

Media sector CDS bond basis tightens in August

Oil & gas credits continued to exhibit the widest positive basis, while media names saw their negative basis tighten.

- 78 [Markit CDX NA IG](#) constituents trade with a CDS-bond basis greater +/- 50bps
- Barrick Gold saw its basis move from positive to negative as the price of gold rebounded
- Four of the top ten credits that exhibited tightening in the positive direction were media companies

The CDS bond basis captures the relative value between a cash bond and CDS contract of the same credit entity. Loosely defined, it is the difference between a bond's swap spread and its CDS spread.

CDS bond basis = CDS spread – cash bond spread

Fluctuations in the basis give rise to arbitrage trading opportunities, since theoretically the basis should be zero. To take advantage of these opportunities a positive basis would involve selling the cash bond (pay spread) and concurrently selling protection (receive spread) on the same credit entity. Likewise a negative basis trade would involve buying the bond (receive spread) and simultaneously buying protection (pay spread) on the same credit.

An analysis of the most liquid US investment grade five year CDS which makes up the 125 constituents of the Markit CDX NA IG and their corresponding reference bonds show many discrepancies which could be arbitrated away. This analysis is based on the actual CDS bond basis (mid) as calculated by [Markit's Bond Pricing](#) service.

Using a 50bps threshold, there are currently two entities trading with a positive basis, down from four in July. On the negative side, there are more possibilities in the CDX NA IG, with 76 names, up 17bps since July 22nd.

Biggest monthly movers

Name	Basis as of 31/07/2015	Basis as of 31/08/2015	Monthly change	Bond liquidity score	CDS liquidity score	Utilisation	Sec lending Inventory (nominal)	On Loan (as % of face Value)
Beam Suntory Inc	-135	-93	42	2	2	0	91968952	0
Time Warner Inc	-69	-37	32	1	2	7	330734144	1
MeadWestvaco Corp	-224	-196	27	4	2	0	24789000	
21st Century Fox America Inc	-69	-46	22	5	1			
Staples Inc	-99	-77	21	1	2	24	52817000	3
Dow Chem Co	-66	-36	20	1	2	0	432135200	0
CBS Corp	-76	-57	20	1	2	1	134624096	0
Cox Comms Inc	-139	-119	19	2	2	0	137272096	
Viacom	-52	-33	19	1	2	3	149890192	1
Kohls Corp	-37	-18	18	1	2	41	80058352	5

Media names dominated the list which saw the biggest monthly change in basis on the positive side. Time Warner, 21st Century Fox, CBS Corp and Viacom all saw their cash bond spread increase at a greater pace than the CDS spread. The media sector has come under scrutiny over the past month amid the possibility of slowing international demand.

Name	Basis as of 31/07/2015	Basis as of 31/08/2015	Monthly change	Bond liquidity score	CDS liquidity score	Utilisation	Sec lending Inventory (nominal)	On Loan (as % of face Value)
CAMPBELL SOUP CO	-41	-72	-31	1	1	6	106707000	1
Newmont Mng Corp	-16	-52	-35	1	2	16	117065000	2
Ingersoll Rand Co	-166	-201	-35	5	2	0	27951000	
ARROW ELECTRS INC	-120	-155	-35	2	1	0	45229000	0
Tyson Foods Inc	-50	-88	-38	1	1	0	20202368	0
Motorola Solutions Inc	-51	-90	-39	1	2	2	98140752	0
Nabors Inds Inc	50	1	-49	2	2	77	89962552	7
Weatherford III Ltd	-32	-105	-72	1	2	8	193433200	1

Among names which saw the biggest monthly move on the negative side, Nabors, an offshore driller, wiped out its basis over the past month. Its basis tightened from 50bps to -1bps.

Positive basis

Name	Basis as of 31/07/2015	Basis as of 31/08/2015	Monthly change	Bond liquidity score	CDS liquidity score	Utilisation	Sec lending Inventory (nominal)	On Loan (as % of face Value)
FreeportMcMoran Inc	77	90	13	1	1			
Teck Res Ltd	79	60	-19	2	1	44	148883712	7
Transocean Inc	53	26	-27	1	1	94	182195888	11
APACHE CORP	24	18	-6	1	2	13	118176304	3
Enbridge Inc	5	12	7	1	3	0	117873528	0
CDN NAT RES LTD	15	12	-3	1	2	10	130289952	2

As of the end of August, there are only seven entities that exhibit a positive basis, down

from ten last month. Barrick Gold, the largest global gold miner, dropped off this list. Its basis was 41bps on July 22nd but reversed to -20bps as of August 31st. In particular there was sustained pressure on the price of gold mid-July as levels hit five year lows and investors duly sought protection through CDS.

All seven of the names with a positive basis belong to the oil & gas sector. Freeport, Teck and Transocean remain the three credits with the widest positive basis, 90bps, 60bps and 26bps, respectively. Volatility in the price of oil has continued into the month of August and CDS levels remain wide as investors remain cautious.

In terms of taking advantage of the positive basis trade, Freeport's cash bond currently does not sit in a lending programme tracked by [Markit Securities Finance](#). So in practical terms it would be difficult to short. Transocean's \$154m bond is nearly fully utilised (already out on loan), while Teck's five year cash bond is only 44% utilised, but is up from 36% last month as arbitragers took advantage of the spread.

Negative basis

Name	Basis as of 31/07/2015	Basis as of 31/08/2015	Monthly change	Bond liquidity score	CDS liquidity score	Utilisation	Sec lending Inventory (nominal)	On Loan (as % of Face Value)
Ingersoll Rand Co	-166	-201	-35	5	2	0	27951000	
MeadWestvaco Corp	-224	-196	27	4	2	0	24789000	
ARROW ELECTRS INC	-120	-155	-35	2	1	0	45929000	0
Ford Mtr Co	-127	-135	-8	3	2	0	14463950	0
Avnet Inc	-114	-132	-18	2	1	0	11539950	0
Norfolk Sthn Corp	-125	-131	-6	4	1	0	24913000	
Duke Energy Carolinas LLC	-115	-128	-14	4	2			
Starwood Hotels & Resorts Wwide Inc	-119	-126	-7	2	1	3	25433470	0
Cox Comms Inc	-139	-119	19	2	2	0	137272096	
EXPEDIA INC	-101	-119	-18	3	2			

Most names in the Markit CDX NA IG index trade on a negative basis. This follows the historic trend in the US over the past few

years and is mainly driven by low interest rates as many reference bonds trade above par. CDS sellers guarantee a par amount, usually 100, and will therefore settle for a lower spread in a case of default.

While shorting the reference bond is not as straightforward with positive basis trades, going long and taking advantage of the negative basis trade may prove to be just as difficult. Ingersoll Rand, a diversified industrial conglomerate, now has a negative basis of 200bps, the widest on the list, having widened 35bps in August. It has a liquidity score of 5, the lowest possible score according to [Markit's Bond Pricing](#) service, indicating that the bond is very thinly quoted.

Neil Mehta

Analyst

Markit

Tel: +44 207 260 2298

Email: neil.mehta@markit.com

For further information, please visit 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.