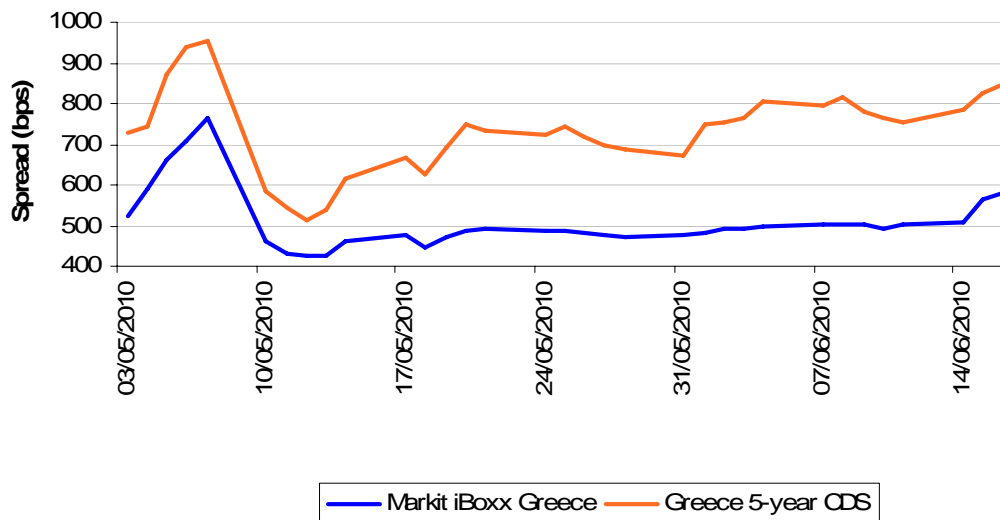


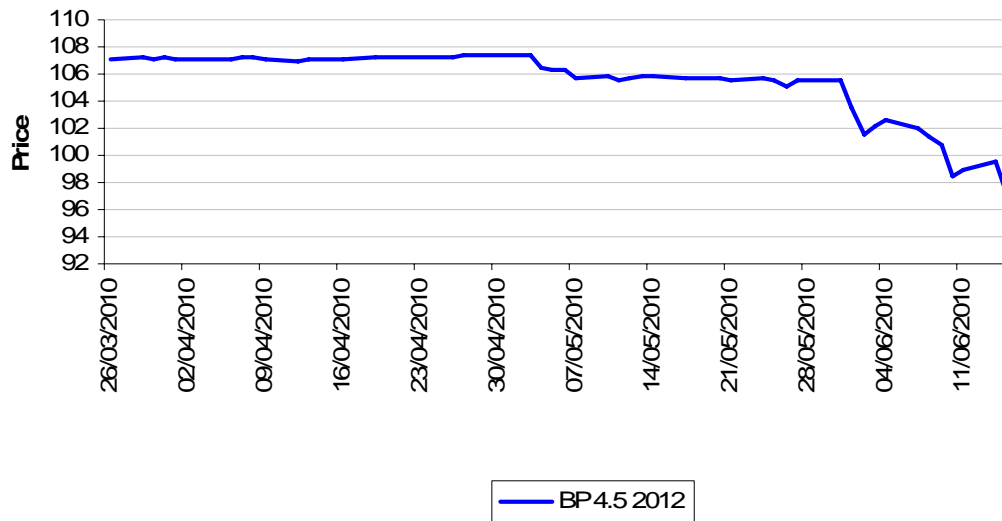
Markit Evaluated Bonds: Q2 Round-Up

The European bond markets have experienced another turbulent few weeks, something investors are becoming all too accustomed to. Concerns over government budget deficits and the solvency of certain countries, notably around the eurozone's periphery, have sent shudders through the market and created a climate of fear. European corporate bond issuance has collapsed in recent weeks, a casualty of the febrile conditions. Issuance in May was just \$7.1 billion, well below the average and the lowest monthly figure since 1995, according to Dealogic.



Greece, in particular, has been the driving force behind the volatility. The asset swap margin on the Markit iBoxx Greece benchmark bond index reached a peak of 763 basis points on May 7 amid fears that a debt restructuring was imminent. Contagion across the eurozone's weaker economies – Portugal, Spain, Italy and Ireland – was a real danger and led to spreads widening across the broader market. A €750 billion bailout from the EU and IMF alleviated some of the pressure and led to the asset swap spread on the index returning to 423bps the following week. But the rally proved short-lived, with investors recognising that the medium-term solvency issues had not been addressed.

The spreads on Greek government bonds were already widening before it received another blow. Moody's downgraded the sovereign to junk on June 14, following on from S&P's similar action a few weeks previously. While this was not a great surprise to the markets – CDS and bonds were already trading equivalent to junk – it had important implications. Benchmark bond indices such as the Markit iBoxx Europe require bonds to have investment grade ratings. Greek government bonds will be removed from the index at the next rebalancing at the end of June, forcing some funds to sell their holdings. Unsurprisingly this had a widening effect on spreads, with Greek sovereign CDS trading around 800bps and the Markit iBoxx Greece index jumping to 577bps from 508bps. It's worth noting that liquidity has been reasonably robust over this volatile period. The Markit Evaluated Bonds Liquidity Score of the 6.1 2015 bond has been steady at one, the highest score, though the bid/offer spreads have widened during the more eventful days.



Source: Markit Evaluated Bonds

Aside from sovereigns, a case of idiosyncratic event risk had a significant impact across the corporate market. The oil spill in the Gulf of Mexico has had a catastrophic effect on BP's credit standing as well as the environment. The company's failure to stop the leak caused widespread resentment in the US, forcing the Obama administration into a more aggressive response. The threat of punitive damages and claims led many investors to question BP's solvency.

Bond prices duly plummeted and the credit curve became inverted, a classic sign of credit distress. Five-year CDS exceeded 500bp, an astonishing level for a AA credit. Rating downgrades followed soon after. Again, the Markit Evaluated Bonds Liquidity Score was steady at one, despite the oscillations in prices, indicating a high level of market quotes, transparency and turnover in BP issues. BP has since agreed to suspend its dividends and set aside \$20 billion for damages and claims. While this crystallises considerable costs, it eases some of the concerns about unlimited liabilities. If a default is averted – always an unlikely prospect – then sovereigns and financials should resume their role as the main drivers of bond sentiment.

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