4th floor
Ropemaker Place
25 Ropemaker Street
London
EC2Y 9LY
United Kingdom

tel +44 20 7260 2000
fax +44 20 7260 2001
www.markit.com

Markit Commentary

June 29th 2016

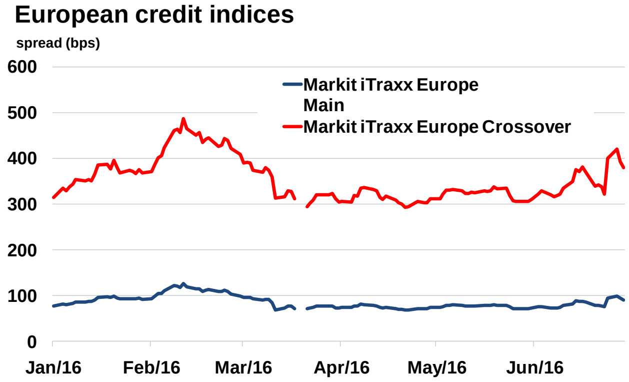
Corporate bond returns hold firm after Brexit

Euro and sterling corporate bond returns have held up despite rising credit risk following the UK's decision to leave the European Union.

- Markit iTraxx Europe Main index widened to 99bps, but still 21% off year to date highs
- Sterling corporate bond returns are higher than this time last week
- Early 2016 volatility had larger negative impact on corporate bond returns than Brexit

Euro and sterling corporate bond returns have remained steady following the UK's decision to leave the EU last week. The potential downside risk of the referendum result has seen investors seeking refuge in safe haven government bonds rather than riskier corporate bonds, keeping bond yields stable.

Unlike earlier this year

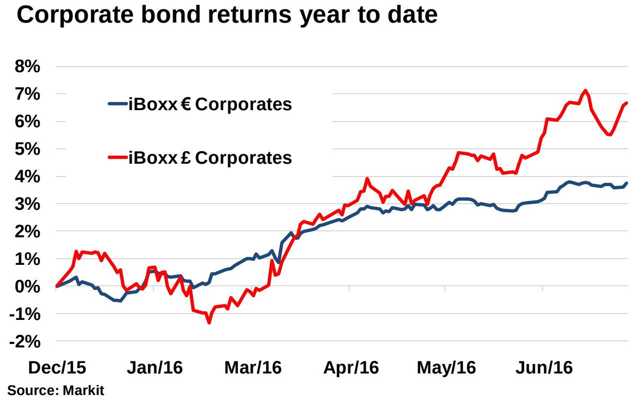


Source: Markit

Uncertainty around the consequences of Brexit on European companies has meant that corporate credit risk in the region has intensified. The Markit iTraxx Europe Main index, which compromises of 125 investment grade single name CDS spreads, saw its spread widen to 99bps following the Brexit vote, from 75bps before. Likewise its sub investment grade equivalent, the Markit iTraxx Europe Crossover index, saw its 5-yr spread widen sharply.
Interestingly, levels remained tighter than those seen following the heightened market volatility at the start of the year. On February 11th, the Markit iTraxx Europe Main index widened to 120bps, 21% higher than June 27th's level. The credit market's reaction to Brexit has been knee jerk, but more subdued in comparison to the start of the year.

The monetary backdrop in Europe remains accommodative, with QE extended to corporate bonds and banks having access to cheap funding. The downside risks of crude oil and commodity prices have dissipated since the start of the year, and across the Atlantic the Fed has distanced itself from imminent interest rate hikes.

Bond returns stable



Source: Markit

The limited reaction in corporate credit markets, coupled with falling government bond yields, has meant European corporate bond yields have remained stable, with limited impact on returns. In sterling markets, the Markit iBoxx £ Corporates has returned

6.66% so far this year and is 1.15% higher since the day of the referendum. Soaring gilt prices have cancelled out any spread widening among sterling corporate bonds. Among euro denominate corporates, the Markit iBoxx € Corporates index has seen very little negative impact on total returns. According to Markit's iboxx indices, Volatility at the start of the year had much greater negative impact on corporate bond returns than Brexit.

Neil Mehta

Fixed Income Analyst

Markit

Tel: +44 207 260 2298

Email: neil.mehta@markit.com

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