

High Price Bonds Beware of New Issues

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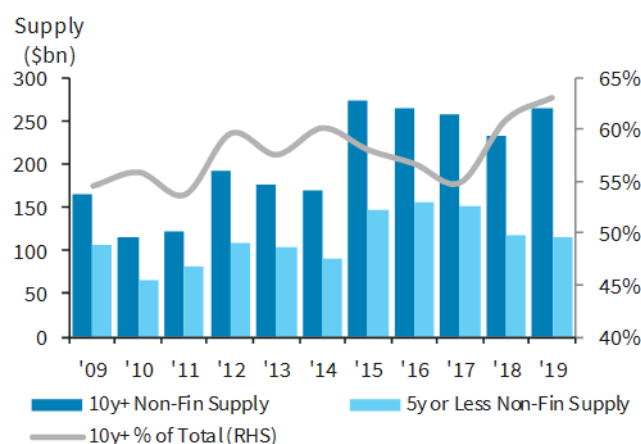
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Year-to-date, 63% of total non-financial issuance has been 10y+ paper – the highest portion in the post-crisis era. As we discussed in last week's investment grade section (*Low Yields Heighten Concerns for Long Bonds*), historically low yields at the long end of the Treasury curve relative to the front end should encourage issuers to favor long-dated securities, and we have seen a recent spate of borrowers redeem front-end debt with proceeds from newly issued long bonds to get ahead of refinancing needs. Barclays Rates Research expects Treasury yields to remain low in the medium term (*Deepening Fault Lines*), so absent a meaningful pickup in volatility, this funding trend should continue for the final months of 2019.

Declining yields have also raised the dollar prices of secondary bonds, specifically at the long end of the curve. The dollar price for the 25y+ corporate index is currently \$115.7, the highest since January 2015. This means that new issues, which normally price near par, are more likely to be compared with bonds trading above par, which makes estimating new issue concessions challenging. OAS does not account for differences in price between two bonds, and while there is usually an adjustment to account for the lower price of new issues relative to the secondary market, it may not fully account for the price difference. Effectively, new bonds end up pricing cheap to premium secondary debt in dollar price-adjusted OAS terms. This should weigh on valuations of high dollar price bonds when new issues are printed. With roughly 90% of 25y+ paper trading above \$105, most companies looking to issue long bonds have seasoned debt that could be vulnerable to this dynamic.

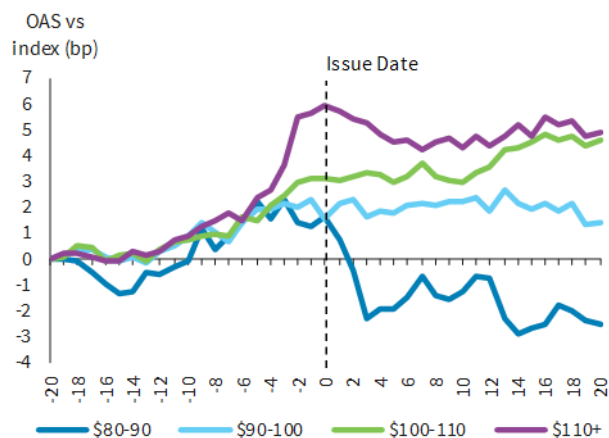
Indeed, we find that when borrowers bring new long bonds to the market, their higher dollar price bonds underperform. Figure 2 shows the median OAS performance of secondary 25y+ debt in the days surrounding new 25y+ issuance from the same issuer, broken out by the seasoned bond's dollar price. To adjust for market sentiment, the OAS move is the change in the bond's basis versus the 25y+ index. As the graph demonstrates, all secondary issues underperformed the index in the days preceding issuance, but bonds trading above par widened more before the issue date and continued to underperform after, whereas bonds trading below \$90 actually tended to outperform after the new bond printed, on average. We would expect similar results at other tenors as well.

FIGURE 1
Non-Financial \$10y+ Issuance versus <5y Issuance since 2009



Note: Supply is through August 13 for each year Source: Bloomberg, Barclays Research

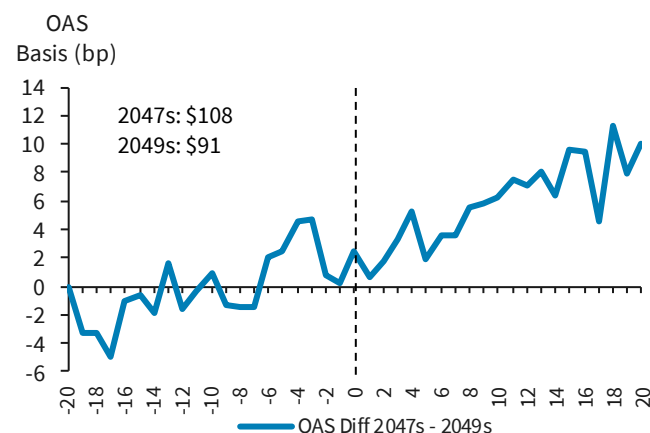
FIGURE 2
Median Performance of 25y+ Bonds around Issuance, by Dollar Price



Note: Senior industrials only, since 2015. Source: Bloomberg, Barclays Research

FIGURE 3

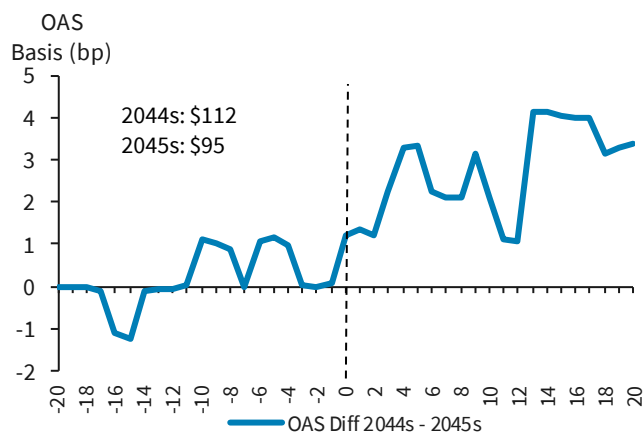
AT&T 5.65s of 2047 (High Dollar Price) versus 4.55s of 2049 (Low Dollar Price)



Source: Bloomberg, Barclays Research

FIGURE 4

Apple 4.5s of 2044 (High Dollar Price) minus 3.45s of 2045 (Low Dollar Price)



Source: Bloomberg, Barclays Research

We can also isolate a number of recent instances when companies that had both lower and higher dollar price bonds outstanding printed new issues. Figures 3 and 4 show the cumulative OAS basis between high dollar price and low dollar price 30y bonds for AT&T and Apple in the days surrounding their issuance of new 30y securities. In February 2017, prior to AT&T's issuance of new 30y debt, its 2047s traded at \$108, versus \$91 for its 2049s. Similarly, in May 2015, Apple issued a new 30y bond, and 20 days prior to issuance, the existing 2044s were at \$112, versus \$95 for the 2045s. In both instances, there was a minimal spread differential a few days prior to issuance, but the low dollar price bonds outperformed the high dollar price bonds meaningfully in the days afterward. Although the underperformance is less significant for Apple, its 30y bonds trade at substantially tighter spreads than AT&T bonds.

In our view, investors should be particularly cautious of dollar price when buying in the long end, given our expectation that issuance in this part of the curve should continue. Figure 5 highlights select high dollar price long bonds (greater than \$115) from large cap structures, excluding those that have recently issued 30y bonds.

FIGURE 5

Select High Dollar Price 30y Bonds from Large Cap Structures

Ticker	Bond	Price	OAS	Sector
SYK	4.625s of 2046	\$125.0	123	Healthcare
RDSALN	4.375s of 2045	\$122.1	115	Integrated
TSN	5.1s of 2048	\$121.9	185	Food & Beverage
MO	5.95s of 2049	\$120.6	269	Tobacco
AZN	4.375s of 2048	\$119.3	132	Pharmaceuticals
ZTS	4.45s of 2048	\$118.8	142	Pharmaceuticals
GIS	4.7s of 2048	\$117.8	169	Food & Beverage
AMGN	4.663s of 2051	\$116.7	175	Pharmaceuticals
KR	5.4s of 2049	\$116.2	244	Supermarkets
CI	4.9s of 2048	\$116.0	198	Healthcare
JNJ	3.75s of 2047	\$115.1	93	Pharmaceuticals

Source: Bloomberg, Barclays Research

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ALTRIA GROUP INC, A/CD/CE/D/E/J/K/L/M
MO 5.95 02/14/49 (USD 119.81, 14-Aug-2019)

AMGEN INC, CD/CE/D/E/J/K/L/M/N
AMGN 4.663 06/15/51 (USD 115.96, 14-Aug-2019)

ASTRAZENECA PLC, CD/CE/D/J/K/L/M/N
AZN 4 3/8 08/17/48 (USD 118.63, 14-Aug-2019)

CIGNA CORP, CD/CE/J/K/M/N
CI 4.9 12/15/48 (USD 116.13, 14-Aug-2019)

GENERAL MILLS INC, CD/CE/J/K/M/N
GIS 4.7 04/17/48 (USD 117.44, 14-Aug-2019)

JOHNSON & JOHNSON, CD/CE/J/K/N
JNJ 3 3/4 03/03/47 (USD 116.03, 14-Aug-2019)

KROGER CO/THE, CD/CE/J
KR 5.4 01/15/49 (USD 116.10, 14-Aug-2019)

SHELL INTERNATIONAL FINANCE BV, A/CD/D/E/J/K/L/M/N
RDSALN 4 3/8 05/11/45 (USD 121.15, 14-Aug-2019)

STRYKER CORP, A/CD/CE/D/J/K/L/M/N
SYK 4 5/8 03/15/46 (USD 121.41, 14-Aug-2019)

TYSON FOODS INC, A/CD/CE/D/J/K/L/M/N
TSN 5.1 09/28/48 (USD 121.33, 14-Aug-2019)

ZOETIS INC, CD/CE/D/E/J/K/L/M/N
ZTS 4.45 08/20/48 (USD 115.39, 14-Aug-2019)

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For sectors rated against the Bloomberg Barclays U.S. High Yield 2% Issuer Capped Credit Index, the Bloomberg Barclays Pan-European High Yield 3% Issuer Capped Credit Index excluding Financials, the Bloomberg Barclays Pan-European High Yield Finance Index or the Bloomberg Barclays EM Asia USD High Yield Corporate Credit Index, the analyst expects the six-month total return of the sector to be in line with the six-month total return of the relevant index.

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For sectors rated against the Bloomberg Barclays U.S. High Yield 2% Issuer Capped Credit Index, the Bloomberg Barclays Pan-European High Yield 3% Issuer Capped Credit Index excluding Financials, the Bloomberg Barclays Pan-European High Yield Finance Index or the Bloomberg Barclays EM Asia USD High Yield Corporate Credit Index, the analyst expects the six-month total return of the sector to be less than the six-month total return of the relevant index.

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