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YIELD INSIGHTS
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WHERE COULD YIELD COME FROM TOMORROW? TRENDS IN CREDIT ISSUANCE.

- The healthy pace of global credit issuance could create diversification opportunities for yield seekers
- American companies are increasingly issuing bonds in euros – so-called 'reverse yankees'
- Demand for floating-rate notes has risen due to the rising interest rate environment

With an increasing number of governments and companies tapping capital markets to take advantage of record low borrowing rates, bond investors have never had more choice when it comes to diversifying their sources of yield.

But as the global credit market expands, what are the trends and opportunities that investors should be aware of?

2017 set for a strong year for bond issuance

Globally, debt capital markets have enjoyed a healthy first half of 2017 as investors have continued to go down the credit spectrum in pursuit of the higher yields available on investment grade (IG) and high yield (HY) credit.

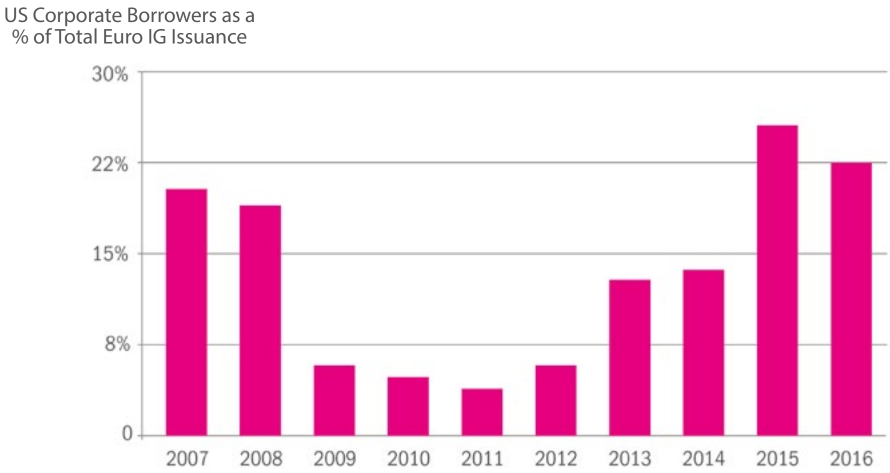
Indeed, year-to-date global high yield bond issuance is 37% higher than 2016 levels[1]. The US HY market in particular saw a surge of activity ahead of the US Federal Reserve raising rates earlier this year – the first week of March 2017 was the busiest week for the high yield primary market since early 2013[2]. Issuance levels for IG markets have also been high, led by an all-time quarterly record for US IG issuance in Q1 20172. Meanwhile European non-financial companies are also forecast for a record year of bond issuance, seemingly "on course to exceed last years' record €478bn[3]" according to ratings agency Fitch, as the ECB's ongoing bond-buying programme continues to keep borrowing costs low.

Rise of the Reverse Yankee

"One trend we've seen in the European credit market is the sustained issuance of reverse yankees" commented Nicolas Trindade, senior portfolio manager at AXA Investment Managers, referring to US companies issuing bonds denominated in euros, or less frequently in sterling.

[1] Source: Dealogic as at June 14, 2017
[2] Source: Thomson Reuters Deals Intelligence Q1 2017
[3] Source: Fitch Ratings Credit Market Research as at 31 May 2017 via the Financial Times

The share of all euro IG issuance from US domiciled corporates has risen steadily from just 4% in 2011 to 22% in 2016[4]



"Historically we saw a lot of European issuers issuing in dollars – so-called yankee bonds. But the reversal of this trend since 2015 has changed the European corporate bond market as the number of US issuers rises and could surpass French issuers as the largest share of the euro IG credit market. May was the largest month in history for reverse yankee supply."

US issuers could potentially surpass French issuers as the largest share of the € IG market[5]

"Reverse yankees can be an attractive option for many US companies as it can be cheaper for them to issue in euros than in dollars, even when you take into account the cost of hedging. Issuing in euros can also be appealing to issuers in countries such as the UK – we've seen some UK household companies which have previously only issued in sterling start to sell bonds in euro as they look to expand their potential investor base and benefit from attractive funding conditions."

Expanding emerging market universe

Emerging markets have also had a bumper year in terms of bond issuance – EM sovereign bond sales rose to $69.9bn in Q1 2017, the strongest quarter on record, while corporate bond sales in Q1 2017 rose 135% year on year[6].

[4] Source: Dealogic end-May 2017

[5] Source: BofA Merrill Lynch as at 9 June 2017. % market size of Euro high-grade index, and projections based on extrapolating recent market growth

[6] Source: Bloomberg as at Q1 2017 via the Financial Times

"We've definitely seen a pickup in terms of issuance from emerging market economies" says Trindade. "Issuance in local currency bonds in particular has risen over the last couple of years, which obviously is a big positive for governments and corporates, because they can better match their assets with their liabilities."

Improving global issuance creates currency opportunities

Corporate issuers' increased appetite for issuing in different currencies has also created the potential for active, multi-currency managers to generate additional alpha. "Aside from the diversification and yield enhancement benefits which exploring the global fixed income universe can bring , it can also provide potential cross-currency relative value opportunities" says Trindade.

"The bonds which some companies offer in different currencies across the globe don't always necessarily trade in line with one another. So a bond from one particular issuer can be cheaper in dollars versus euros, or cheaper in sterling versus dollars for example – allowing you to buy the issuer in its cheapest currency."

Floating-rate notes

Beyond the traditional credit universe, the potential benefits of floating-rate notes (FRNs) are also climbing on investors' agendas.

"In a rising interest rate environment FRNs are appealing because they effectively have no duration risk as their yields aren't sensitive to rate changes. This is particularly appealing to us as short duration managers" comments Trindade. "As investor demand for FRNs has risen in both dollars and euros, we've seen an increasing amount of non-financial companies selling such bonds, in a market which has typically been dominated by financials."

How much debt is too much?

With the global credit universe larger than ever and yields remaining low, "Many investors might say that there is too much debt out there" concludes Trindade. "However I think the market is sustainable, so long as yields don't rise too sharply, which could create issues for debt refinancing down the line".

For more insights on yield investing, visit:

yield.axa-im.investedintomorrow.com

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