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).

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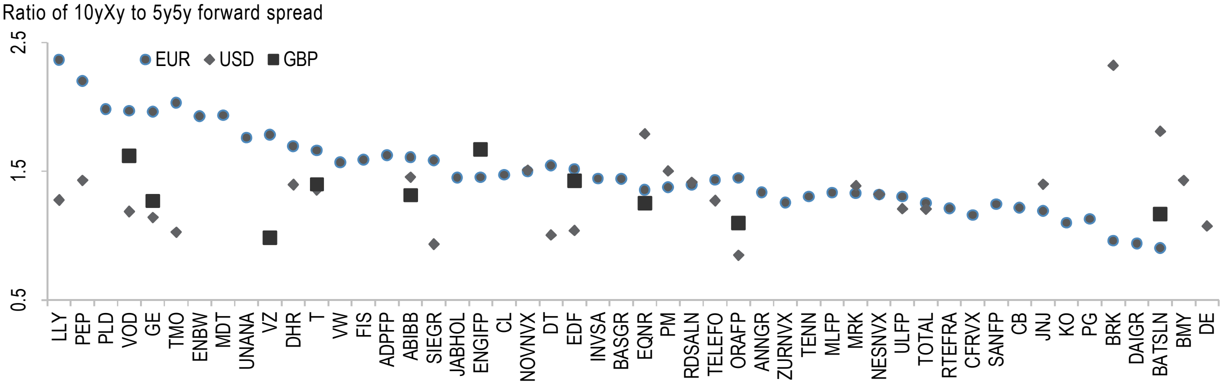
Table 1: Bond Recommendations

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	Voldafone	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.

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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
BMY						80	104	149	45	1.4					
DE						74	104	112	8	1.1					

Source: J.P. Morgan.

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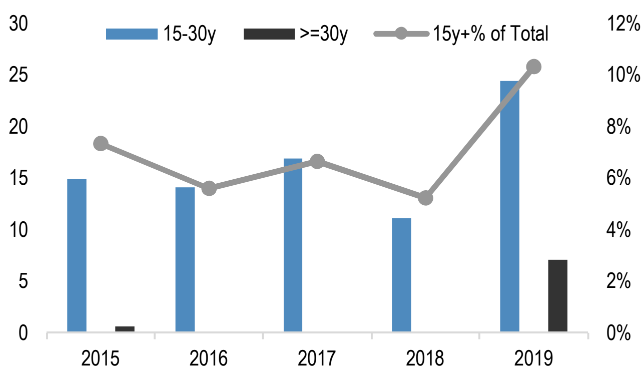
Growing attention

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 1.1× at the start of 2019 to over 1.3× today (Figure 3).

Figure 2: EUR Non-Financial Long Dated Issuance

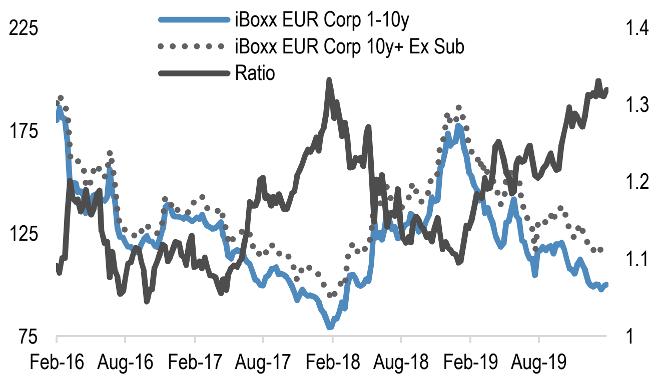
LHS: €bn; RHS: % of total issuance



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

$$\boldsymbol{5y5y\ Forward} = \frac{\boldsymbol{Spread_{10y} \times Duration_{10y} - Spread_{5y} \times Duration_{5y}}}{\boldsymbol{Duration_{10y} - Duration_{5y}}}$$

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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

$$\mathbf{10yXy\ Forward} = \frac{\mathbf{Spread_{(10+X)y} \times Duration_{(10+X)y} - Spread_{10y} \times Duration_{10y}}}{\mathbf{Duration_{(10+X)y} - Duration_{10y}}}$$

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

$$\begin{aligned}
\text{(T-1)}y1yForward &\approx S_T \times T - S_{T-1} \times (T-1) \\
&\approx S_T + (S_T - S_{T-1}) \times (T-1) \\
\\
1y\ Time\ Value &\approx Carry + Slide \\
&\approx S_T + (S_T - S_{T-1}) \times (T-1)
\end{aligned}$$

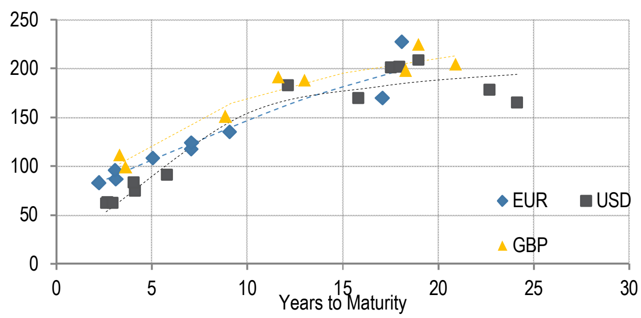
Below, we highlight seven issuers where we think the pick-up from extending into longer-dated bonds is attractive.

GE 2038

Virginia Chambless

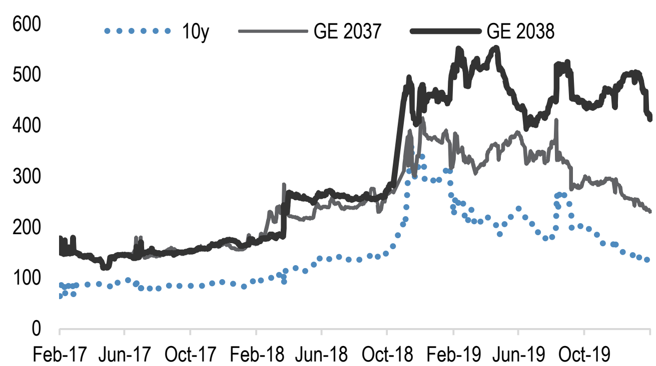
General Electric's credit profile improved in 2019 and we expect further strengthening in 2020. GE has made strides with its multi-year turnaround plan to strengthen the balance sheet and improve business results. A number of asset sales have been completed or are pending which have raised significant 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)



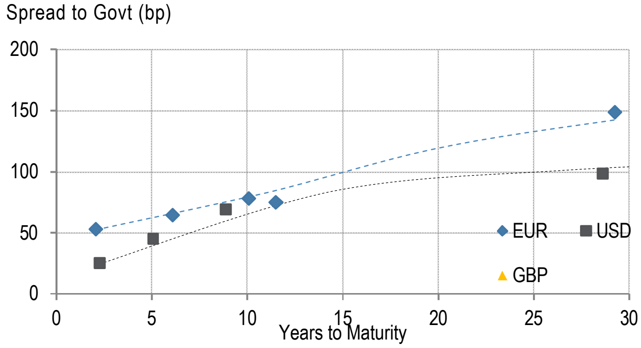
Source: J.P. Morgan.

LLY 2049

Danielle Ward

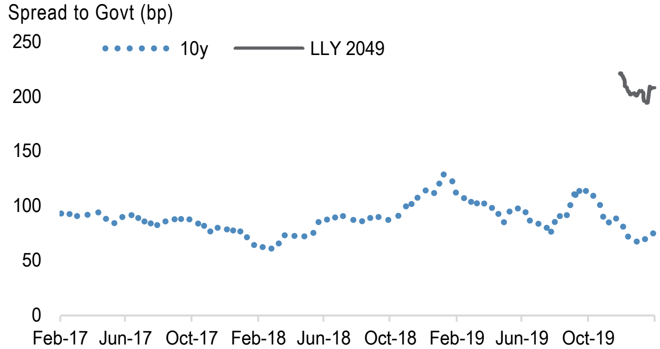
We are constructive on LLY Euro debt given wide trading levels relative to similar or lower-rated pharma credit peers (e.g. MRK, GSK) and our expectation that acquisition activity will be limited to bolt-ons in the coming quarters. LLY recently revisited the Euro market to issue longer-dated notes (2031 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)



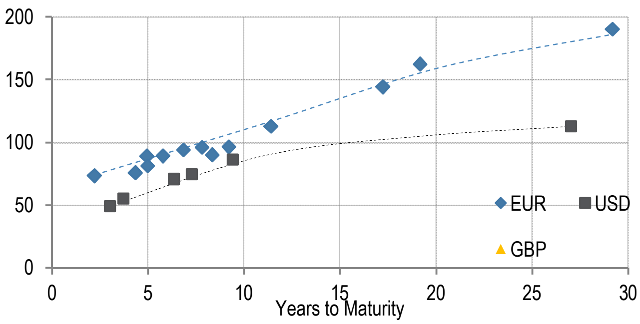
Source: J.P. Morgan.

Danielle Ward

TMO 2039 and 2049

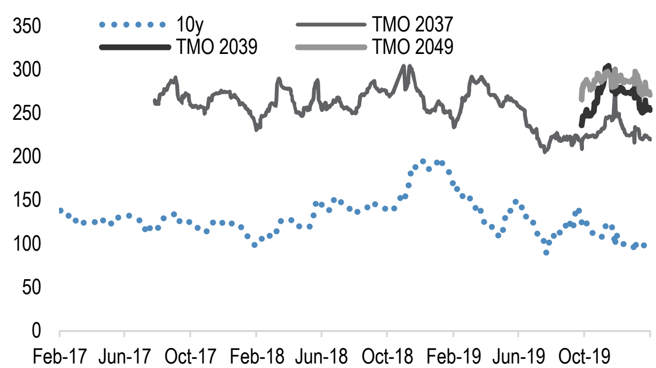
TMO's credit profile is solid, with a strong track record of delivering good organic growth rates and deleveraging swiftly after leverage-boosting M&A. We acknowledge that TMO is actively pursuing M&A opportunities in the near-term, which may well require debt funding, but we consider the group's decent 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.

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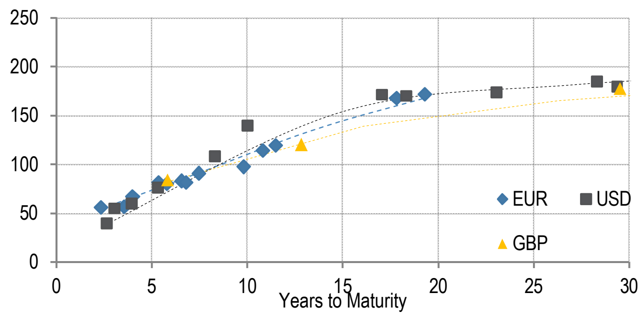
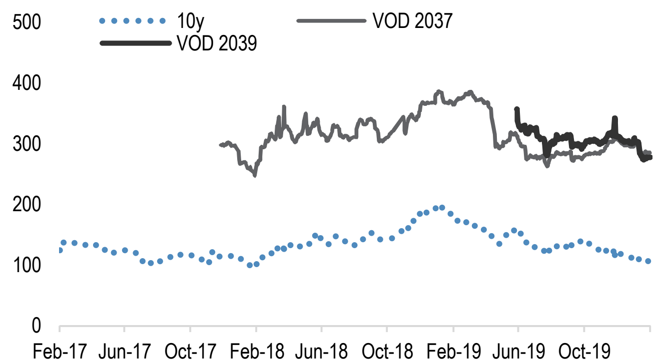
Figure 10: Spread Curve
Spread to Govt (bp)



Source: J.P. Morgan.

Figure 11: Spread History
Spread to Govt (bp)



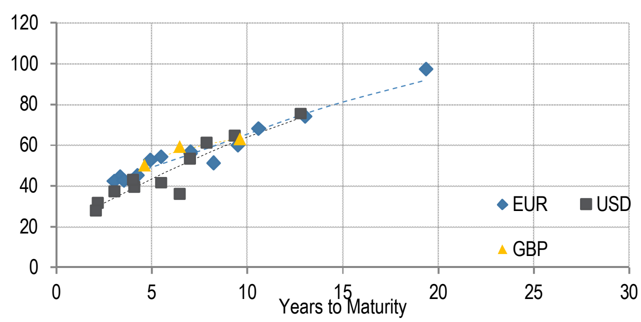
Source: J.P. Morgan.

Ela Kurtoglu

UNANA €2039

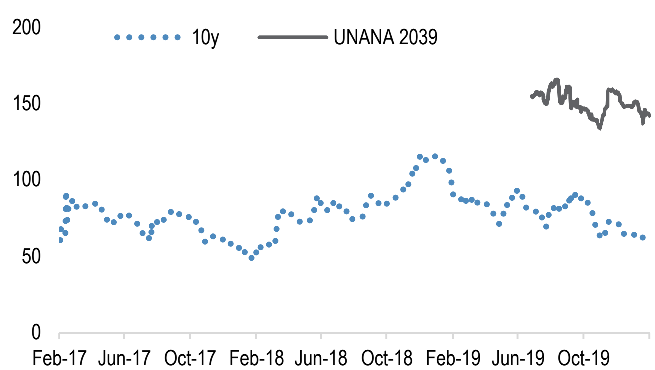
We have a Neutral recommendation on Unilever due to stable credit profile with relatively tight trading levels; however, we highlight that the curve is the steepest among consumer names and we think the longer that € bonds (2030s, 2033s and 2039s) are relatively attractive for strong A credit ratings.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

Andres Gonzalez-Puelles

ENBW €2039

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

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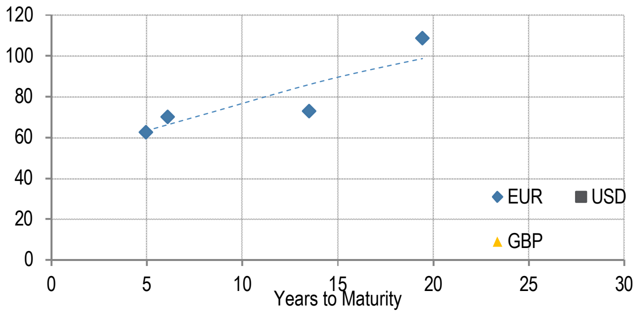
extending duration across its rather steep curve, buying its long dated 6.125% 2039 bonds and selling the short end 4.875% 2025 bonds for a ~40bps pickup.

Figure 14: Spread Curve

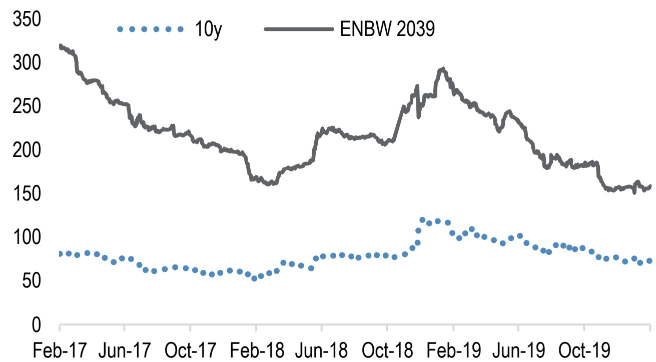
Spread to Govt (bp)



Source: J.P. Morgan.

Figure 15: Spread History

Spread to Govt (bp)



Source: J.P. Morgan.

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