EUREX

Risk-on Democracy

HY/IG Spread near US Elections

Elections are often viewed as sources of risk for investment portfolios. The uncertainty on the future structure of government expresses itself in the credit spread of corporate bonds on a systematic level across the whole market. However, only a subset of issuers will be significantly impacted by the outcome of the elections, and spreads tend to fall post-hoc, in particular for riskier High Yield bonds. We find that spreads have tightened after all elections in the past 24 years besides the 2000 and 2008 elections, where the US economy was already in recession, and that a strategy of trading the spread between High Yield and Investment Grade bonds has been

We focused on the spread between High Yield (HY) and Investment Grade (IG) bonds, comparing well-rated and lower-rated bonds. Our goal was to assess the impact of elections on both volatility and returns, focusing on both riskier and more stable assets.

To conduct this study, we selected indices representing IG bonds (LUACTRUU Index) and HY bonds (LHVLTREU Index). We performed a volatility study on bond prices, defining our time frame as three months before and three months after each election.

This trend held in most election cycles, with the yield spread between HY and IG bonds typically decreasing rapidly after elections. Consequently, our conclusion pointed towards a strategy favoring long positions in HY debt and short positions in IG debt. This strategy proved beneficial in five out of the last six election cycles, apart from 2008. This anomaly was likely due to the global financial crisis of 2008-2009, which overshadowed the election's impact on the markets at the time.

Our graphical analysis also reveals that the profitability of this strategy holds regardless of whether a Democrat or a Republican candidate wins.

We have also plotted the current trajectory of this strategy on the dotted line, if we had implemented it 90 days before the election.

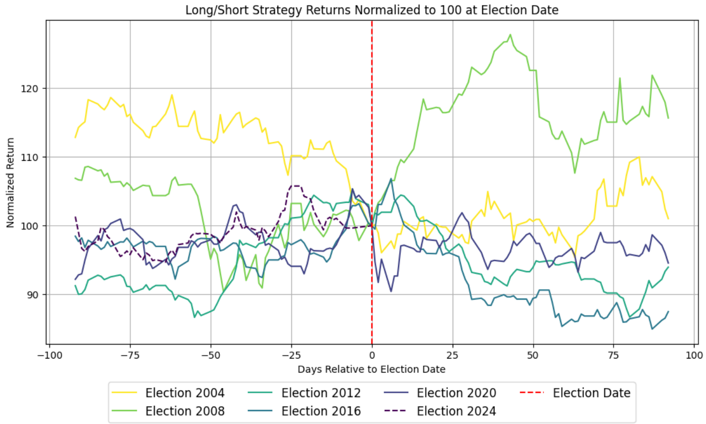

Figure 1: Difference OAS HY-IG Normalized to 100 during all US Elections, (Elections 2000 OAS Data not available), Source: Bloomberg LP, Eurex Calculations

We observed that post-election OAS changes are mostly negative, but we wanted to show the comparative change between HY and IG bonds.

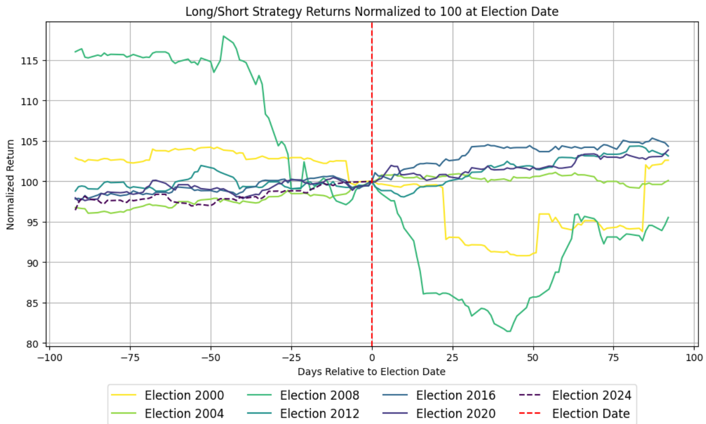

Figure 2: Long HY / Short IG returns during all US Elections, Source: Bloomberg LP, Eurex Calculations

To conclude, our findings indicate that, as expected, the spread of corporate bonds tends to decline after elections. This effect is even more pronounced for HY bonds compared to IG bonds, and a long-short strategy has been profitable in most situations.

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