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Markit Recap – 9/28/2015

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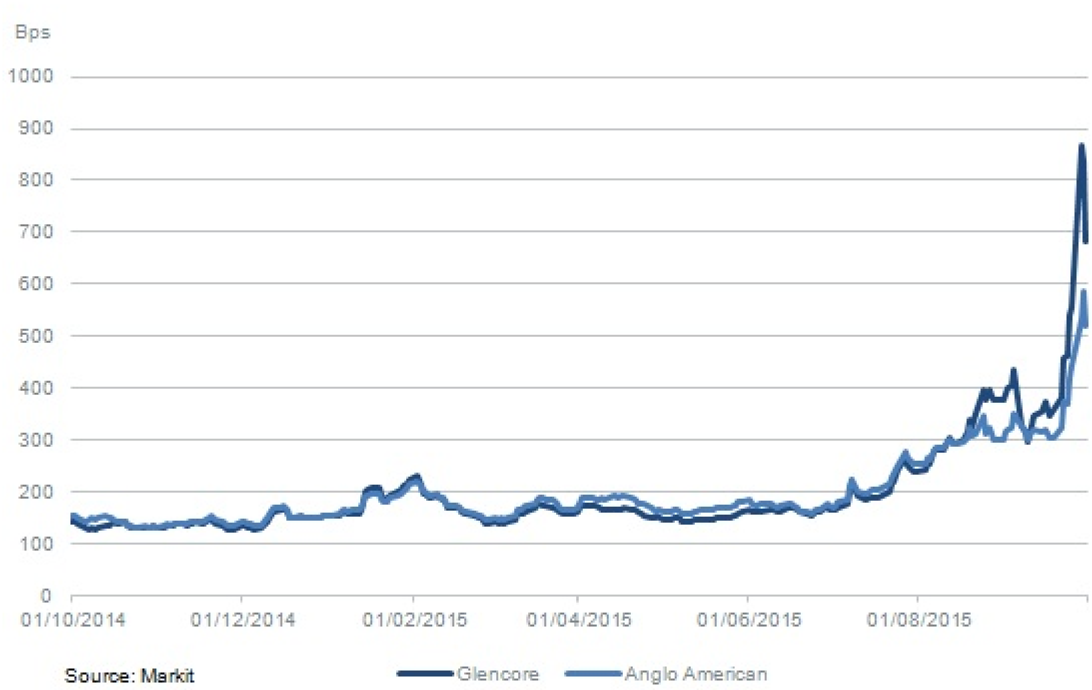
In recent years, the credit markets have become accustomed to volatility, despite the best efforts of central banks to tame the beast. But where it was sovereigns and banks that were the instigators during the crises of 2007-2012, in 2015 it is the commodities sector that is providing the oscillations.

Nowhere was this more evident than in the performance of Glencore. The company's spreads exceeded 900bps and its curve inverted on Monday September 28 following reports that the firm's equity would be wiped out if commodity prices stayed at current levels. This is well into junk territory; indeed, Glencore now has an implied rating of CCC, according to Markit data. It couldn't be clearer that Glencore's efforts to reduce debt and salvage its investment grade rating (including a $2.5bn share issue, assets sales and cancelling dividends) haven't convinced the credit markets.



By Thursday October 1, Glencore's curve had tightened at the short-end (though it was still inverted) and five-year spreads had recovered to 600bps, an improvement from earlier in the week but still more than 400bps than where it was trading three months ago. Some may question liquidity in Glencore's CDS given the drop in trading activity compared to pre-crisis levels. The bid-ask spread ballooned to over 100bps in Monday when the name was at its most distressed, suggesting that liquidity has been impaired. But DTCC data showed that Glencore was the second-most heavily traded corporate credit in the week ending September 25, with $2.2bn gross notional (only Volkswagen traded in higher volumes). It would be no surprise to see it take first place this week. Anglo American, the credit most directly affected by the Glencore contagion, also traded heavily.

Glencore has taken steps to reassure investors that its debt reduction plans are credible, and has opened up its balance sheet – sometimes criticised as opaque – to greater scrutiny. In particular, it has revealed details on its $17bn of inventories and said it will free up capital by reducing less profitable trading activity. We will find out soon if this is enough to prove the markets wrong and stave off a descent to junk.

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