

# SEK Credit Market 2016

*- Navigating in stormy waters – hold on to your hat*

29 January 2016

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# Outlook for the SEK credit market 2016

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- *The macroeconomic situation provides a mixed picture for credits in 2016.*
- *We expect spreads to widen in all rating categories over the year.*
- *We prefer domestically oriented sectors that benefit from the strong Swedish economy and low interest rates. We remain cautious on sectors exposed to commodity prices and emerging market weakness.*

# 2016 in summary

## Widening is set to continue

- The weaker outlook for emerging markets, with downside risk to growth expectations, volatile commodity prices and overall softer demand in the industry sector mitigated by supportive central banks and low interest rates, provides a mixed picture for credits to 2016.
- Following the weakening expectations for global growth, we expect spreads to widen over the year across all rating segments. We consider bond picking to be the name of the game. With low coupons and potential further widening, the room for mistakes is limited.
- In terms of sectors, we prefer the more domestically oriented ones that benefit from the relatively strong Swedish economy and low interest rates, such as real estate and construction. We also like airlines and pulp and paper, while we remain negative on sectors more exposed to low commodity prices and emerging market weakness, such as oil-related sectors, capital goods and metals and mining.

## Market outlook

Spreads	↗	We expect spreads to widen slightly over the whole rating spectrum with generally steeper curves.
Supply	→	We expect supply to increase slightly on the back of higher redemptions but do not expect the outstanding amount to show net growth in any of the subgroups. In general, well-funded companies with limited needs of new funding.
Demand	→	Demand is largely affected by fund flows and, given our expectations of a modest performance, we argue that demand could remain subdued, especially at the longer end of the curve.
Company fundamentals	→	Low organic growth and muted currency gains could affect margins negatively. Potential increase in shareholder friendly moves with M&A, share buybacks and increased dividends. The low oil price could make companies more cautious.
Funding conditions	→	Funding conditions should remain favourable, as the Nordic banks continue to be aggressive in their terms and pricing.

Source: Danske Bank Markets

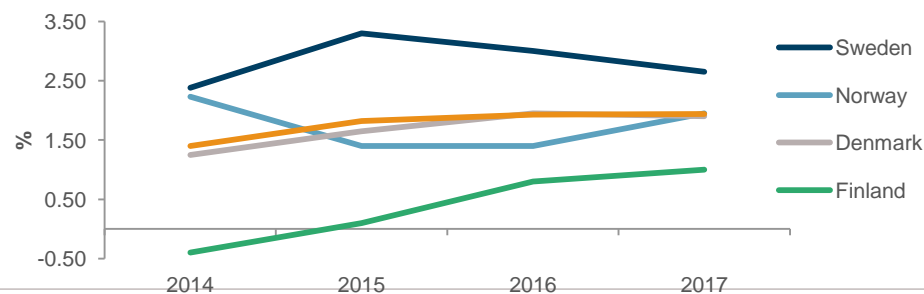
## Sector outlook\*

Real estate	●	Low-for-long interest rates and solid vacancy rates support the sector. We prefer residential due to the housing shortage.
Banks	●	Low interest rates and heavy regulations should continue to hit the banks over the next few years. However Nordic banks remain robust.
Construction	●	Shortage of housing supply, increased refurbishing and increased focus on infrastructure investments is supportive for the sector.
Oil related	●	Oil price says it all. No signs of decreased supply.
Capital goods	●	Decline in commodity prices puts pressure on demand. FX will not save growth this year and leverage rose over 2014/15.
Metals and mining	●	Increased global supply has pushed commodity prices down and import bans have not shown the desired effects yet.
Airlines	●	Lower fuel costs and good capacity utilisation support the sector. Increased Nordic capacity could effect prices negatively.
TMT	●	Revenues have stabilised over the past 12 months along with solid EBITDA margins. We expect a stable performance over the year.
Utilities	●	Power prices below breakeven levels and low expectations on a recovery are likely to accentuate earnings pressure.
Pulp and paper	●	Demand has increased mainly in packaging paper, driven by increased online trade and environmental solutions. The publication paper decline has slowed down following capacity reductions.

\* Selected sectors

Source: Danske Bank Markets

## GDP growth Nordics and Europe



Source: Danske Bank Markets, Bloomberg

# Total return forecast

## 2Y

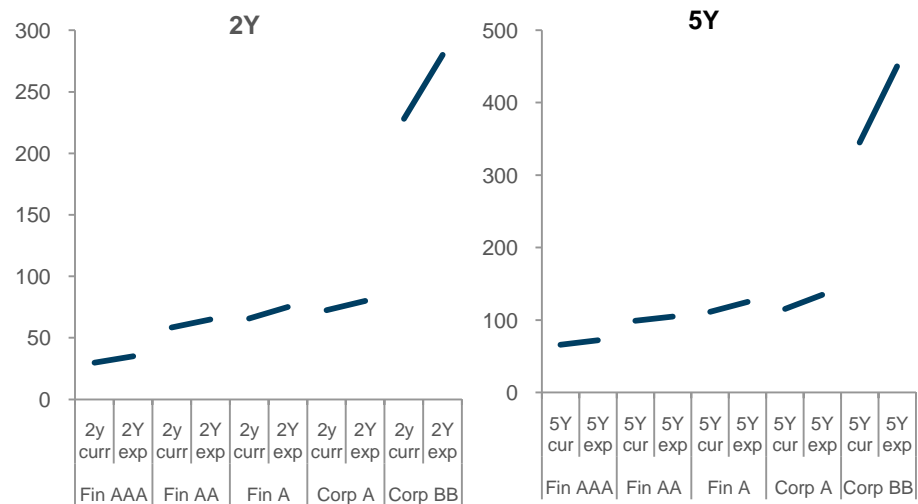
Category	Spread forecast	Spread Δ, bps	Rates Δ, bps	Carry	Total return
Fin AAA	35 bps	+5 bps	-11 bps	0.04%	0.23%
Fin AA	65 bps	+7 bps	-11 bps	0.33%	0.57%
Fin A	75 bps	+9 bps	-11 bps	0.41%	0.57%
Corp A	80 bps	+8 bps	-11 bps	0.47%	0.65%
Corp BBB	100 bps	+17 bps	-11 bps	0.58%	0.77%
Corp BB	280 bps	+52 bps	-11 bps	2.03%	2.16%

- For 2016, we forecast higher spreads in the SEK market across all sectors and maturities.
- Higher beta sectors such as BB stay true to their categorisation and widen more in proportion to today's market. Five-year is helped significantly by our FI forecast of flat or slightly lower swap rates compared with today.
- We prefer the 2Y BBB segment and selective ventures into 2Y X-over and BB.

## 5Y

Category	Spread forecast	Spread Δ	Rates Δ	Carry	Total return
Fin AAA	72 bps	+6 bps	-2 bps	1.08%	2.40%
Fin AA	105 bps	+6 bps	-2 bps	1.41%	2.84%
Fin A	125 bps	+13 bps	-2 bps	1.54%	2.87%
Corp A	135 bps	+20 bps	-2 bps	1.58%	2.86%
Corp BBB	180 bps	+41 bps	-2 bps	1.82%	2.86%
Corp BB	450 bps	+105 bps	-2 bps	3.87%	2.88%

## Spread change expectations (bp)



Source: Danske Bank Markets (all charts)

# Sensitivity analysis (total return)

## 5Y A Financials

		Spread change				
		-100	-50	0	50	100
Rate change	100	1,6%	-0,7%	-3,0%	-5,2%	-7,3%
	50	4,0%	1,6%	-0,7%	-3,0%	-5,2%
	0	6,5%	4,0%	1,6%	-0,7%	-3,0%
	-50	9,1%	6,5%	4,0%	1,6%	-0,7%
	-100	11,7%	9,1%	6,5%	4,0%	1,6%

- To illustrate the current sensitivity of credits to changes in the rate environment or spreads, we calculate potential total return given symmetrical scenarios
- The x-axis in each table is the instantaneous change in the credit spread from current\* average levels, while the y-axis is the instantaneous change in the swap rate
- In our view the up-side potential is limited due to the low interest rates and tight spreads.

## 5Y BBB Corporates

		Spread change				
		-100	-50	0	50	100
Rate change	100	1,9%	-0,4%	-2,7%	-4,8%	-7,0%
	50	4,3%	1,9%	-0,4%	-2,7%	-4,8%
	0	6,8%	4,3%	1,9%	-0,4%	-2,7%
	-50	9,3%	6,8%	4,3%	1,9%	-0,4%
	-100	11,9%	9,3%	6,8%	4,3%	1,9%

## 5Y BB Corporates

		Spread change				
		-100	-50	0	50	100
Rate change	100	4,0%	1,8%	-0,3%	-2,4%	-4,4%
	50	6,3%	4,0%	1,8%	-0,3%	-2,4%
	0	8,6%	6,3%	4,0%	1,8%	-0,3%
	-50	11,0%	8,6%	6,3%	4,0%	1,8%
	-100	13,4%	11,0%	8,6%	6,3%	4,0%

Note: Spread change on x-axis, rate change on y-axis. \* Current levels as of 18 January 2016

Source: Danske Bank Markets (all charts)

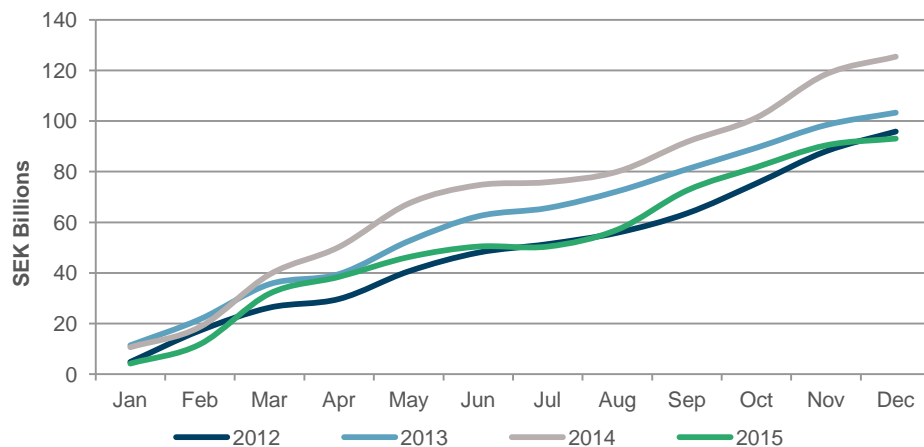
## SEK market wrap-up

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- **Primary market activity:** Continued low activity over the last few months of the year, especially within the corporate and municipality segment. Bank appetite remains high, which tempers high-yield supply.
- **Spread development:** Spreads widened significantly across all rating categories over 2015.
- **Fund flows:** At the end of the year, we saw outflows in both investment-grade and high-yield funds.
- **Total returns:** The SEK investment-grade space has had a tough year, while the high-yield space has provided a fairly reasonable return, especially in the real estate segment.

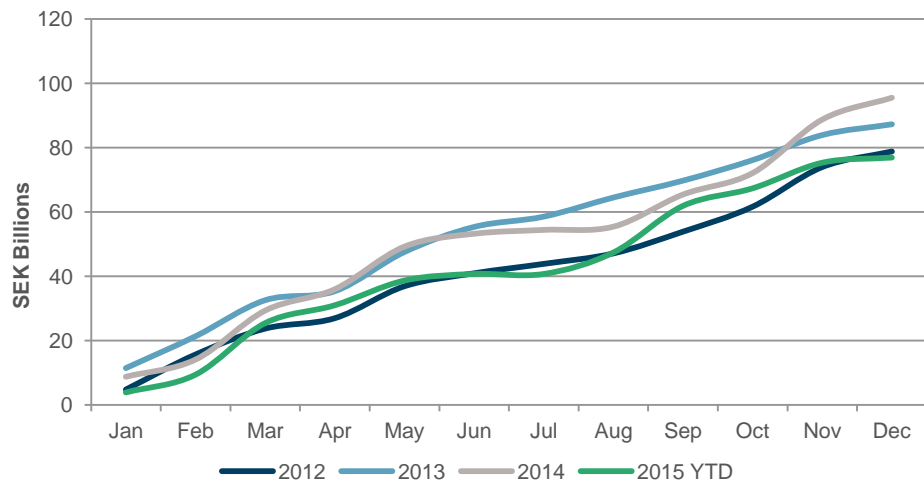
# Primary activity

## Corporates

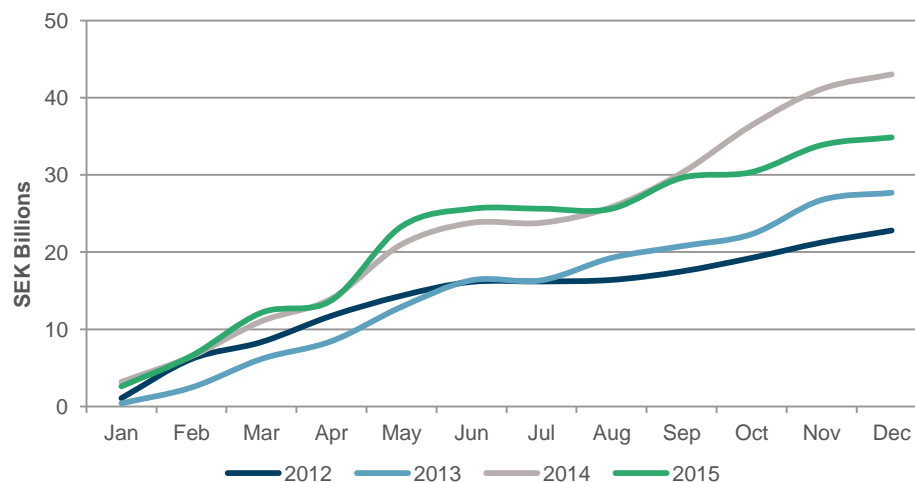


- In 2015, issuance activity was tempered by a strong appetite from the Nordic banks, well-funded companies and low investment and M&A activity.
- **Corporates** issued bonds totalling SEK93bn, which is around SEK32bn less than in 2014. We think corporates will continue to be cautious with capex and expansion investments well into 2016, which, in combination with continued appetite from banks, should result in modest net supply.
- Issuance of **senior unsecured financials** has continued on a weak path. Bonds amounting to SEK76bn were issued in 2015, compared with SEK95bn in 2014.
- **Municipalities'** funding needs remain high but from a capital market perspective KI has started to be more aggressive in its terms, resulting in a lower supply on a single name basis, a theme we think will continue in 2016.

## Senior financials



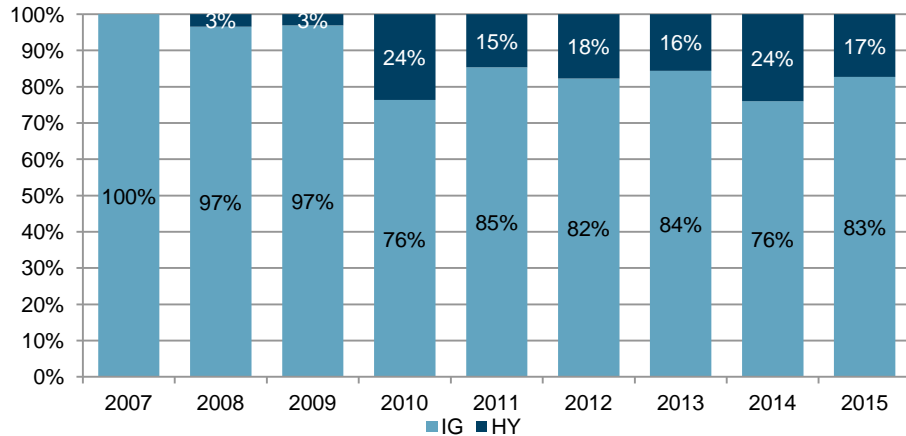
## Municipalities



Source: Danske Bank Markets, Bloomberg (all charts)

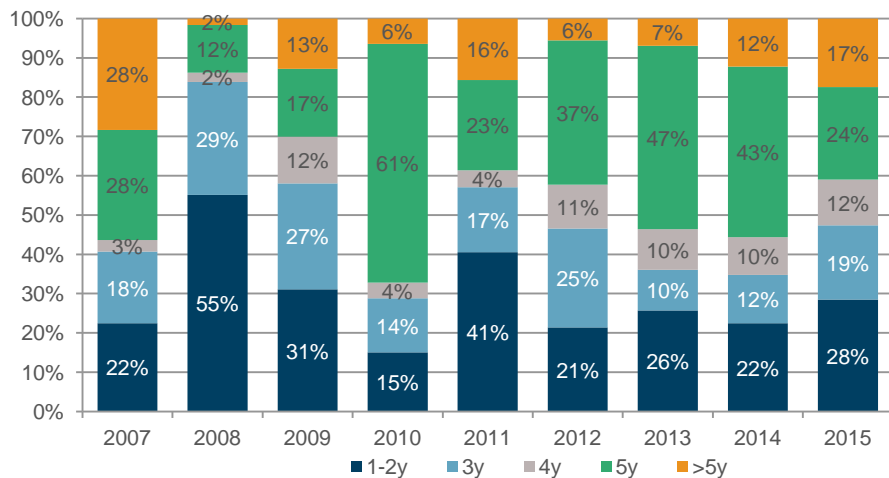
# Primary activity

## Corporates high yield/investment grade

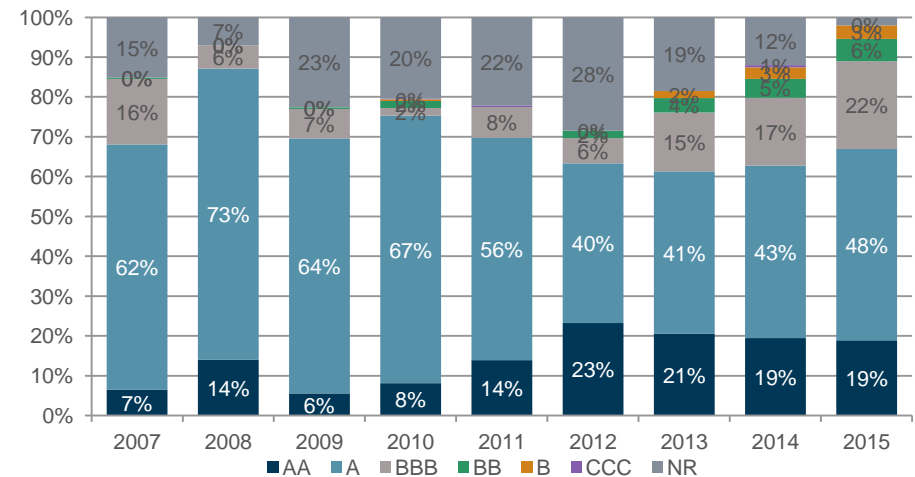


- The vast majority of the names in the SEK market have an 'A' category rating or better (shadow ratings included), due primarily to the high shares of banks.
- In 2015, we saw an increased appetite for maturities between one and four years, while the historical sweet spot, five years, decreased. The amount of bonds with maturity longer than five years increased over the year to 17%.
- High-yield issuance slowed down over the year, as a result of very competitive bank financing and lower interest from sponsor-related issuers. As long as the banks continue to be aggressive in pricing and terms, we expect limited primary activity. In 2015, high yield issues accounted for 17% of the SEK new issue market, compared with 24% in 2014.

## Maturity distribution (corporates)



## Rating distribution (corporates, financials and municipalities)

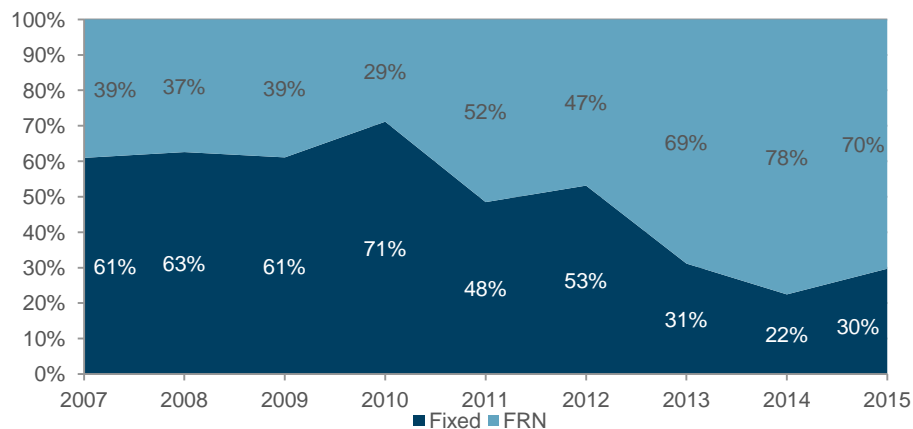


Source: Danske Bank Markets, Bloomberg (all charts)



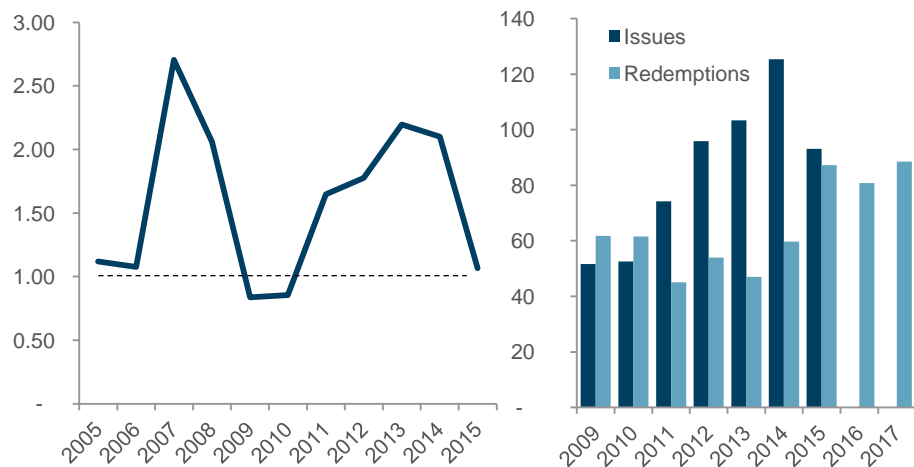
# Primary activity

## Fixed/float (corporates, financials and municipalities)

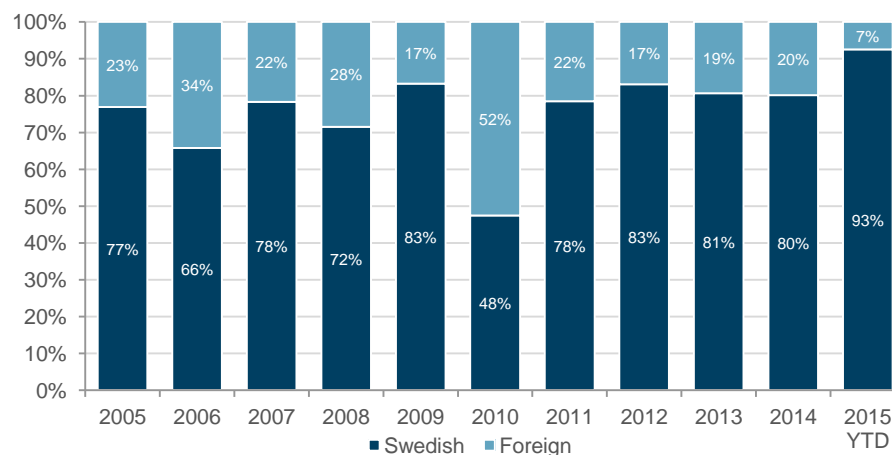


- The trend for an increasing share of floating rate notes has been clear over the past few years. Interestingly, the fixed share recovered in 2015 on the back of uncertainties regarding negative Stibor and the related effects.
- The ratio between new issuance and redemptions has been between 1.6x and 2.2x since 2011. In 2015, the ratio decreased to just above 1.0x. From an historical perspective, redemptions will remain high over the coming two years, which should affect gross volumes positively.
- Low interest for foreign companies to issue bonds in SEK, with only 7% of the volume issued by companies domiciled outside of Sweden.

## New issue/redemption ratio (corporate)



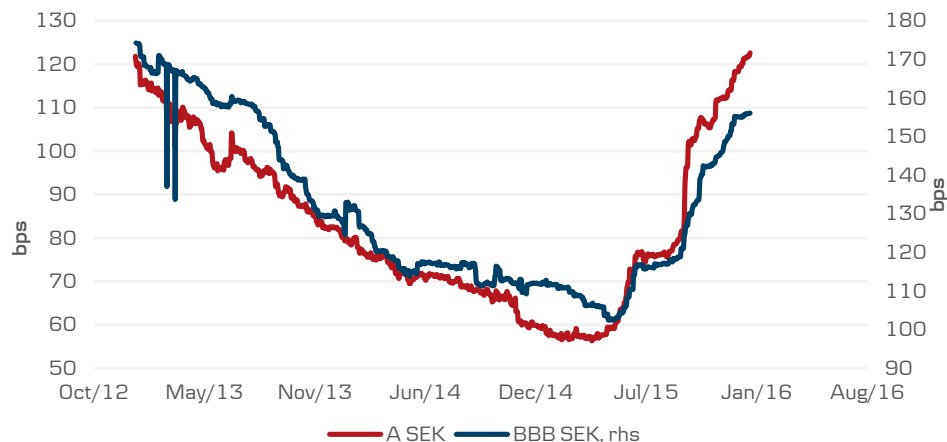
## Swedish vs foreign issuers (Corporates)



Source: Danske Bank Markets, Bloomberg (all charts)

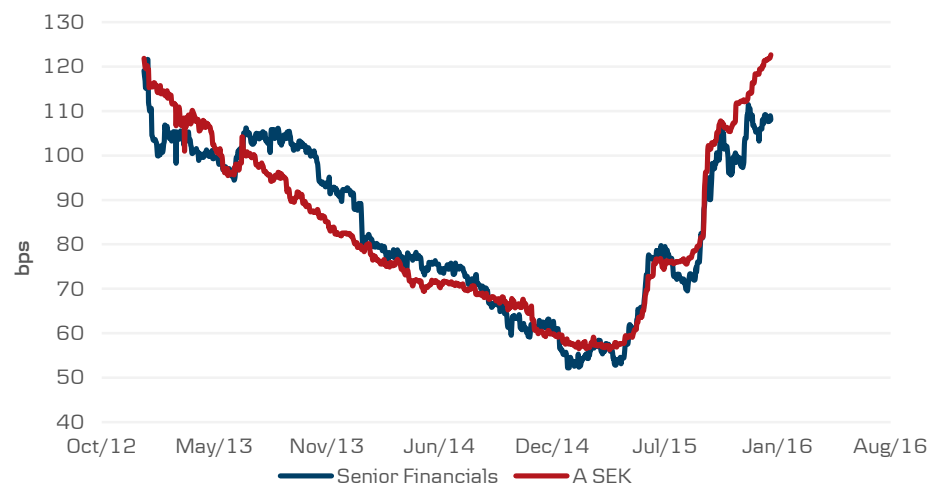
# Spread development and curves

## Spreads investment grade corporates, 5 year

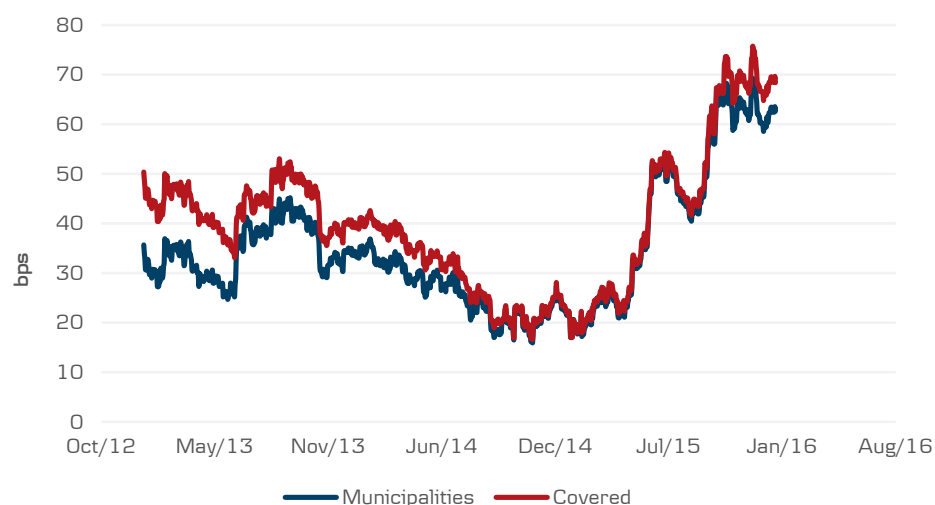


- Major widening has been seen across all rating segments over the past year with covered bonds leading the way.
- The five-year covered and municipalities spread has increased significantly since the bottom in January 2015 and is up more than 50bp since then. The difference in spreads between covered and senior financials has decreased but diverged slightly at the end of 2015.
- An average A category SEK 5Y bond has widened by more than 60bp since the lows in April, while the BBB category for the same maturity has widened around 55bp over the same period. Spreads in the senior financials space have widened slightly less than A-rated corporates over the past few weeks.

## Spreads A-rated corporates vs senior financials, 5 year



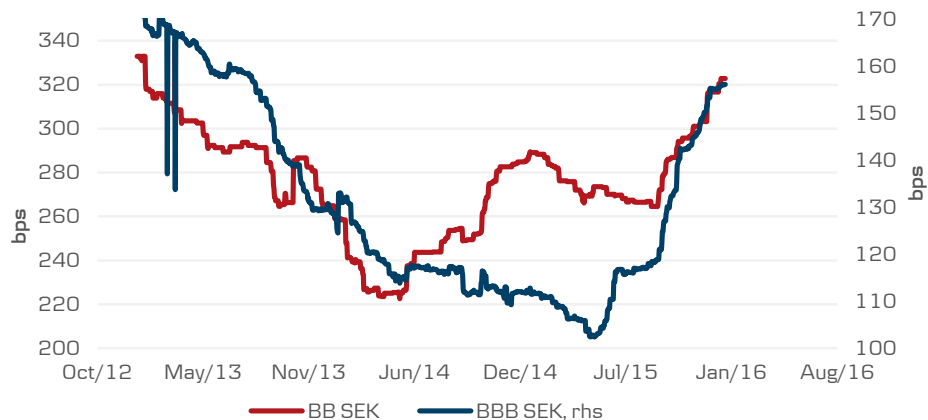
## Spreads covered vs municipalities, 5 year



Source: Danske Bank Markets, Bloomberg (all charts)

# Spread development and curves

## Spreads X-over, 5 year



- SEK high-yield bonds followed the widening trend in the latter part of the year and a generic BB category 5 year bond is some 55bp wider since October. Liquidity remains very poor and we continue to see repricing risks within the segment.
- For the A-category, the bid-ask spread has remained fairly unchanged over the year, with a spike in October due to several name-specific events and a widening in the covered space.
- In the BBB category, the bid-ask spread has showed a similar trend as the A-category and is somewhat wider over the year.

## Bid offer development – A rating category

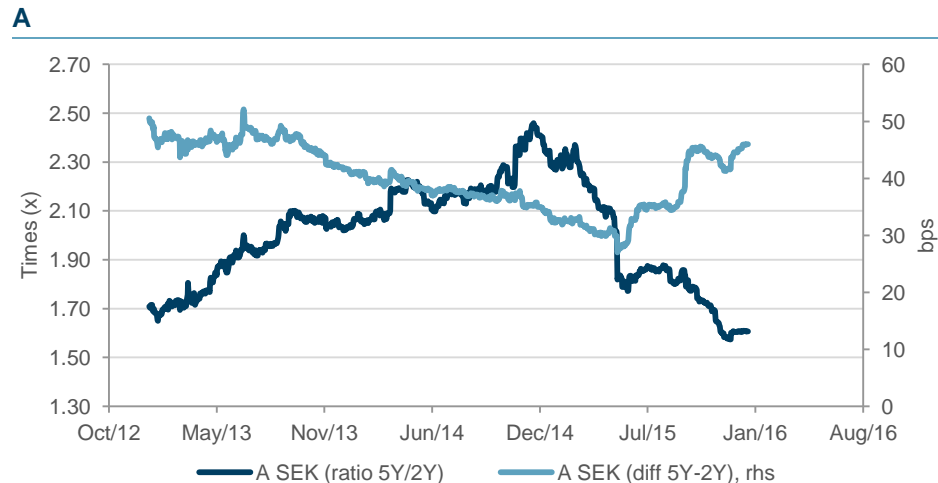


## Bid offer development – BBB rating category

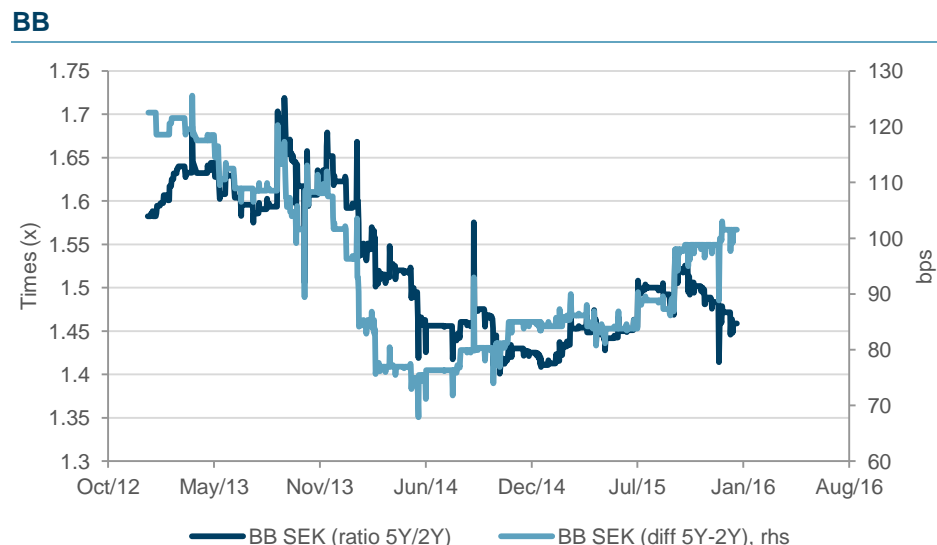
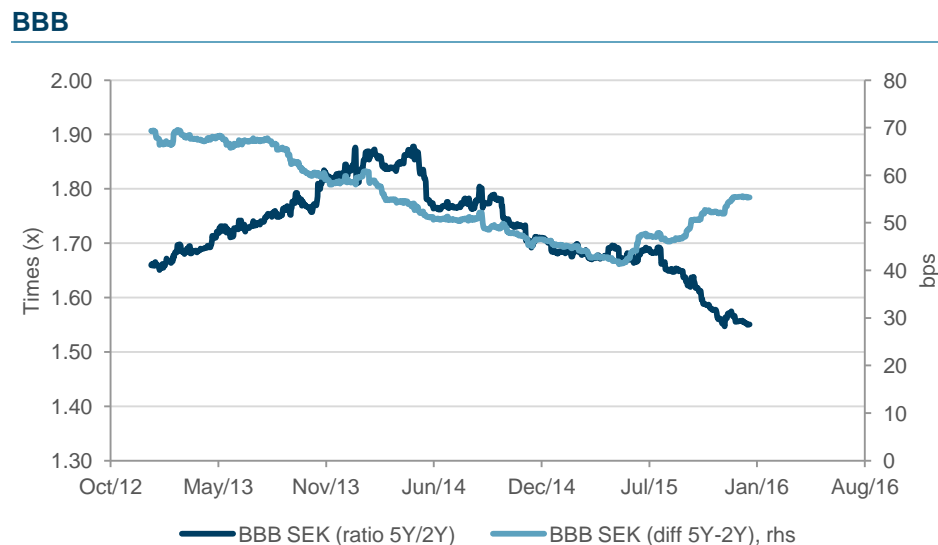


Source: Danske Bank Markets, Bloomberg (all charts)

# The curvature of the rating categories



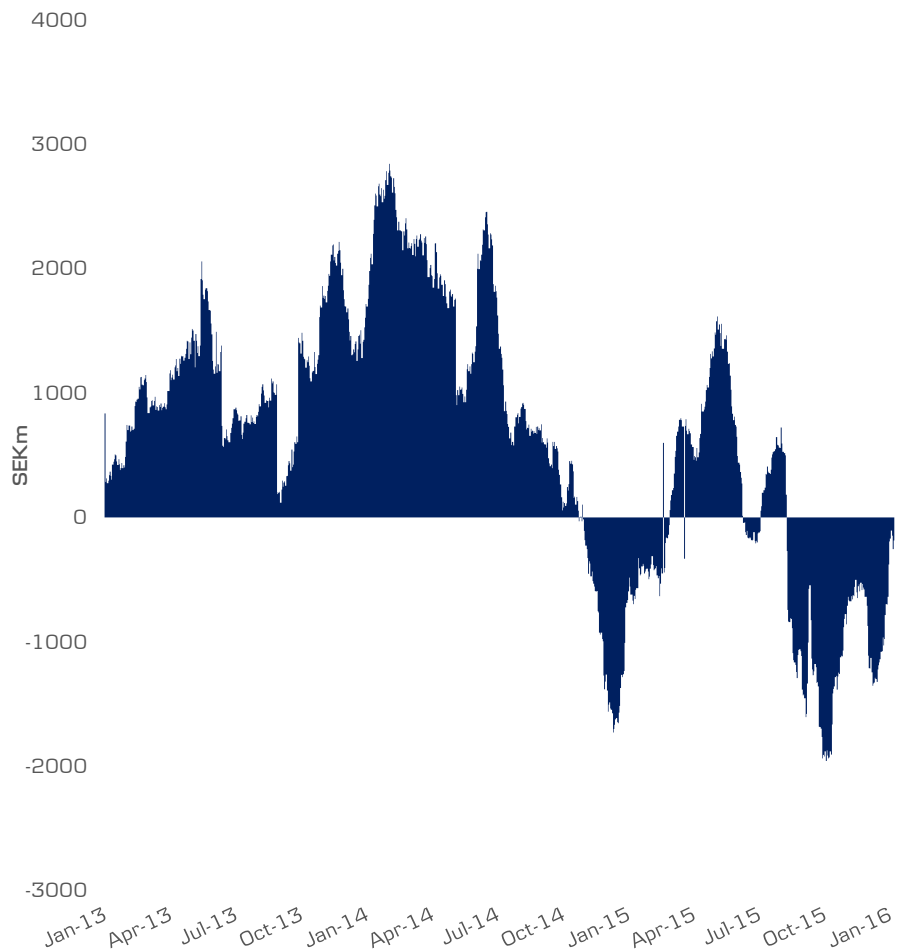
- To conclude where we find the best value on the curve and to get a sense of whether the curves have been steeper or flatter, we look at the ratio between the 5Y and the 2Y point and the difference between the two for our rating curves.
- In the A category, the trend has been flatter curves and the ratio between 5Y/2Y implies the two-year point should be more attractive in a risk/reward perspective. Within BBB, the trend is the same and the ratio between 5Y and 2Y is c.1.55x. In basis points terms, around 55bp is paid to extend the maturity by three years.
- In BB, the picture has been slightly different, with widening at the longer end throughout the year. However, at the end of 2015, the curves have flattened and we consider the extra 100bp offered for a three-year extension as insufficient.



Source: Danske Bank Markets, Bloomberg (all charts)

# Fund flows high yield

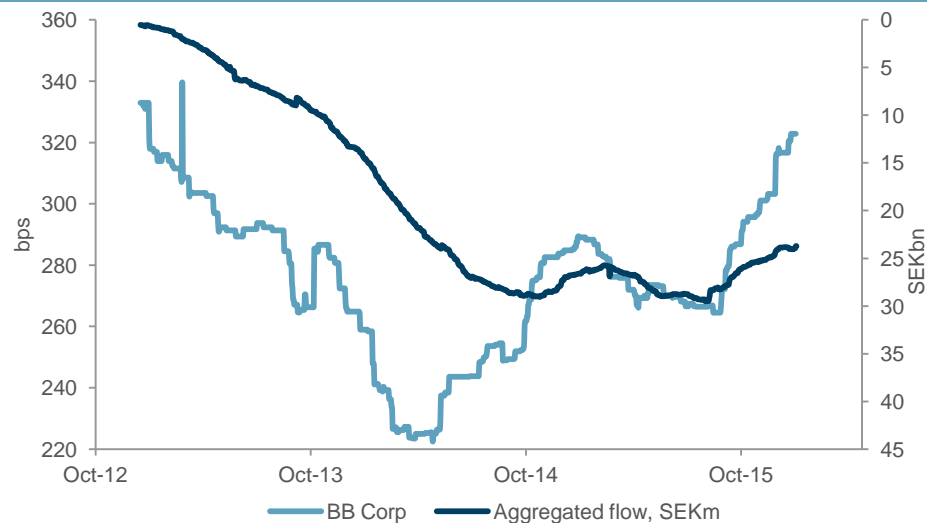
## High-yield fund flow, rolling 30 days



Source: Danske Bank Markets, Bloomberg (all charts)

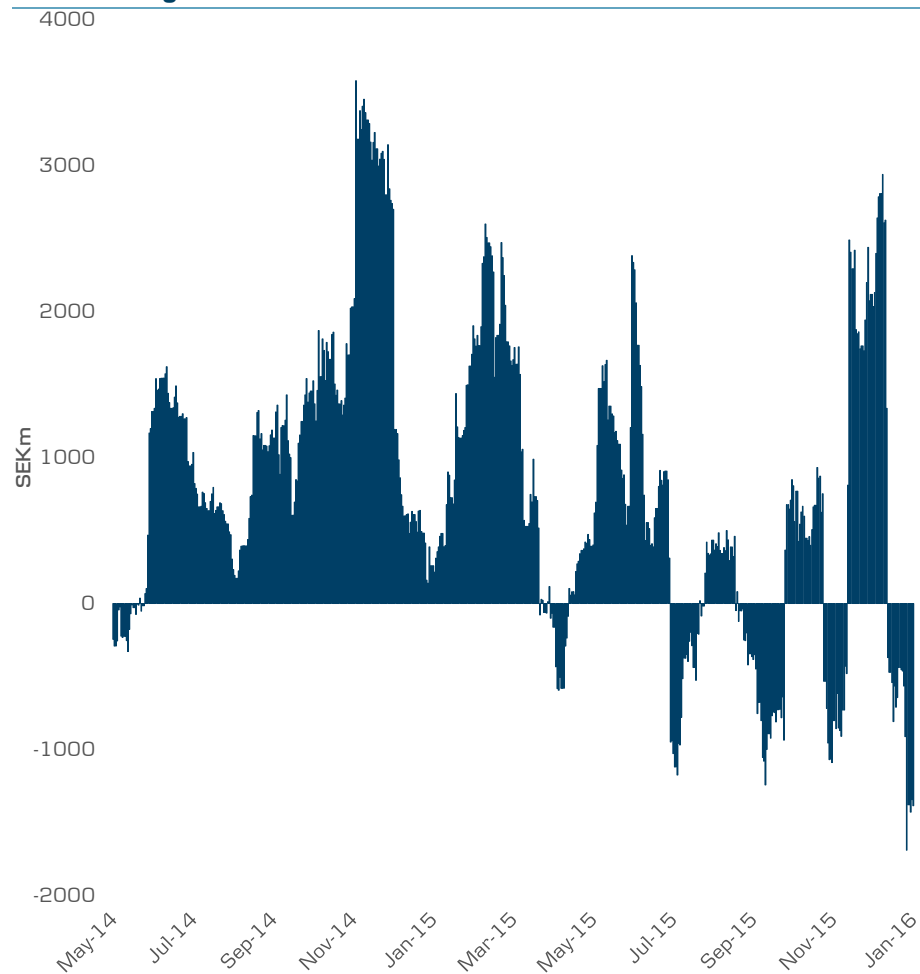
- To get a better view of the fund flows in the SEK market, we have classified funds into high yield or investment grade and used the reported NAV and total assets value to illustrate the direction of the flow.
- Over the past four months, there has been aggregate outflow for the Swedish HY funds. The flow has followed the widening trend seen in the BB segment and in the high-yield territory it seems that there is a strong link between performance and flows, which intuitively feels right.

## Spreads vs aggregated flow (inverted)



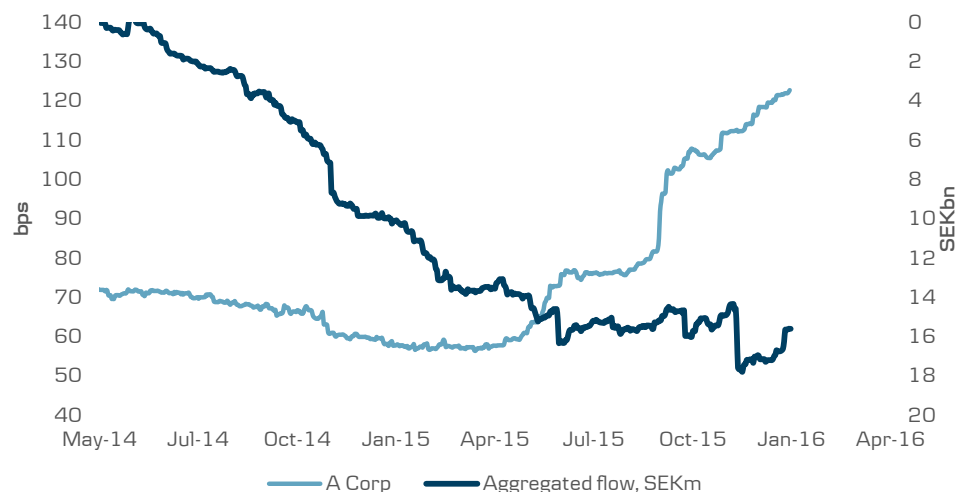
# Fund Flows IG

## Investment-grade fund flow



- On an aggregated basis, investment-grade funds shows more or less neutral development over the past six months, although with mixed flow between the months.
- In general, and historically, spreads and flow seem to have a strong correlation – at least until the sharp repricing seen over the latter part of the year. The decoupling of flow and performance is, in our view, due to more ‘sticky money’ in the investment-grade universe.
- However, as a result of the weak performance, we believe we could potentially see more outflow and shifts into other asset classes at the beginning of 2016.

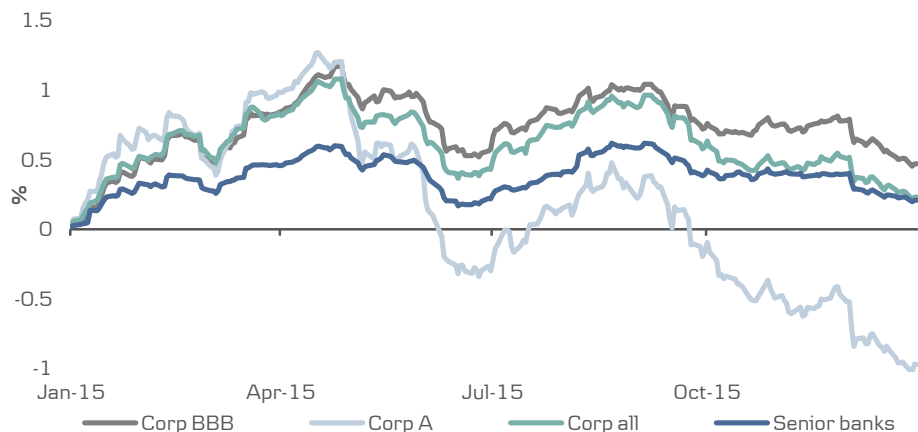
## Spreads vs aggregated flow (inverted)



Source: Danske Bank Markets, Bloomberg (all charts)

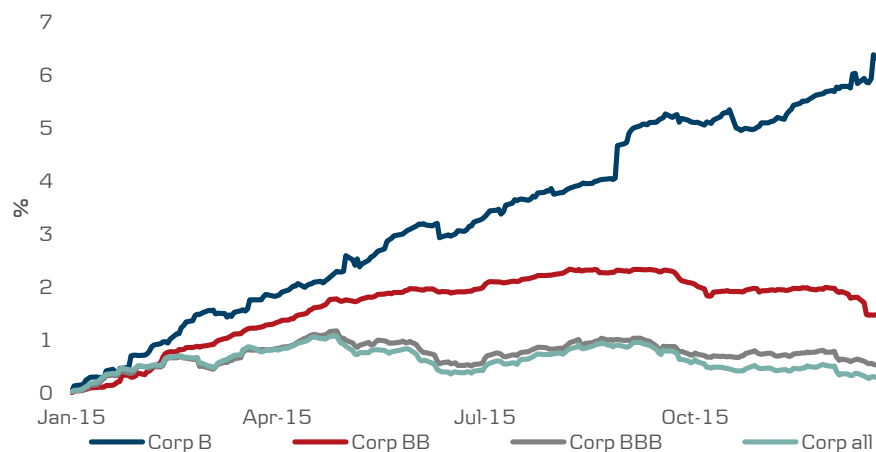
# Total return

## Total return investment grade

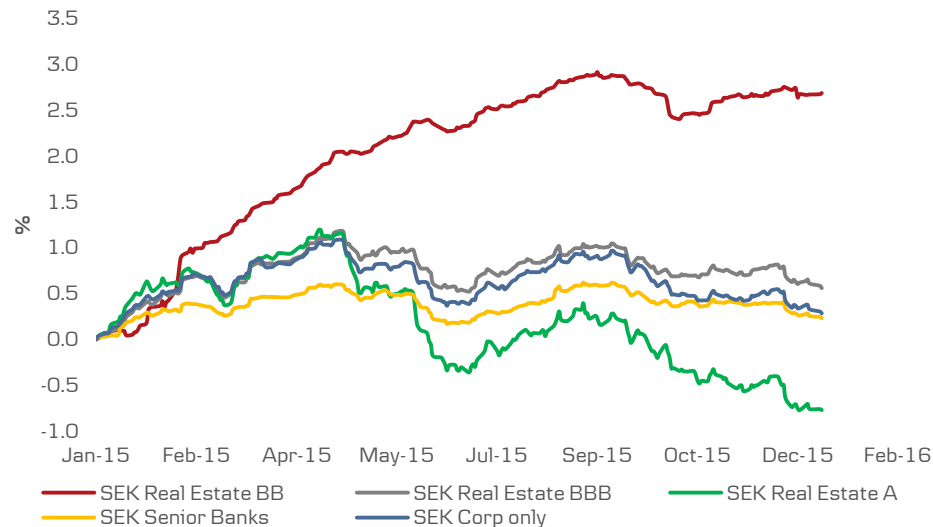


- At the beginning of 2015, the A category outperformed the other investment-grade categories but in the latter part of the year it was the other way around. The A category contributed a negative total return of almost -1%. A portfolio consisting of senior banks had a total return of around 0.22% and BBB category 0.45%.
- Within the high-yield segment, a portfolio consisting of SEK BB bonds had a return of around 1.5%, while B showed a total return of 6% in 2015.
- In the real estate spectrum, there were also deviations between the categories. The BB category performed strongly in 2015, while A-rated names, as for corporates, underperformed the most. Real estate BB showed a total return of 2.6%.

## Total return high yield/X-over



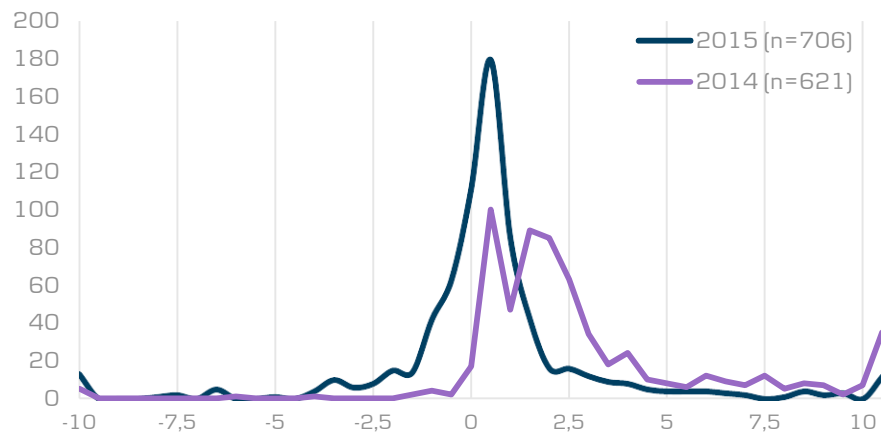
## Total return real estate



Source: Danske Bank Markets, Bloomberg (all charts)

# Total return distribution

## Total return histogram non-financials (y-axis = no. of bonds)



- Looking at the distribution of returns of all SEK non-financial bonds, 2015 was in a way a more 'normal' year than others in recent memory despite showing a lot weaker returns on average.
- The significant positive skew in 2014 turned into a fairly well shaped bell curve in 2015. A total of 184 bonds delivered negative return in 2015 (15 in 2014), while the number of bonds with very high return (10%-plus) also decreased from 35 to 12.

## Top performers (total return)

TAGRSS 11 08/31/17 #	23,17%
AINMTS 9 ¾ 03/19/19	18,41%
TRADSS 6 ¾ 12/20/18 #	17,71%
DMORPH 7 09/05/19 #	13,85%
SASSS 9 11/15/17 #	13,65%
ESTANL 7 ½ 05/29/19 #	12,78%
TLFSTO 10 05/22/16 #	11,57%
BEFSE 9.4 10/30/17 #	10,42%
MAGBOS 8 05/02/18 #	10,08%
BACTI 11 12/12/16 #	10,03%

## Worst performers (total return)

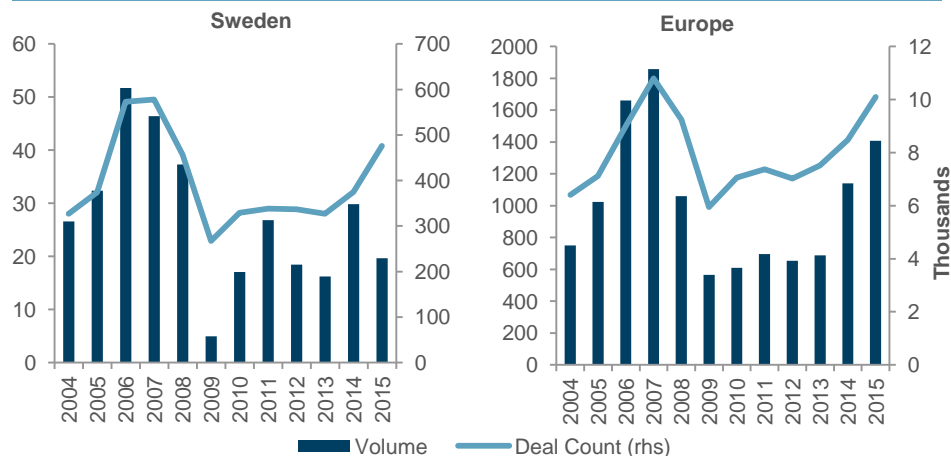
STAAKA 3 ? 04/24/37	-14,33%
STAAKA 3 ¾ 10/15/41	-14,41%
STAAKA 4.35 07/08/41	-14,52%
STAAKA 2.95 09/17/42	-17,72%
BERTMT 0 04/22/20 #	-17,85%
MOBHOL Float 05/23/18	-18,27%
STAAKA 2.08 04/17/45	-31,39%
SDRLNO Float 03/18/19	-34,60%
CNDYKG Float 01/29/18	-50,40%
PARSS 13 ½ 03/03/16	-99,26%

Source: Danske Bank Markets, Bloomberg (all charts and tables)



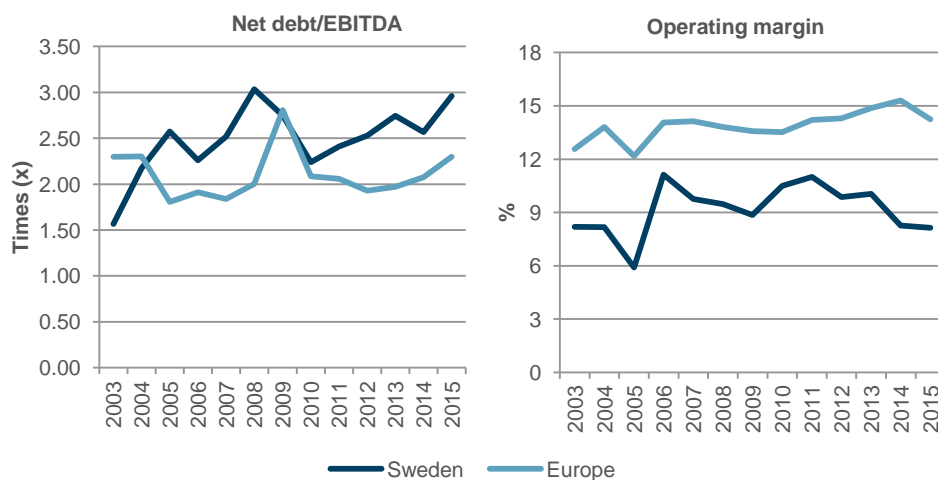
# Credit health metre

## M&A activity (Sweden and Europe) (USDbn and no.)

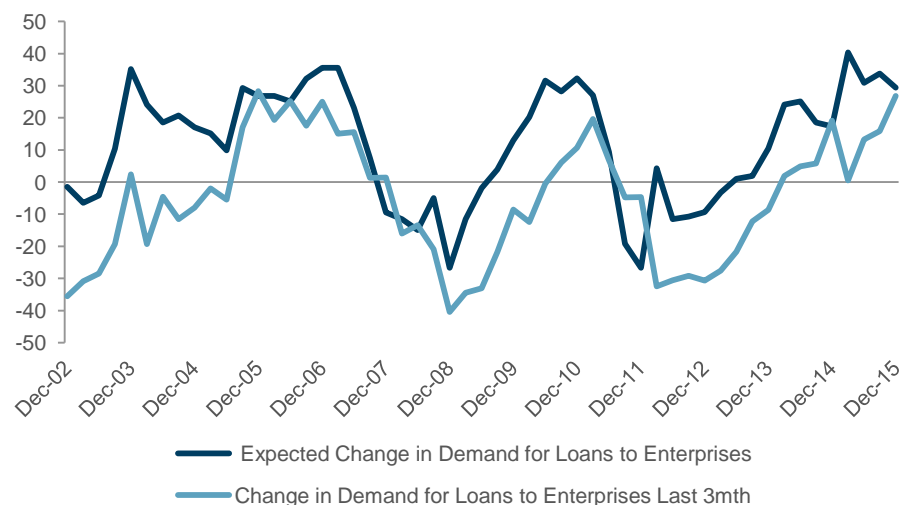


- In 2015, Swedish M&A activity was muted compared with Europe as a whole. However, it is interesting that the number of deals has increased but the average size of the deals has decreased significantly.
- On an aggregated basis, leverage has increased among the largest listed companies in Sweden as well as in Europe over the past few years. For the Swedish aggregate, reported net debt/EBITDA has increased towards 2007 levels, while European companies seem to have been more cautious. Margins have remained fairly stable but decreased somewhat in 2014-15, particularly in Sweden.
- The ECB's bank lending survey points to continued supportive banks in Europe.

## Credit metrics



## ECB bank lending survey



Source: Danske Bank Markets, Bloomberg (all charts)

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