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Markit Commentary

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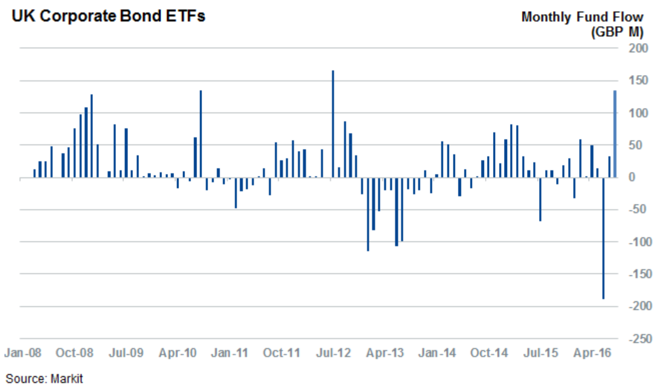
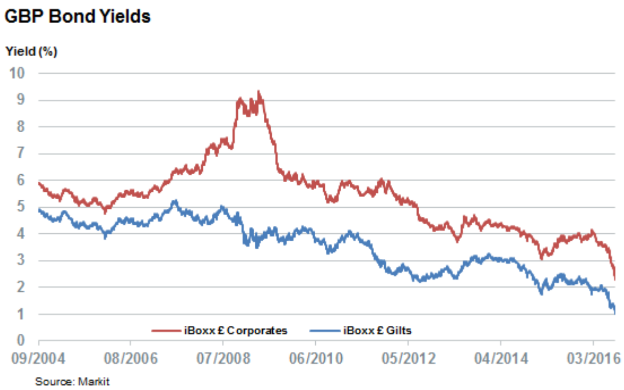
Investors pick UK corporates over gilts in BOE QE rally

Pound denominated bond yields are sinking across the board, but ETF investors are being preferring to stick to corporate bonds over lesser yielding gilts.

— UK corporate bond ETFs on track for largest monthly inflow as yield sinks to all-time low
— Pound denominated corporate bond spreads at a 15 month low, but still 60bps from all-time low
— Gilt ETFs have only attracted £32m of inflows so far this month

The Bank of England's resumption and expansion of its quantitative easing (QE) programme is having the desired effect of lowering yields across the UK bond spectrum. Both the Markit iBoxx £ Gilts and £ Corporates index have seen their yields sink to new all-time lows in each of the four trading days since Thursday with both indices now trading 29 and 47bps tighter.





The inclusion of corporate bonds into the QE basket has seen the spreads demanded by investors to hold pound denominated investment grade corporate bonds fall by 20bps. This spread compression means that the iBoxx £ Corporates has returned over 1% more than its gilt peer in the four days since last Thursday.

The collapsing bond yields are rekindling investor demand for UK bond ETFs as the 25 such ETFs have seen over £146m of inflows in the four trading days since last Thursday. This added to an already strong inflow trend seen in the days leading up to the MCP's announcements and takes the asset class's AUM past the £7bn for the first time ever.

Corporate ETFs surge ahead

Corporate bond products have attracted the vast majority of the post MCP flows with over £134m flowing into the asset class so far this month which put August on track to comfortably beat the previous inflow record set back in July 2012.

Spreads in the asset class now stand at a 15 month low, but are still over 60bps wider than the all-time low set before the financial crisis, and investors may be looking to position themselves to profit from further spread compression in the asset class.

The iBoxx £ Corporates' current duration means that investors could make around 5% of returns should its spreads match the all-time low levels seen back in 2005.

Gilts fail to attract inflows

While high flying corporate bond funds are seeing voracious appetite from investors as spreads shrink following the BOE's move, gilt funds have failed to see that level of enthusiasm as only £36m of new assets has flowed into gilt ETFs in august so far. These timid inflows could speak to the fact that the 1% that the asset class currently yields has forced yield-seeking investors into other assets such as corporate bonds or equities which both yield much more than gilts.

Inflation linked gilts are also seeing some inflows with £14m on new assets flowing into the asset class in the last four days.

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