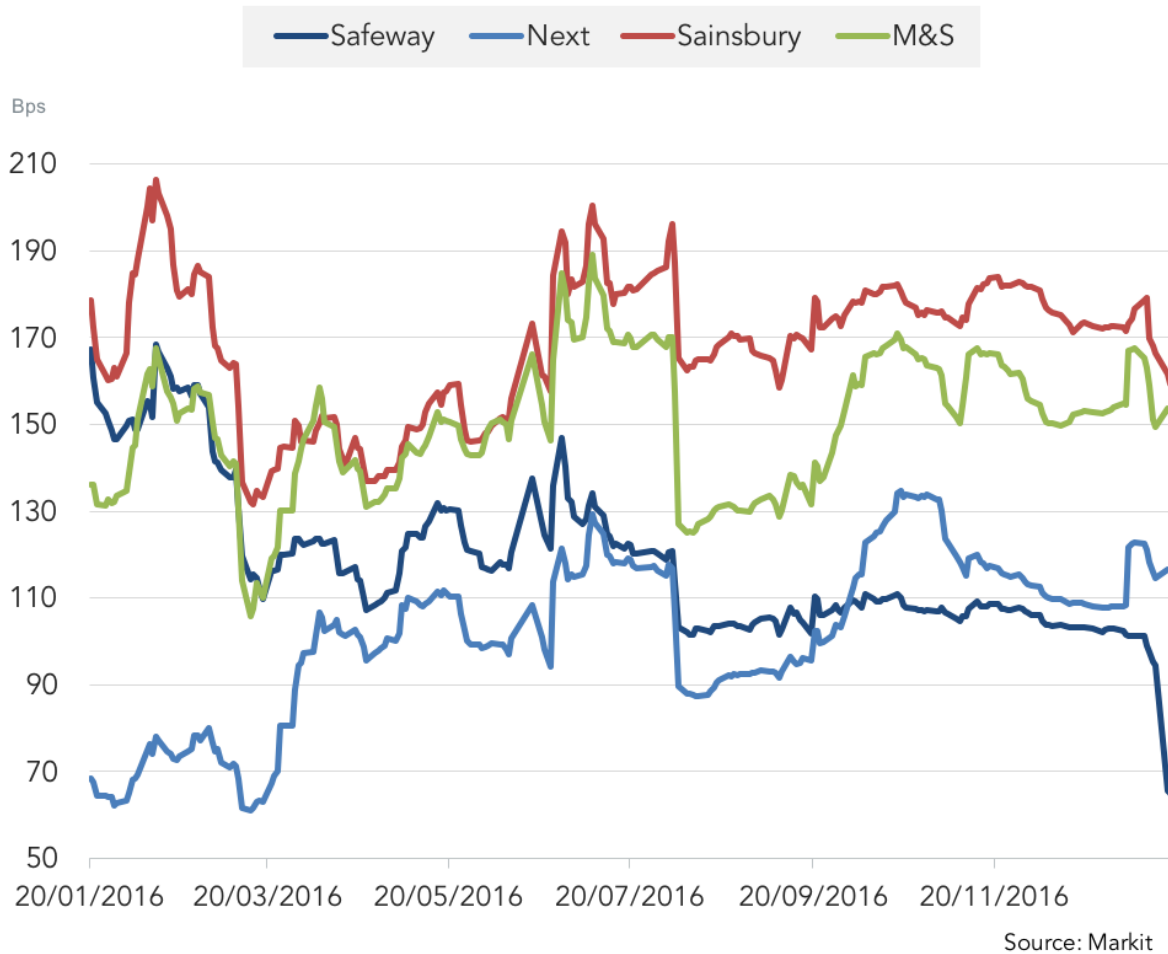


Markit Recap – 1/16/2017

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Speeches by UK prime ministers were rarely market moving events, despite what some of the more breathless commentators in the broadcast media would have you think. But perhaps this has changed since the Brexit referendum in June last year, even if the spin doctors manage the message in advance.

The main thrust of Theresa May's speech this week was leaked in the days leading up to her address, so traders and investors were not exactly hanging on her every word. But there were still some pronouncements that did affect sentiment, particularly in the FX markets, such as the confirmation that the final deal will be put to parliament.

The credit markets were more subdued, as they have been since the beginning of the year. But there is little doubt that Brexit is factor for credits with high UK exposure. Take the retail sector, for example. Performance has been lacklustre, at best, since the boost from the Bank of England loosening measures in August. High street

chain Next posted disappointing Christmas sales and warned of a tough year ahead; its spreads are now trading at 116bps, 26bps wider than the Bank of England's action. Marks and Spencer has also struggled, while supermarkets such as Sainsbury and Tesco have held up better.

Given the rise in inflation and a sharp increase in producer prices, it is no surprise to see protection buying on names exposed to UK consumers. However, a bearish position certainly wouldn't have paid off on Safeway Plc. This credit cross guarantees the debt of WM Morrison – a smaller competitor to Tesco and Sainsbury – and hence trades in the CDS market. Up until this week, the firm's spreads were range bound at 90-110bps. But on January 16 they dipped sharply to 65bps after a tender for the outstanding 2018 Safeway bonds. It could leave the name perilously short of deliverables if the cross-guarantee is eliminated, and therefore markedly increases orphaning risk.

This news drove the spreads in Safeway tighter. It demonstrates that CDS users need to be monitoring changes in financial policy and corporate structure, as well as factors such as profitability and leverage. What can seem a no-brainer strategy can come undone, even if the fundamental logic remains sound.

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