

## CDS implied and credit agency ratings diverge

There are currently 21 investment grade credits with CDS spreads implying junk status, while high yield North American consumer driven credits continue to improve.

- North American Basic Materials and Financials make up the biggest chunk of investment grade names with CDS implying high yield status
- Noble Group has the widest gap between average rating and implied rating; BBB and CCC
- High yield consumer-led credits lead names whose CDS implies an investment grade status

The second half of this year has seen fixed income markets blighted by bouts of idiosyncratic risk among single name credits. Names such as Volkswagen and Glencore have dominated headlines amid unexpected news and broader macro volatility.

The pace at which such risks have escalated has left traditional credit risk measures such as credit ratings lagging, with market participants increasingly looking for more rapidly reacting measures of risk. The use of CDS data has been one such method, providing liquidity amid volatility and transparency.

Using Markit's CDS pricing service, implied ratings can be derived based on single name 5-yr CDS spreads and associated CDS sector curve spreads. Discrepancies between actual credit ratings and implied credit ratings give an indication of gaps between market perception and rating agency perception of credit risk. While there are some limitations between the comparison, such as CDS liquidity and credit agency time horizons, the analysis provides useful insight.

### Investment grade, implied high yield

Of the 1043 single name senior CDS credits, currently 21 investment grade issuers trade at CDS levels that imply high yield status.

Sector/Region	Asia	Europe	N.Amer	Others	Grand Total
Basic Materials	0%	14%	14%	5%	33%
Consumer Goods	0%	5%	0%	0%	5%
Consumer Services	0%	5%	5%	0%	10%
Energy	0%	0%	5%	5%	10%
Financials	0%	0%	19%	5%	24%
Government	0%	0%	0%	10%	10%
Industrials	5%	0%	0%	0%	5%
Utilities	0%	0%	0%	5%	5%
<b>Grand Total</b>	<b>5%</b>	<b>24%</b>	<b>43%</b>	<b>29%</b>	<b>100%</b>

Unsurprisingly, the basic materials sector makes up 33% of the 21 names. The second half of this year has seen commodity prices hit by slowing global trade, particularly in major importer China, straining credits in the sector.

Commodities supplier Noble Group's CDS spread currently implies a CCC rating, three notches below its average rating of BBB. While in Europe, miners Glencore and Anglo American CDS spread imply a single 'B' rating even though both are currently still hanging onto investment grade status.

On the sovereign front, Republic of Brazil CDS implies high yield status, although its average rating remains on the cusp, with only S&P having made the move to downgrade it to BB+.

ShortName	Ccy	Sector	Region	AvRating	CDS Sector Implied Rating
Noble Group Ltd	USD	Basic Materials	N.Amer	BBB	CCC
Barrick Gold Corp	USD	Basic Materials	N.Amer	BBB	BB
Assur Gty Corp	USD	Financials	N.Amer	A	BB
ASSUR GTY MUN HLDGS INC.	USD	Financials	N.Amer	BBB	BB
Vnesheconbank	USD	Financials	E.Eur	BBB	BB
Dillards Inc	USD	Consumer Services	N.Amer	BBB	BB
Assur Gty Mun Corp	USD	Financials	N.Amer	A	BB
CASINO GUICHARDPERRACHON	EUR	Consumer Services	Europe	BBB	BB
Nabors Inds Inc	USD	Energy	N.Amer	BBB	BB
TOSHIBA Corp	JPY	Industrials	Asia	BBB	BB
Volkswagen AG	EUR	Consumer Goods	Europe	A	BB
Anglo Amern Cap PLC	EUR	Basic Materials	Europe	BBB	B
Bco Nacional de Desenvolvimento Economico e Social BNDES	USD	Government	Lat.Amer	BBB	B
Federative Rep Brazil	USD	Government	Lat.Amer	BBB	B
Eskom Hldgs SOC Ltd	USD	Utilities	Africa	BBB	B
FresportMcMoran Inc	USD	Basic Materials	N.Amer	BBB	B
Glencore Intl AG	EUR	Basic Materials	Europe	BBB	B
MBIA Inc.	USD	Financials	N.Amer	BBB	B
Noble Corp	USD	Energy	OffShore	BBB	B
Vale SA	USD	Basic Materials	Lat.Amer	BBB	B
XSTRATA LTD	EUR	Basic Materials	Europe	BBB	B

Financials make up 24% of the names, with a large concentration in North America. These are dominated by US municipal bond insurers MBIA and Assur Gty Corp, which have seen CDS spreads widen during the contagion caused by US municipalities such as Puerto Rico.

### High yield, implied investment grade

On the flip side of the trend, there are currently 103 credits that are currently rated as high yield by rating agencies, while their CDS spreads imply otherwise. These issuers are broadly equally split between Europe and North America, which could be a sign of the US' improving economic fundamentals and easy monetary policy in Europe.

Sector/Region	Asia	Europe	N.Amer	Others	Grand Total
Basic Materials	0%	7%	2%	0%	9%
Consumer Goods	1%	2%	11%	0%	14%
Consumer Services	0%	7%	13%	1%	20%
Energy	0%	0%	3%	0%	3%
Financials	0%	10%	3%	1%	14%
Government	1%	2%	0%	1%	4%
Healthcare	0%	1%	4%	0%	5%
Industrials	3%	7%	4%	0%	14%
Technology	1%	3%	2%	0%	6%
Telecommunications	0%	5%	6%	0%	11%
Utilities	0%	1%	0%	1%	2%
<b>Grand Total</b>	<b>6%</b>	<b>44%</b>	<b>47%</b>	<b>4%</b>	<b>100%</b>

The biggest sectors that stand out in North America are good and services consumer sectors. Owing to the US's economic recovery, names such as Saks, E W Scripps and TRW Automotive all see CDS spreads implying an 'A' rating, even though rating agencies have them below BBB.

Elsewhere, European financials continue see their credit risk tighten among an easy monetary backdrop and continued balance sheet improvement. Particularly among Europe's periphery, Spanish banks such as Banco de Sabadell and Banco Pop Espanol and Banca Monte dei Paschi di Siena, Italy's oldest bank, all now see CDS levels implying a BBB rating.

### Neil Mehta

#### Fixed Income Analyst

Markit

Tel: +44 207 260 2298

Email: neil.mehta@markit.com

For further information, please visit [www.markit.com](http://www.markit.com)

The intellectual property rights to this report provided herein is owned by Markit Group limited. Any unauthorised use, including but not limited to copying, distributing, transmitting or otherwise of any data appearing is not permitted without Markit's prior consent. Markit shall not have any liability, duty or obligation for or relating to the content or information ("data") contained herein, any errors, inaccuracies, omission or delays in the data, or for any actions taken in reliance thereon. In no event shall Markit be liable for any special, incidental, consequential damages, arising out of the use of the data. Markit is a trademark owned by the Markit group.

This report does not constitute nor shall it be construed as an offer by Markit to buy or sell any particular security, financial instrument or financial service. The analysis provided in this report is of a general and impersonal nature. This report shall not be construed as providing investment advice that is adapted to or appropriate for any particular investment strategy or portfolio. This report does not and shall not be construed as providing any recommendations as to whether it is appropriate for any person or entity to "buy", "sell" or "hold" a particular investment.