Investment Grade

Tailwinds from across the Pond

CORE

2019's debut EUR issuers were overwhelmingly US companies, and we expect more first-time issuers in 2020. We find that tenor-matched USD-IG bonds from debut EUR issuers outperform in the weeks leading up to issuance; therefore, we screen for debut reverse Yankee candidates in 2020.

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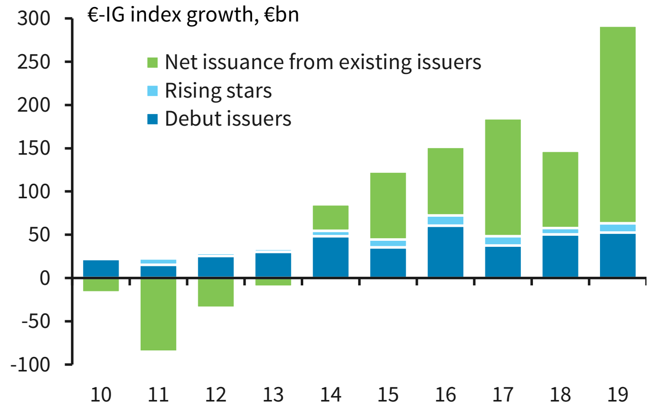
A key theme in both the €-IG and $-IG primary markets has been US companies increasingly tapping the €-IG corporate bond market, as we highlighted in *2020 Supply Outlook: Lower and Longer*. Indeed, almost 20% of issuance from US companies has been in non-USD-denominated bonds, the majority in euro. Although much of the reverse Yankee supply (EUR issuance from US companies) has been from established €-IG market issuers, first-time issuers have also been active, accounting for 20% of reverse Yankee supply in 2019.

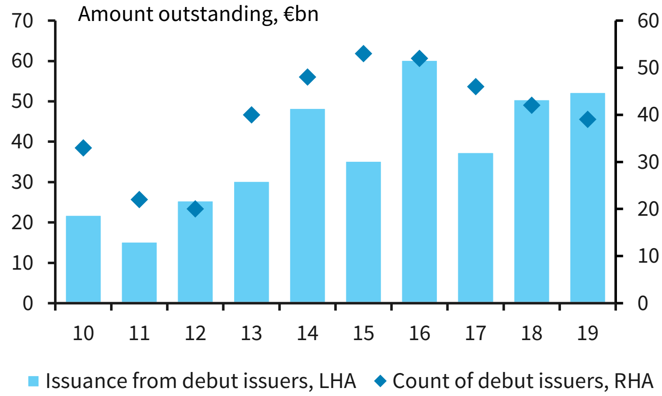
Over the past five years, debut €-IG issuers from all countries have accounted for around 30% of the growth of the €-IG index (Figure 1). This theme continued at a steady pace in 2019, as the €-IG market saw €52.4bn of index-eligible supply from a total of 39 debut issuers. In volumes, this was the second largest year of supply from first-time €-IG issuers in the past decade (Figure 2). Interestingly, while the volume of issuance was only a little lower than its peak in 2016, the number of debut issuers was considerably lower. We think this explains why debut issuers garnered so much attention last year. Debut issuers have been coming to the market with larger bonds and multi-tranche deals, not just testing the waters of investor demand with smaller-sized bonds. This suggests greater tolerance from €-IG investors for new issuers and improved market depth compared with prior years.

FIGURE 1. **Debut Issuers Have Been Responsible for 30% of €-IG Index Growth over the Past Five Years**



We define debut issuers as companies issuing benchmark size €-IG bonds that did not previously have €-IG benchmark-size corporate bonds outstanding.
Source: Bloomberg, Barclays Research

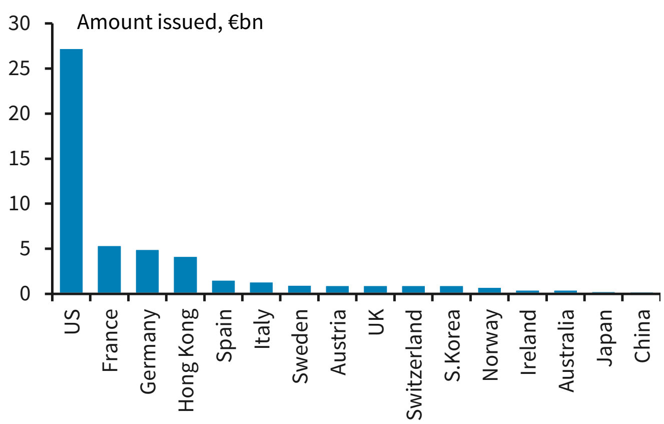
FIGURE 2. **2019 saw c.€52bn of Supply from Debut €-IG Issuers**



Index-eligible issuance per year from companies that did not previously have €-IG index-eligible corporate bonds outstanding.
Source: Bloomberg, Barclays Research

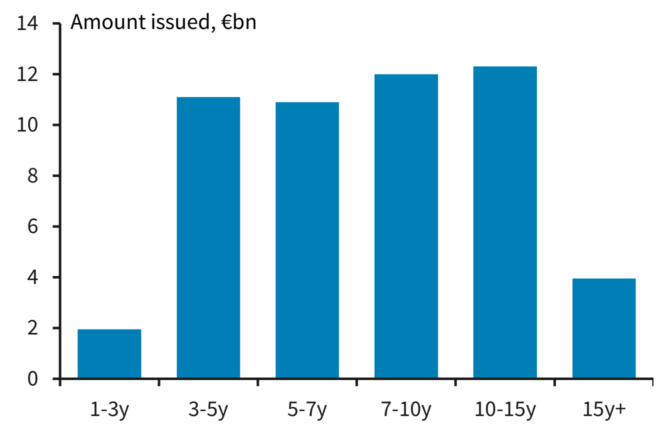
Most important, we find that US companies made up more than half of debut issuance, with no other country contributing more than 10% of overall 2019 debut issuance volumes (Figure 3). In addition, a considerable amount of debut bonds were issued at longer tenors; with close to a third of new bonds issued with ten years or more to maturity (Figure 4). For context, just 9.1% of the €-IG index is made up of 10y+ bonds. Aside from general risk appetite and the rally in spreads, several factors helped the market absorb larger, longer-dated deals from first-time issuers in 2019. In particular, almost half of the "debut supply" came from large US companies with European revenues that European investors were perhaps already familiar with (Figure 9).

FIGURE 3. **€-IG Issuance from Debut Issuers in 2019, by Country**



Source: Bloomberg, Barclays Research

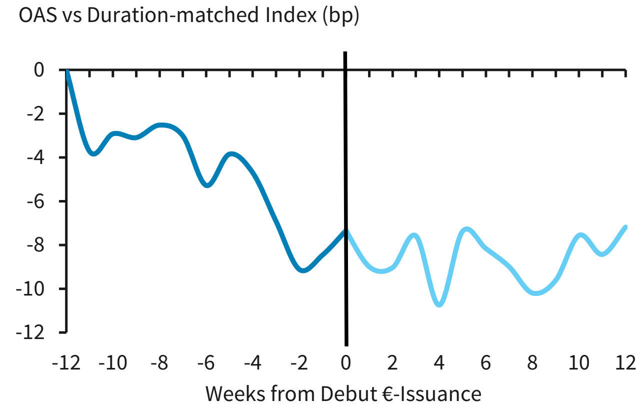
FIGURE 4. **€-IG Issuance from Debut Issuers in 2019, by Tenor**



Source: Bloomberg, Barclays Research

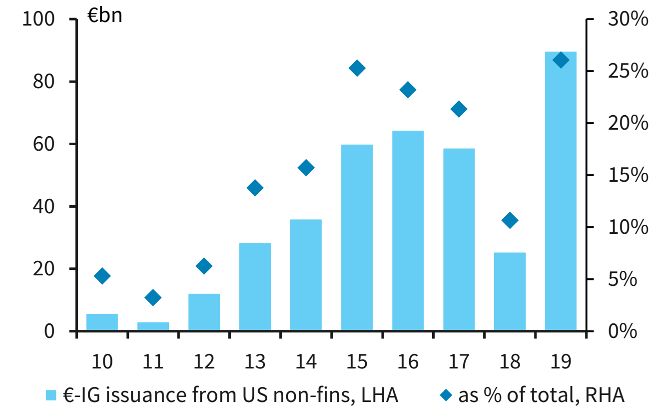
The tapping of European markets by US companies is important for $-IG investors, because as companies diversify their funding needs across both markets, it reduces USD supply, which is positive for the valuations of their USD debt. Specifically, we analyze the performance of the USD debt of US companies around the time of their debut EUR issuance. Between 2017 and 2019, USD debt spreads tightened (versus the index) in the weeks leading up to the issuance of a similar-tenor €-bond, although the outperformance was more limited in the weeks after the new deal came to market (Figure 5). Deal roadshows prior to issuance likely result in this information getting priced into spreads. This suggests that identifying companies that are likely to go to the EUR market could be a significant source of alpha.

FIGURE 5. **Tenor-matched $-IG Bonds Outperform in the Weeks gefore Debut €-IG Issuance**



Source: Bloomberg, Barclays Research

FIGURE 6. **US Companies Made up a Record Share of €-IG Non-financial Supply in 2019**



Source: Dealogic, Barclays Research

More Debut Reverse Yankees to Come

We expect reverse Yankee issuance to remain elevated given better financing terms available in the the €-IG market. With US Treasury yields highest among their developed market peers, the lower all-in yield in the €-IG market is attractive for multi-national corporations as they look to optimize funding costs (Figure 7). Although hedging activity is somewhat opaque, anecdotally, many US companies issuing in euros are choosing not to hedge their FX risk and are instead relying on "natural" hedges from euro-denominated revenues.

Furthermore, even on a currency-hedged basis, EUR debt is cheaper from the issuer's perspective, as cross-currency hedging costs for US companies issuing EUR corporate debt continue to improve, in part due to an accommodative Fed. Historically, there is a strong correlation between lower hedging costs and reverse Yankee supply levels (Figure 8 shows the relative ratio of reverse Yankee issuance to USD supply versus the momentum in cross-currency hedging costs)[1]. This technical should also support reverse Yankee issuance.

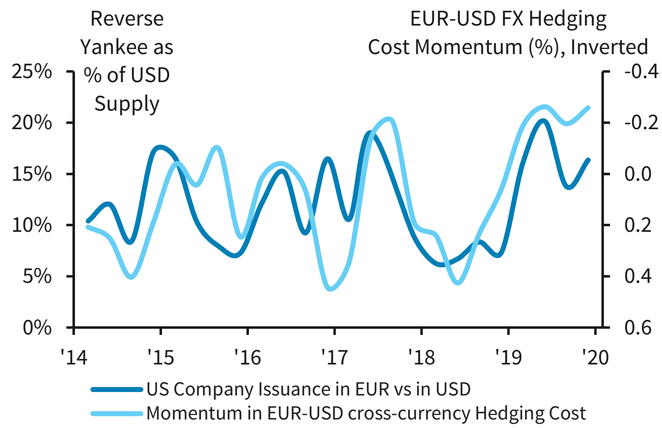
US companies have been able to issue larger sizes (both at an individual bond level and across multi-tranche deals) and longer tenors, which is indicative of strong demand for reverse Yankee issuance. In 2019, the €-IG market saw twenty-three 20y bonds issued and, more unusually, eight 30y bonds, the first time the 30y segment of the European market has been open since 2015. Although we do not think these longer-dated bonds have as much natural demand from domestic investors as in the £-IG and $-IG markets (*Six 30y bonds don't make a trend*,), we think there are enough pockets of demand from overseas buyers and yield-driven investors to allow the €-IG market to digest more longer-dated debt.

[1] Momentum is calculated as the difference between current month EURUSD hedging cost and average of prior three months' readings.

FIGURE 7. **Large Differential between €- and $-IG Yields**

Source: Bloomberg, Barclays Research

FIGURE 8. **€-Issuance Tends to Follow Changes in Hedging Cost**



Source: Bloomberg, Barclays Research

Examining the US issuers that came to the €-IG market last year, we find that they are all large US companies, all but one had existing $-IG bonds outstanding at the end of 2018, and all but one have some €-denominated revenues, even if reporting makes it hard to assign the exact revenue exposure to the region (Figure 9). A priori, these are the characteristics that we would expect for US companies issuing in €-IG to lock in cheaper funding costs by not hedging their FX risk and instead relying on their euro revenues as a "natural" hedge.

FIGURE 9. **US Companies That Issued Index-eligible €-IG Corporate Bonds for the First Time in 2019**

Ticker	Month of first issue	Number of bonds issued*	Amount issued (€bn)*	Sector	Index rating	Index-eligible $-IG bonds outstanding (end-18, mn)	European revenue exposure (%)
BSX	Nov-19	1	900	Healthcare	BBB	4,800	22
CL	Feb-19	4	2,000	Consumer Products	AA-	3,700	15
COF	Jun-19	2	1,250	Banking	BBB+	23,385	Negligable
EEFT	May-19	1	600	Technology	BBB	-	35
EMR	Jan-19	3	1,500	Div Manufacturing	A	2,100	17
FISV	Jun-19	3	1,500	Technology	BBB	4,850	<10
HOG	Nov-19	1	600	Automotive	BBB+	3,400	16
KKR	May-19	1	650	Brokerage etc	A	2,000	See notes
MDT	Mar-19	10	11,250	Healthcare	A-	23,045	See notes
MMC	Mar-19	2	1,100	P&C	A-	4,950	18
MO	Feb-19	4	4,250	Tobacco	BBB	11,500	See notes
OMC	Jun-19	2	1,000	Media	BBB+	4,400	31
WLK	Jul-19	1	700	Chemicals	BBB	1,945	7

*Issuance over the course of 2019. Medtronic breaks down revenue into three segments: US; non-US DM, and EM. 31.5% of 2019 FY revenues were from non-US DM, which includes Western Europe, as well as Japan, Australia, New Zealand, Korea, and Canada. While Altria (MO) does not have any EUR-denominated revenue at present, the EUR bond issuance was designated as a net investment hedge of its stake in Anheuser-Busch InBev (in which it has a 10.1% ownership stake). We estimate that Altria (MO) received EUR367mn in dividends in 2019 as a result of its equity stake in ABIBB. The magnitude of KKR's revenue exposure to Europe is unclear, but it does have some European revenue exposure through its PE, credit, real estate, and infrastructure businesses.
Source: Bloomberg, Barclays Research

Given the potential upside for the $-debt of debut reverse Yankee issuers, we identify US companies that do not currently have €-IG debt outstanding but are likely to issue in that market in the medium term (Figure 10). Specifically, we screen for companies where Europe (ex-UK) makes up at least 10% of total revenue exposure. Furthermore, we restrict our universe to companies with at least $3bn of index-eligible $-IG bonds outstanding, as larger, more well-known companies should have more ability and desire to issue in multiple currencies. Finally, we removed companies where our US fundamental analysts believe the likelihood of €-IG issuance is low based on near-term funding needs.

FIGURE 10. US Companies with European Revenue Exposure That Do Not Currently Have €-IG Bonds Outstanding

Ticker	Name	Amount of $-IG debt outstanding	Number of $-IG bonds outstanding	Sector	European Revenues
DIS	Walt Disney Co	27,836	37	Communications	12%
XOM	Exxon Mobil Corp	19,900	14	Energy	19%
QCOM	QUALCOMM Inc	13,000	8	Technology	12%
DOW	Dow Inc.	11,813	15	Basic Industry	35%
IP	International Paper Co	8,241	11	Basic Industry	14%
HPE	Hewlett Packard Enterprise Co	7,579	6	Technology	37%
EBAY	eBay Inc	5,600	7	Consumer Cyclical	15%
TXN	Texas Instruments Inc	5,350	8	Technology	21%
COL	Rockwell Collins Inc	5,150	6	Capital Goods	19%
GLW	Corning Inc	4,675	9	Technology	12%
EL	Estee Lauder Cos Inc	4,000	8	Consumer Non-Cyclical	43%
SPGI	S&P Global Inc	3,698	6	Communications	25%
GOOGL	Alphabet Inc	3,680	3	Technology	33%
STX	Seagate Technology	3,671	6	Technology	16%
ADI	Analog Devices Inc	3,600	6	Technology	23%
NKE	NIKE Inc	3,500	5	Consumer Cyclical	25%
SWK	Stanley Black & Decker Inc	3,054	6	Capital Goods	26%

Note: We excluded companies from the screen that do not break out European revenues in company filings. In addition, we included European revenue percentages for companies that included European revenues with other regions.
Source: Factset, Bloomberg, Barclays

A similar trend extends to the sterling market. However, US issuers are a smaller percent of debut £-IG issuers, as UK housing associations dominated new issuance (see *The 2020 European debutante ball* for more details).

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