

Markit CDS-Bond Basis Report July 2012

- Spanish names tend to have negative to slightly positive basis
- High correlation with sovereign is a factor
- But aversion to cash securities on the cusp may be playing a part

Markit iTraxx Europe

It has been impossible to ignore the blanket coverage of the eurozone debt crisis by the financial commentariat. Bond yields and CDS spreads figure largely when the fate of countries in the currency bloc's are being analysed.

So it makes sense to look at how the relationship between bonds and CDS is evolving over time. Specifically, this report looks at theoretical CDS-bond basis, i.e. comparing the 5-year CDS spread of a credit with the asset swap spread of a theoretical 5-year bond. This uses a methodology developed by Markit's Evaluated Bond team. Further details can be provided by Markit on request.

Positive basis credits

Credits with the highest positive CDS-bond basis (ranked by basis)

Name	ASW	CDS	Basis	Basis Change	Basis % Change
Aegon N.V.	107	305	198	-12	-6
Assicurazioni Generali S p A	228	402	174	-5	-3
Commerzbank AG	136	311	174	-53	-30
Holcim Ltd	85	254	169	1	1
METRO AG	104	261	157	-59	-37
BNP Paribas	127	260	133	12	9
Societe Generale	168	302	133	12	9
Deutsche Bk AG	80	210	130	-39	-30
ALSTOM	147	278	130	-26	-20
EADS N V	57	183	126	21	17

Negative basis credits

Credits with the highest negative CDS-bond basis (ranked by basis)

Name	ASW	CDS	Basis	Basis Change	Basis % Change
CADBURY Hldgs Ltd	139	34	-105	22	-21
Next plc	237	141	-96	15	-16
Tate & Lyle PLC	146	77	-69	6	-9
Reed Elsevier PLC	139	80	-59	10	-18
Centrica plc	129	80	-50	21	-41
Compass Gp PLC	95	56	-39	10	-26
Bco SANTANDER SA	476	447	-29	62	-214
Utd Utils plc	114	85	-29	21	-73
Koninklijke Ahold N V	182	154	-28	9	-33
Wolters Kluwer N V	96	80	-17	5	-33

Telefonica Gas Natural Enel Telecom Italia



Fig. 1 Spanish corporate basis lower than Italian

Peripheral eurozone debt has had a torrid time over the second quarter of 2012. The future of the eurozone – at least in its current form - is still in doubt. Inevitably, this has had a knock-on effect on corporates, particularly names based in the periphery. Spain, for example saw its spreads widen to record levels before mounting a partial recovery after an EU summit on

June 28-29 announced an agreement on direct bank recapitalisations.

The most liquid Spanish names in the CDS universe followed suit. But Figure 1 shows that the bond market was not as predictable. The positive basis – CDS trading wider than bonds - on names such as Telefonica and Gas Natural – compressed and even turned negative, a relatively rare occurrence in the current European market. The CDS market performed poorly but the bond market was even worse.

Perhaps the tenuous BBB ratings of the Spanish sovereign and domestic utilities are making cash investors even more risk averse. There has been a tentative recovery in recent weeks, but the Spanish names are struggling to enter positive territory, unlike similar credits in Italy and most other countries. However, the Moody’s downgrade of Italy to Baa2 could result in corporates in that country following the Spanish negative basis path.



Fig 2. Negative basis in peripheral sovereigns

Spain itself has a negative basis (see Fig. 2), with CDS faring better than bonds post-summit. All of the peripheral sovereigns saw their basis compressed over this period, and it would probably take official intervention for this to be reversed significantly.

Basis becoming more positive

Top 10 credits where CDS-bond basis changed by a positive amount

Name	ASW	CDS	Basis	Basis % Change	Basis Change
Bco SANTANDER SA	476	447	-29	-214	62
Telefonica S A	501	510	9	441	41
Glencore Intl AG	249	344	94	27	25
Vivendi	206	211	5	456	23
CADBURY Hldgs Ltd	139	34	-105	-21	22
TelefonAB L M Ericsson	127	157	30	73	22
EADS N.V	57	183	126	17	21
Utd Utils plc	114	85	-29	-73	21
Centrica plc	129	80	-50	-41	21
Telekom Austria AG	122	128	5	341	18

Basis becoming more negative

Top 10 credits where CDS-bond basis changed by a negative amount

Name	ASW	CDS	Basis	Basis % Change	Basis % Change
Gas Nat SDG SA	486	514	28	-228	-63
ENEL S p A	328	450	122	-49	-59
METRO AG	104	261	157	-37	-59
Commerzbank AG	136	311	174	-30	-53
Casino Guichard Perrachon	152	214	62	-82	-51
Carrefour	154	251	97	-49	-48
Deutsche Bk AG	80	210	130	-30	-39
Telecom Italia SpA	425	500	74	-51	-38
ATLANTIA SPA	316	401	86	-41	-35
LLOYDS TSB BK PLC	222	290	67	-44	-29

Markit CDX NA IG

Positive basis credits

Name	ASW	CDS	Basis	Basis Change	Basis % Change
MetLife Inc	151	294	142	-5	-4
Safeway Inc	233	342	109	78	71
Berkshire Hathaway Inc	54	157	104	9	9
Dell Inc	130	209	79	11	14
NRUC Fin Corp	47	110	63	4	6
Kinder Morgan E. P. L P	146	207	61	17	27
Cisco Sys Inc	28	88	60	-4	-6
Caterpillar Inc	69	122	53	-21	-39
Gen Elec Cap Corp	123	171	48	8	17
Cdn Nat Res Ltd	106	151	45	-10	-23

Negative basis credits

Name	ASW	CDS	Basis	Basis Change	Basis % Change
EXPEDIA INC	459	354	-163	-13	8
Ingersoll Rand Co	284	182	-134	-32	24
Marsh & McLennan Cos Inc	308	206	-133	-1	1
Altria Gp Inc	288	185	-99	-19	19
Cardinal Health Inc	246	144	-94	3	-4
Darden Restaurants Inc	309	207	-84	-19	23
Starwood Hotels & Resorts Wwide Inc	325	222	-77	15	-20
Un Pac Corp	224	123	-77	-49	64
Arrow Electrs Inc	353	250	-75	-28	37
Cox Comms Inc	236	135	-72	-14	19

Basis becoming more positive

Name	ASW	CDS	Basis	Basis % Change	Basis Change
Safeway Inc	233	342	109	71	78
Alcoa Inc.	306	349	42	94	40
Computer Sciences Corp	384	384	0	-6308	24
CBS Corp	120	126	5	419	23
Transocean Inc	234	233	-1	-1672	21
Kinder Morgan Engy Partners L P	146	207	61	27	17
Starwood Hotels & Resorts Wwide Inc	222	145	-77	-20	15
Dell Inc	130	209	79	14	11
Berkshire Hathaway Inc	54	157	104	9	9
Lockheed Martin Corp	78	79	0	2165	9

Basis becoming more negative

Name	ASW	CDS	Basis	Basis % Change	Basis Change
Exelon Corp	182	141	-40	-122	-49
Un Pac Corp	123	46	-77	-64	-49
Johnson Ctls Inc	133	151	19	-242	-45
CSX Corp	126	64	-62	-61	-38
News America Inc	137	90	-46	-77	-36
Ingersoll Rand Co	182	48	-134	-24	-32
Sara Lee Corp	166	105	-62	-50	-31
DIRECTV Hldgs LLC	158	170	12	-241	-28
Arrow Electrs Inc	250	175	-75	-37	-28
ConocoPhillips	61	67	6	-410	-26



Fig. 2 Basis in US railroad companies

The majority of names in the Markit CDX IG index have a negative CDS-bond basis, unlike the Markit iTraxx Europe. Railroad firms CSX Corp and Union Pacific saw their basis become even more negative over the second-quarter. Both are robust credits and two of the tightest names in the CDX IG index. Their

implied ratings – calculated from CDS data - are single A, better than their actual ratings of 'BBB'. The negative basis indicates that the bond market is more in line with the rating agencies than the CDS market.

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