

## Micro dominates monthly CDS-bond basis moves

A turn in risk sentiment over the past month has seen individual risks dominate fluctuations in the CDS bond basis.

- Over the past month, positive basis in EUR investment grade corporates has fallen from 46% to 43%
- M&A activity in Marathon Petroleum has seen its basis move 51bps further negative
- ABN Amro's upcoming IPO has led to basis tightening from -94bps to -59bps over the past month

The CDS-bond basis captures the relative value between a cash bond and CDS contract of the same credit entity. Fluctuations in the basis give rise to arbitrage opportunities. It is defined as an entities bond swap spread subtracted from its CDS spread.

*CDS-bond basis = CDS spread – cash bond spread*

Both spreads measure an entity's credit risk, so theoretically the basis should be zero. In practice other factors such as liquidity and transaction costs come into play. Nevertheless, to take advantage of a positive basis would involve selling the cash bond (paying spread) while selling protection (receiving spread) on the same credit. Conversely, a negative basis trade would involve buying the bond (receiving spread) while buying protection (paying spread) on the same credit.

### Dataset

An analysis of investment grade corporate bonds across USD and EUR sees many such discrepancies that could be arbitrated away. The sample of bonds is taken from [Markit's iBoxx indices](#), which incorporates liquid bonds. Since the 5-yr point on a CDS curve is typically the most liquid tenor, only bonds maturing between June 2020 and June 2021 will be taken into consideration to diminish liquidity concerns. This analysis is based on

the actual CDS-bond basis (mid) as calculated by [Markit's bond pricing service](#).

After August and September's turbulent fixed income markets, the past month has seen mixed sentiment. October saw a rebound in credit, as idiosyncratic risks subdued, EM concerns diminished and US interest rate risk expectations were pushed into 2016. But the first half of November has seen volatility raise again after a better than expected US jobs report and another downturn in commodity prices, piling pressure on weaker credits.

### USD

Using the constituents of the Markit iBoxx \$ Liquid Investment Grade index, all but two of the 79 bonds in the sample exhibited a negative basis as of November 13th, down from three one month ago. The negative basis trend is one that has been prevalent in USD for some time, owing to a number of factors such as falling interest rates (many bonds trading above par), an increase in counterparty default risk and relative liquidity.

Name	Bond	CDS bond basis		
		13 October 2015	13 November 2015	Change
Marathon Petroleum Corp	MARAPET 5.125 03/01/21	-14	-64	51
Hewlett-Packard Co	HPQ 4.3 06/01/21	-2	-50	48
Xerox Corp	XRX 4.5 09/15/21	-60	-88	28
Bank of Nova Scotia	BNS 4.375 01/13/21	-29	-45	16
El du Pont de Nemours & Co	DD 3.625 01/15/21	-45	-59	14

Marathon Petroleum saw a 51bps swing in its basis from -14bps to -64bps, making it the largest monthly mover. Bond spreads have jumped as the company chases the [acquisition of MarketWest Energy](#), which is likely to be financed part in cash, while CDS

spreads have lacked liquidity. Another name whose basis turned further negative is Hewlett Packard, which saw a restructuring plan over the past month, with the market anticipating [further growth challenges](#).

Name	Bond	CDS bond basis		
		13 October 2015	13 November 2015	Change
L-3 Communications Corp	LLL-Corp 4.75 07/15/20	-175	-147	-27
HSBC Holdings PLC	HSBC 5.1 04/05/21	-61	-38	-23
General Electric Capital Corp	GE-CapCorp 4.625 01/07/21	-63	-42	-22
The Coca-Cola Company	KO 2.45 11/01/20	-41	-20	-20
Amgen Inc	AMGN 3.45 10/01/20	-66	-48	-18

Among the credits that saw the biggest positive monthly change in basis, L-3 Communications tops the list, although it still exhibits a large negative basis. The space communications company posted better than expected Q3 earnings.

## EUR

Within the Markit iBoxx € Corporates index, 45 of the 106 eligible bonds currently trade with a positive basis, down from 49 a month ago. Financials largely make up the top names with the widest negative basis, such as Barclays, Macquarie and BNP Paribas, although there has been little change over the past month.

Name	Bond	CDS bond basis		
		13 October 2015	13 November 2015	Change
Petroleos Mexicanos	PEMEX 3.125 11/27/20	7	-21	27
RCI Banque	RENAUL-RCIBanq 2.25 03/29/21	22	-2	24
EWE AG	EWE 4.125 11/04/20	-10	-33	23
EDP Finance BV	EDP-FinBV 4.125 01/20/21	-40	-62	22
Nordea Bank AB	NORDEA 4.0 03/29/21	22	0	21

Another downturn in oil prices in November on oversupply concerns saw Petroleos

Mexicanos' CDS-bond basis move from positive to negative over the past month. Energy related names followed suit with EWE AG and EDP seeing their CDS-bond basis widen 23 and 22bps, respectively.

Name	Bond	CDS bond basis		
		13 October 2015	13 November 2015	Change
ABN AMRO Bank NV	AMROBK 6.375 04/27/21	-94	-59	-34
Casino Guichard-Perrachon SA	GROUPE 4.726 05/26/21	48	80	-31
Prologis LP	PRGLP 1.375 05/13/21	-45	-16	-29
Sumitomo Mitsui Banking Corp	SUMIBK-Bank 2.25 12/16/20	-22	4	-26
ProLogis LP	PRGLP 1.375 10/07/20	-45	-20	-25

Dutch bank ABN Amro saw its CDS-bond basis tighten from -94bps to -59bps over the past month as the government looks set to privatise part of the bank on the back of a profitable Q3.

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