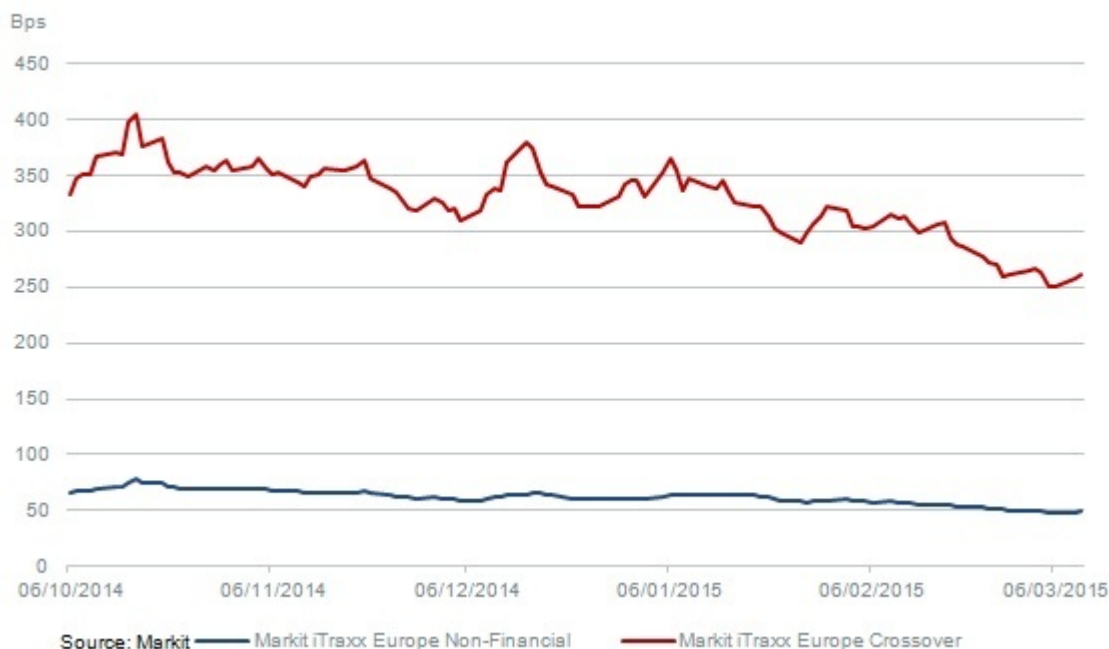


Markit Recap – 3/9/2015

THE LEAD | March 11, 2015

Central bank domination of financial markets entered another level this week with the commencement of full QE in Europe. National central banks, at the behest of the ECB, began their purchases of government bonds on March 9. Yields on sovereign bonds in several countries were already negative before the start of QE, and they descended even further when bond buying began in earnest.



The effects on the credit markets are multi-faceted. But there is little doubt that the expectation of QE has compressed spreads, particularly at the lower end of the ratings scale. Sovereign yields are at rock-bottom, and investment grade debt is not much better, leaving fixed-income investors little choice other than the high-yield market.

If one is looking for evidence, then look no further than the upcoming CDS index roll. Normally, the constituents of the Markit iTraxx Crossover index are required to have a spread at least twice the average spread of the Markit iTraxx Non-Financial index to be eligible for inclusion. But this requirement has been relaxed to 1.5 times the Non-Financial spread for the March roll and onwards. The rally in sub-investment grade credit – the Crossover tightened from 400bps in October to 250bps last week – has been so strong that many high-yield names are trading at levels that investment grade firms might find respectable.

The impact of central bank intervention on the eurozone's periphery is profound. Sovereign debt issued by the likes of Portugal and Spain is trading at miniscule yields; indeed, Portugal's 10-year debt is trading below 2% for the first time on record. It is even lower than the US equivalent, the first time this has arisen since 2007.

The US is on a very different monetary path to the eurozone, and this reflected in the chasm between US and core eurozone yields. Last week's strong jobs report has fuelled expectations that the Federal Reserve will finally hike rates, perhaps as soon as June this year. There was a telling reaction in the markets – share prices fell and credit spreads widened. Even in the US, where the economy is performing strongly in comparison to other developed countries, investors are uncertain whether current valuations can be maintained without loose monetary policy. The attraction of a region where the central bank is committed to intervention – the eurozone – may be difficult to resist.

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