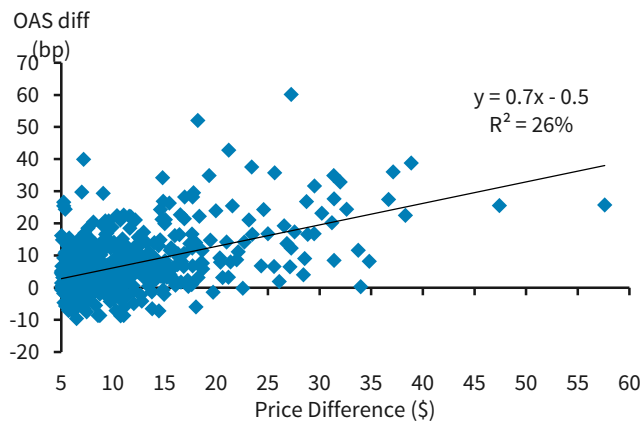
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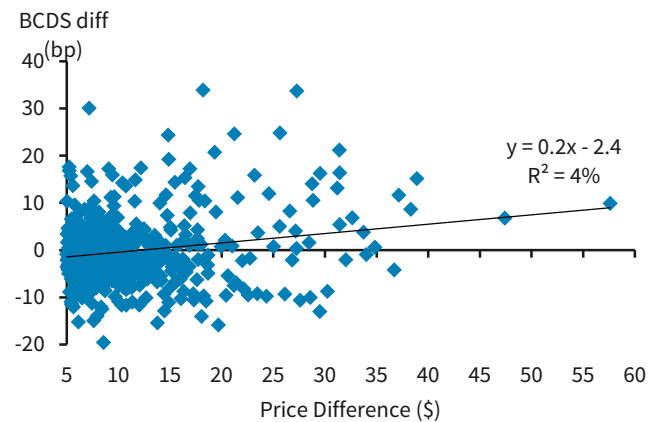
spread difference for these pairs as a function of the price difference. On average, the spread compensation per dollar is approximately 0.7bp. This is down about 0.1bp from when we did a similar analysis in 2017 (see [Price Check for Credit Spreads](#)). Part of the wider spread for higher dollar price bonds is due to their lower expected recovery rates. Accounting for this using bond-implied CDS (BCDS) spreads, high price bonds trade only slightly wide - about 0.2bp/\$ - of their lower price counterparts (Figure 3). This is justified given that the former are likely less liquid and more exposed to potential downside from new issuance (see [High Price Bonds Beware of New Issues](#)).

FIGURE 2. OAS Pickup Offered by High Price Bonds



Source: Bloomberg, Barclays Research

FIGURE 3. BCDS Pickup Offered by High Price Bonds



Source: Bloomberg, Barclays Research

While valuations between high and low coupon bonds appear fair in aggregate, there is significant dispersion at the rating and ticker levels. Figure 4 shows the average compensation for dollar price across different rating buckets: it is about 0.5bp/\$ for single-A debt and increases to 0.7-1.1bp/\$ for BBBs. This makes sense because investors should receive more compensation for putting extra cash in bonds with higher credit risk.

While BAA3 high coupon debt offers the highest bp/\$, we believe it screens as rich. First, despite having meaningfully wider spreads (250bp versus 190bp), the spread compensation is only slightly higher than for the BAA2 bucket. In fact, high coupon BAA3 bonds trade tighter than their lower price counterparts in BCDS terms. Furthermore, the BAA3 bucket is also the most exposed to the risk of a downgrade to high yield, a scenario in which high coupon bonds tend to underperform (see [Large Angels Fall Harder but Bounce Higher](#)). In contrast, we see better value in high coupon BAA1 and BAA2 debt that trades wider than lower coupon bonds even in BCDS terms. Below, we highlight select long and short opportunities in high coupon debt.

FIGURE 4. Spread Compensation for High Coupon Bonds by Rating Notch

Rating	Price Diff	Avg Low \$-px OAS (bp)	OAS Diff (bp)	OAS/\$ (bp)	BCDS Diff (bp)
A1	\$10.0	98	4.2	0.4	(1.4)
A2	\$11.3	107	5.4	0.5	(1.0)
A3	\$10.5	120	5.1	0.5	(0.6)
BAA1	\$11.4	144	7.5	0.7	0.8
BAA2	\$10.5	194	10.3	1.0	1.4
BAA3	\$9.5	252	10.4	1.1	(2.1)

Source: Bloomberg, Barclays Research

Trade Ideas

Figure 5 highlights select high coupon BAA3 bonds that appear rich compared with lower priced debt in their capital structure. In each case, the high coupon trades at least 10bp rich (in BCDS terms) of its lower price counterpart.

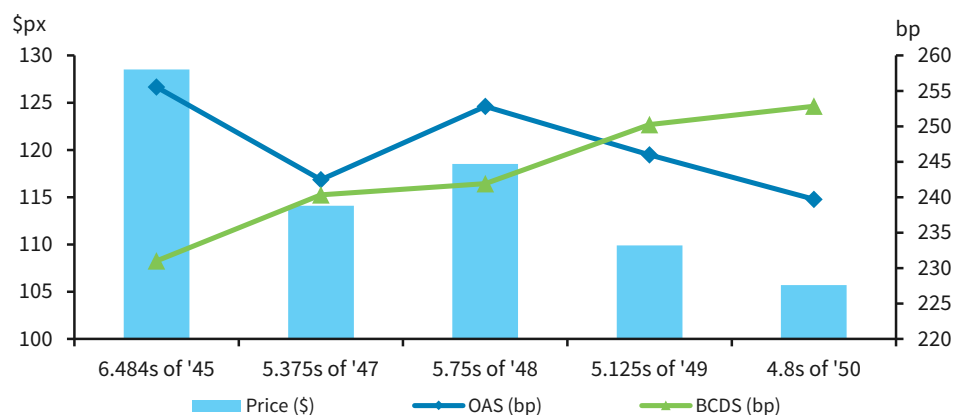
FIGURE 5. High Coupon BAA3 Bonds That Screen as Rich

Ticker	Rating	Low Coupon		High Coupon		High - Low Coupon	
		Bond	Price	Bond	Price	OAS Diff (bp)	BCDS diff (bp)
ETP	BAA3	5.95s of '43	\$110.5	6.5s of '42	\$119.1	-9	(20)
CHTR	BAA3	4.8s of '50	\$105.7	5.375s of '47	\$114.1	3	(13)
TWC	BAA3	5.5s of '41	\$114.0	5.875s of '40	\$119.4	-2	(11)
KHC	BAA3	6.5s of '40	\$125.7	6.875s of '39	\$131.1	-6	(11)
CHTR	BAA3	5.75s of '48	\$118.5	6.484s of '45	\$128.5	3	(11)
DISCA	BAA3	4.95s of '42	\$112.6	6.35s of '40	\$131.1	8	(11)

Note: BCDS is the default adjusted spread

Source: Bloomberg, Barclays Research

One example where high coupon bonds appear rich is in the long end of Charter debt (CHTR). Figure 6 shows the OAS and BCDS of five long-dated CHTR bonds. Despite trading the tightest in OAS terms, the recently issued 2050 bonds trading close to par appear to be the most attractive on a price-adjusted basis (ie, in BCDS terms).

FIGURE 6. CHTR 30y Bonds

Note: BCDS is the default-adjusted spread

Source: Bloomberg, Barclays Research

On the flip side, Figure 7 highlights select high- to mid-BBB bonds that appear cheap, trading at least 10bp wider than lower coupon debt on a BCDS basis.

FIGURE 7. High Coupon BAA2 and BAA1 Bonds That Screen Cheap

Ticker	Rating	Low Coupon		High Coupon		High - Low Coupon	
		Bond	Price	Bond	Price	OAS Diff (bp)	BCDS diff (bp)
AIG	BAA1	4.7s of '35	\$118.3	6.25s of '36	\$135.3	21	17
TRPCN	BAA1	4.75s of '38	\$116.4	6.2s of '37	\$131.9	26	14
T	BAA2	4.85s of '39	\$118.3	5.35s of '40	\$123.9	13	14
ABIBB	BAA1	3.75s of '42	\$107.2	4.625s of '44	\$117.9	21	14
GM	BAA2	5s of '35	\$106.3	6.6s of '36	\$120.9	24	12
UTX	BAA1	4.45s of '38	\$122.6	5.7s of '40	\$140.0	14	12

Note: BCDS is the default-adjusted spread

Source: Bloomberg, Barclays Research

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ABIBB 4 5/8 02/01/44 (USD 118.14, 05-Feb-2020)

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T 5.35 09/01/40 (USD 124.26, 05-Feb-2020)

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CHTR 5 3/8 05/01/47 (USD 114.40, 05-Feb-2020)

CHTR 6.484 10/23/45 (USD 128.16, 05-Feb-2020)

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DISCA 6.35 06/01/40 (USD 132.10, 05-Feb-2020)

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ETP 6 1/2 02/01/42 (USD 119.03, 05-Feb-2020)

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