Bond Market Outlook

Bond Market Contact Group
Meeting of January 22th, 2013

redefining / standards

AXA

Government Bonds
Market outlook

Market Outlook

- Lower gross issuance in the Eurozone from €811bn in 2012 to €732bn(e) in 2013
- Substantial issuance decline from AAA/AA Eurozone countries from €190bn in 2012 to €130bn (e) in 2013
- Higher need of highly rated paper for collateral uses (EMIR, central clearing set up)

- But macro economic conditions still challenging in Europe and sovereign rating downgrade risks not excluded
- Substantial net new issuance from France at €62bn, Spain €28bn or Italy €23bn expected for the year 2013
- Italy the second largest gross issuer in the Eurozone with €155bn expected in 2013

- Announcement of OMT by ECB: a critical breakthrough perceived by markets and investors to stabilise the government bond markets
- Progressively re-opening risk appetite for periphery countries among investors

Data source: BNPP

Government Bonds
Current appetite and investment considerations

- **Investment considerations :**
  - Long term investment for duration management purpose
  - But existing investments already sizeable exposing us to potential rating downgrade and yield volatility
  - A credit component introduced in what was formerly perceived a risk free asset
  - Inclusion of Collective Action Clause, CAC, not a game changer and no additional cost seen relative to non CAC bonds
  - Greek PSI left a bad case in memories

- **Current appetite :**
  - Current absolute low yield in AAA/AA countries
  - Risk of yield increase / normalisation
  - No significant appetite for taking long Core government bonds at current levels
  - Reallocation towards quasi-govies (supranationals / agency) with potential spread pickup versus Government bonds
  - Search for new asset classes with low volatility and stable cash flow profiles enabling long term investments (such as infrastructure debt)
  - Renewed appetite for selected Periphery government debts but with shorter duration

- Search for long dated assets to match duration target remains a key ALM challenge

Bank senior, covered and structured
Market outlook

Bank senior bonds :

- Market size of €450bn
- €160bn expected gross issuance and negative net issuance of minus €100bn in 2013
- Impacted by substantial rating downgrades in the last 3 years
- New resolution framework and bail-in clauses after 2018
- Massive spread compression after the period of market stress with elevated spread volatility

Bank covered bonds :

- Market size over €1tn
- Negative net issuance expected for the year 2013
- Importance of covered bond legislation and protective framework
- Credit quality resilience and relatively highly rated instruments in Core European Countries
- Some emerging concerns over the degree of asset encumbrance of bank balance sheets

Bank securitization products :

- Limited issuance expected in Europe with relatively tight spread pick-up
- More opportunities expected from the US markets (size, issuance level)

Bank, covered and structured
Current appetite and investment considerations

- **Bank senior bonds :**
  - Improving credit profile mitigating new bail-in legislation risk for investors
  - No appetite for subordinated bonds given elevated equitization risk
  - Very selective process and risk/reward analysis to identify investment opportunities
  - Focus on “National champions “

- **Bank covered bonds :**
  - Secured investments backed by resilient pool of assets in most Core countries
  - Can be considered for long dated investments
  - Current spread level and low yield constraining attractiveness
  - Some few opportunities in Periphery Countries after very selective process and relative value analysis versus government bond/unsecured senior debt

- **Bank securitization products :**
  - Limited appetite in Europe under current market conditions
  - Some opportunities found in the US market (CLO, credit cards, auto loans, etc)

Corporate Credit
Market outlook and current appetite

- **Market outlook :**
  - Growing asset class with a market size over €600bn for investment grade corporates
  - €170bn(e) gross issuance and positive net issuance of €30bn(e) in 2013
  - High Yield European market of smaller size around €250bn
  - Macro economic conditions in Europe still challenging
  - Compressed yield and spread for IG Core Corporate (less 2% of market average yield)

- **Current appetite :**
  - Key rationale for investment remains diversification of fixed income exposure and yield pick-up versus Government bonds
  - Targeted duration of 5 to 7 years due to uncertainty risk over longer horizon
  - Very selective process due to credit, rating migration and liquidity risk
  - Diversification outside Europe remains a clear objective through Emerging markets and US, but already few left opportunities in the US after the rally
  - Search for new opportunities in the loan market (infra / private placement) to get spread pick-up while forgiving some liquidity