



Rising Inequality among Corporate Bonds

Examining corporate bond dispersions over time

IG investors have been discriminating more among issuers and their bonds. Some bonds have been left behind in this year's rally while others have benefitted disproportionately from the search for quality, which includes likely eligibility for a potential restart of the ECB CSPP.

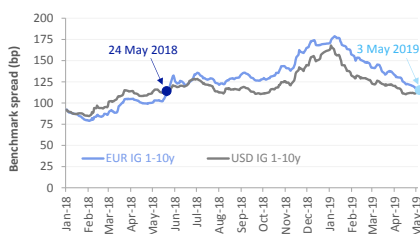
Michal Jezek

Strategist

+44-20-754-55012

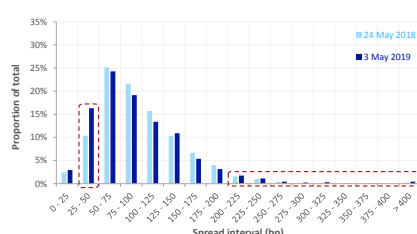
This is not entirely surprising, given most market participants are still licking their wounds after the sharp sell-off in Q4 last year. But it is nonetheless useful to examine the extent to which it has happened. This short update assesses the change in IG corporate bond spread dispersions over time, contrasting Europe and the US during this year's rally.

Figure 1: Same avg. spread but...



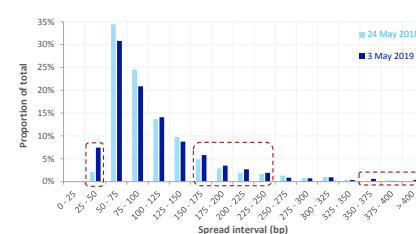
Source : Deutsche Bank, Markit

Figure 2: ...USD spread dispersions



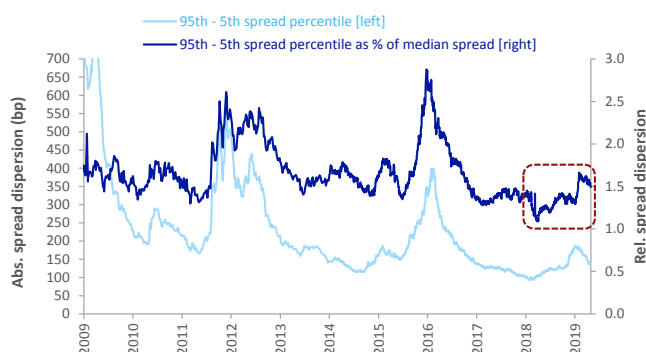
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Figure 3: ...EUR spread dispersions



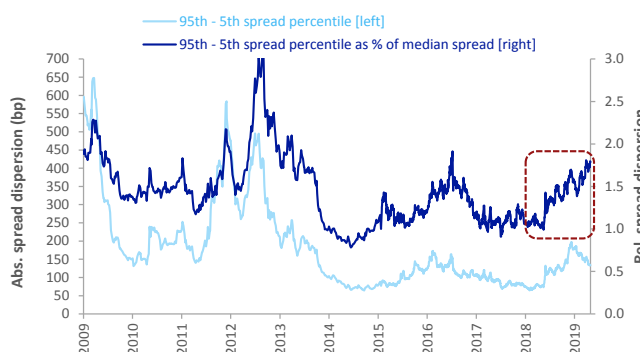
Source : Deutsche Bank, Markit

Figure 4: USD IG snr. 3-7y spread dispersion



Source : Deutsche Bank

Figure 5: EUR IG snr. 3-7y spread dispersion



Source : Deutsche Bank

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Rising corporate bond dispersions over time, esp. in Europe

In our [2019 Global Outlook for IG Credit](#) published last year, we suggested that fundamentals should matter more following the end of QE/CSPP and even though we expected a rally in Q1, we thought differentiation among credits would keep rising.

Since then, the cyclical outlook has improved and central bank rhetoric has become more supportive for risk, providing an opportunity for a carry environment to last longer than we thought back then, as discussed in our recent report [Value of High-Grade Corporate Bonds in Japanified Europe](#). While we do believe there is room for credit to keep grinding if the current escalation of the US-China trade dispute proves to be temporary, we have argued it made sense to search for ways to lean against the consensus without missing out on carry. (The report [Carving Carry-Neutral Macro Credit Shorts](#) summarises our macro credit views and trades.)

However, whether the grind resumes or we go through a sustained sell-off for a while, it seems that investors have started to differentiate between credits more than before, doing more screening and scrambling for "quality" credits. This is not entirely surprising, given most market participants are still licking their wounds after the sharp sell-off in Q4 last year. But it is nonetheless useful to examine the extent to which it has happened. This short update assesses the change in IG corporate bond dispersions over time, contrasting Europe and the US during this year's rally.

We start by observing that there seems nothing out of the ordinary in IG spread performance last year (Fig. 7) and year-to-date (Fig. 8). In particular, the pecking order between single-As and BBBs for both EUR and USD was largely in line with what one would expect, i.e., no specific quality preference is obvious in terms of broad rating buckets. (That said, given last year's sudden fears about the growing proportion of BBBs in IG over time, the relative quality preference may have been partly offset by the notably higher proportion of single-As in this year's primary issuance compared with BBBs, as shown in our most recent [Global Issuance and Fund Flows](#) report.)

Thus, we need to look at the more granular bond level to assess the extent of "quality differentiation". We start by picking a point last year when EUR and USD IG index spreads were similar to today (Fig. 6) and then compare the distribution of spreads on those two days, with each spread being weighted by the bond's market value. The resulting distributions are shown in Figures 9 and 10.

The increase in dispersion in both currencies is highlighted in the charts. First, **this year's rally has taken a lot more IG bonds to the very tight spread levels of less than 50bp**. At the same time, **a greater proportion of bonds has been left behind at spread levels over 150bp**.

Additionally, rather than comparing just two points in time, we construct time series of absolute and relative spread dispersions among IG senior bonds with 3-7y maturities. This is shown in Fig. 11 & 12. **Focusing on relative dispersions, we note the contrast between USD IG where the measure started falling this year and EUR IG where it has continued increasing relentlessly throughout the rally**. As we highlighted [before](#), part of the latter effect is the fact that "quality" in Europe seems to include likely eligibility for a potential restart of the ECB CSPP (Fig. 17 & 18).

The same relative pattern can be observed within single-As and BBBs (Fig. 13-16). Overall, the **search for alpha and liquidity in IG has intensified**.

Figure 6: IG corporate bond spreads

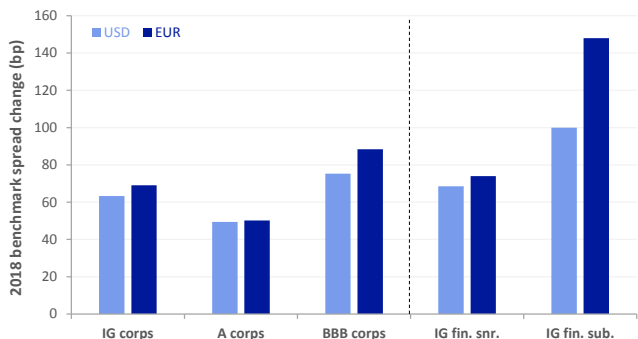


Source: Deutsche Bank, Markit

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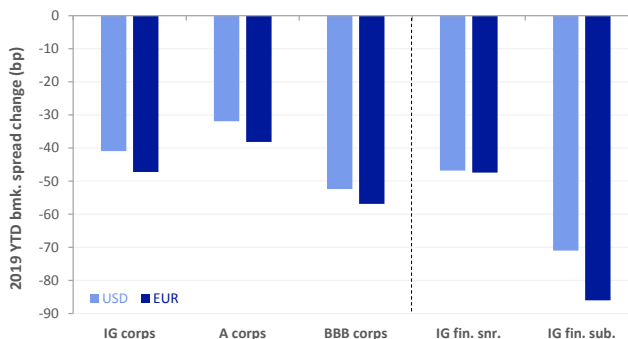


Figure 7: EUR and USD IG spread change in 2018...



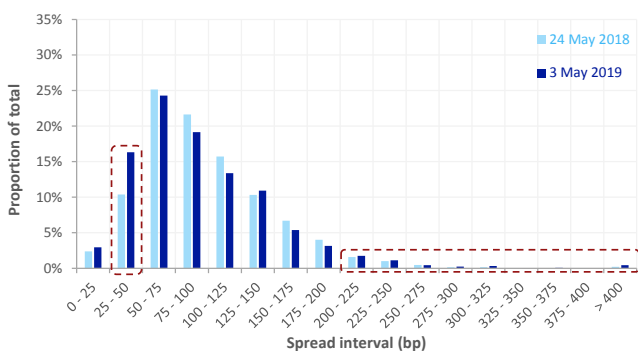
Source : Deutsche Bank, Markit

Figure 8: ...and YTD in 2019



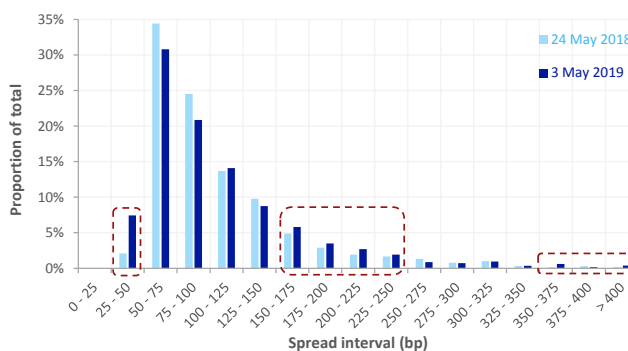
Source : Deutsche Bank, Markit

Figure 9: USD IG 1-10y corp. spread distributions



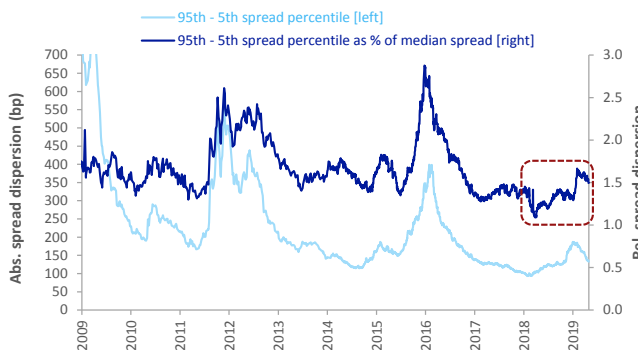
Source : Deutsche Bank, Markit

Figure 10: EUR IG 1-10y corp. spread distributions



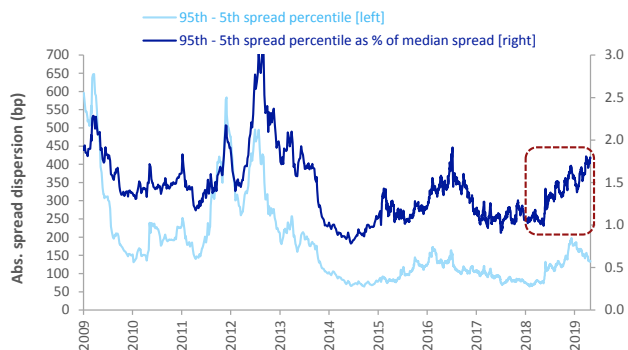
Source : Deutsche Bank, Markit

Figure 11: USD IG snr. 3-7y spread dispersion



Source : Deutsche Bank

Figure 12: EUR IG snr. 3-7y spread dispersion

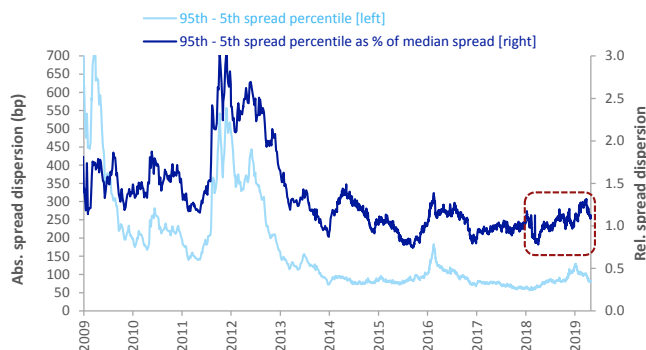


Source : Deutsche Bank

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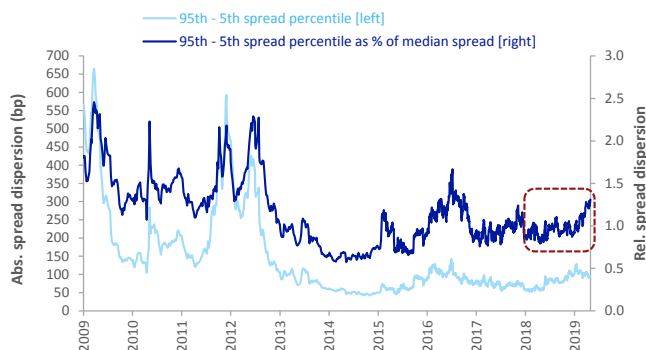


Figure 13: USD single-A snr. 3-7y spread dispersion



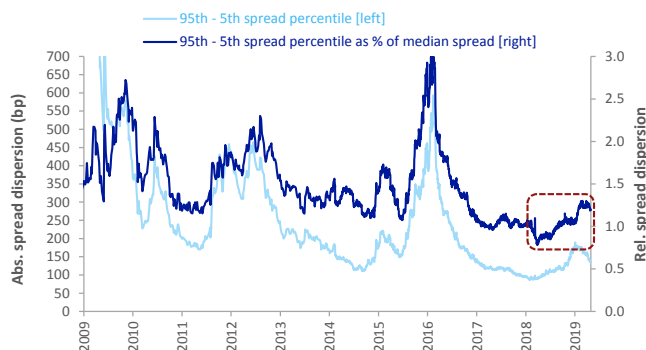
Source : Deutsche Bank

Figure 14: EUR single-A snr. 3-7y spread dispersion



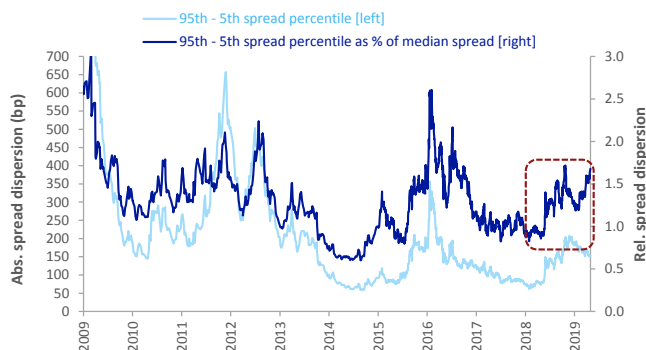
Source : Deutsche Bank

Figure 15: USD BBB snr. 3-7y spread dispersion



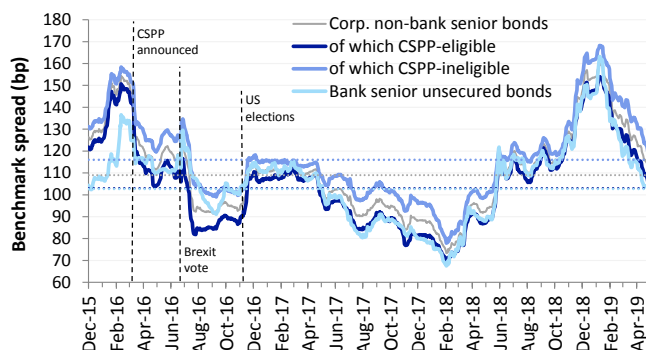
Source : Deutsche Bank

Figure 16: EUR BBB snr. 3-7y spread dispersion



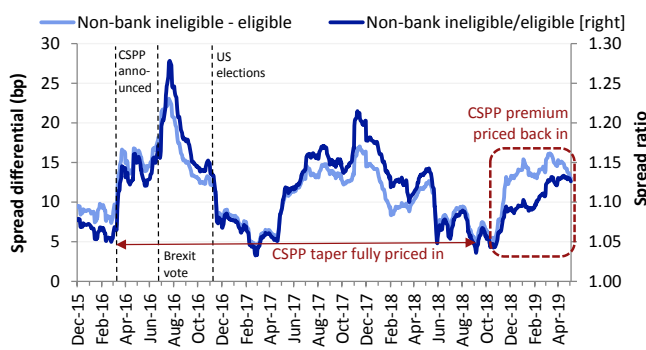
Source : Deutsche Bank

Figure 17: EUR IG bonds - CSPP eligible vs. ineligible...



Source : Deutsche Bank

Figure 18: ...and their spread differentials and ratios



Source : Deutsche Bank

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Appendix 1

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