

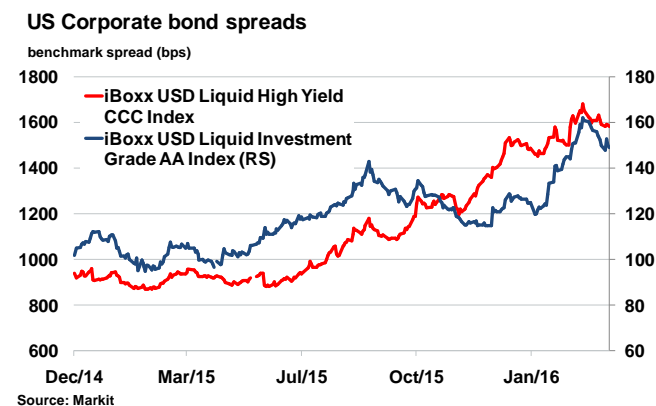
Credit markets steer into calmer waters

After a volatile start to 2016, falling US Corporate bond spreads and receding credit risk among European financials has calmed investor fears over the past few weeks.

- [Markit iBoxx USD Liquid Investment Grade AA Index](#) has tightened 12bps over the past three weeks.
- CDS trading volumes on the [Markit iTraxx Europe Senior Financials index](#) have fallen fourfold as volatility in the sector has receded.
- Following another downgrade, Portugal Telecom's [5-yr CDS spread](#) implies a high probability of default.

US corporates turn corner

Positive sentiment in US fixed income markets continued as bond spreads (yield over US treasuries) tightened for the third consecutive week. It marks a stark contrast to the period of heightened volatility seen at the start of the year which peaked on February 11th.

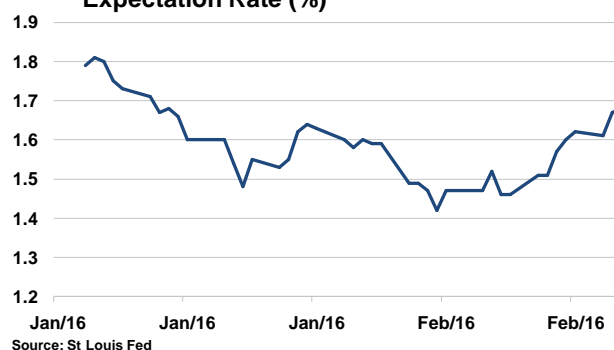


The [Markit iBoxx USD Liquid Investment Grade AA Index](#), constituents of which are corporations such as Walmart and Coca Cola, saw its spread widen to 161bps as of February 11th, the widest since May 2012. Highly rated corporate bond risk is often a gauge of broader fears in the US economy, and although they remain at elevated levels, calmer waters have since seen spreads recede 12bps to 149bps.

At the opposite end of the credit spectrum, CCC rated US corporate bonds have also

seen risk recede with the Markit iBoxx USD Liquid High Yield CCC Index seeing its spread tighten from 1679bps to 1581bps over the past three weeks.

5-Year, 5-Year Forward Inflation Expectation Rate (%)

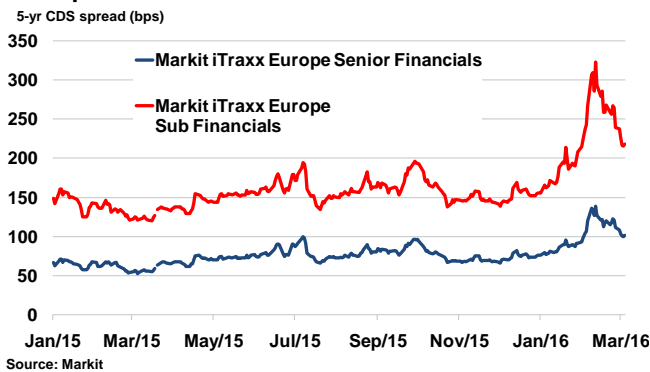


Positive market sentiment has also helped US inflation expectations, spurred on by the rebound in commodity prices. The 5y5y forward inflation expectation rate (what the market expects average five year inflation to be five years on from now) has jumped 28bps from its depths in February. As employment figures continue to impress ([latest non-farm payrolls were a better than expected 242k](#)), inflation has become a key driver of US monetary policy.

European banks brighter

Calmer waters have also translated across the Atlantic led by Europe's financial sector.

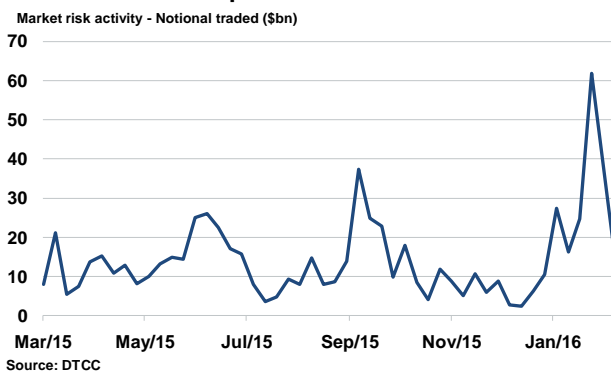
European bank credit risk



The Markit iTraxx Europe Senior Financials index has seen its 5-yr CDS spread tighten to a one month low, while it's riskier counterpart the Markit iTraxx Europe Sub Financials index has seen credit risk tighten over 100bps.

Among the constituents, heavily in the spotlight Deutsche Bank AG has seen its 5-yr CDS spread tighten 20% over the past three weeks, while French banks BNP Paribas and Societe Generale each saw a 30% tightening.

Markit iTraxx Europe Senior Financials

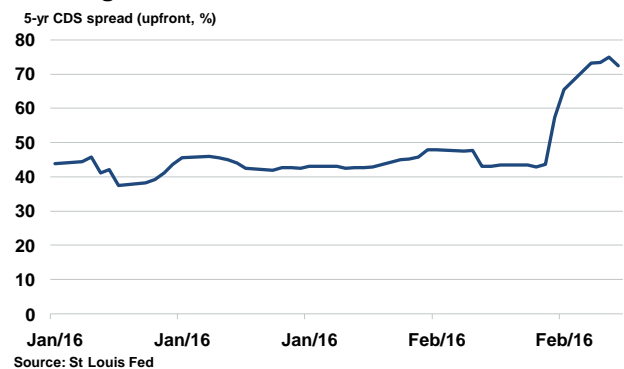


The heightened volatility in the sector also saw trading volumes surge on the Markit iTraxx Europe Senior Financials as investors hedged downside risk in the sector. Since then however, volumes have fallen fourfold as volatility in the sector has receded.

Portugal Telecom woes

Following the [credit downgrade of its Brazilian parent company Oi to CCC](#) this week, credit spreads on beleaguered Portugal telecom now imply a near certain default.

Portugal Telecom Intl Fin B V



Trading on an upfront basis (typical of credit in distress), spreads now indicate investors have to pay upfront \$7.2m per \$10m notional, plus 125k per quarter to insure against default.

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