

Covered bonds outperform in volatility

European covered bonds are the sole corporate bond sector still in positive total return territory for the year so far, encouraging ETF investors to return to the asset class.

- Markit iBoxx € Covered index is up by 60bps for 2015 to date
- Euro denominated covered bonds are now outperforming corporate bonds by 1.5%
- Covered bonds ETFs saw large inflows wake of the recent market volatility

European investment grade corporate bonds have had a turbulent ride over the last nine months. The Markit [iBoxx](#) € Corporates index returned 1.9% in the opening four and a half months of the year, only to relinquish all these gains in a subsequent 3.7% selloff triggered by fears of a possible Grexit. While the asset class has regained some of its lost ground, the index's total returns are still negative for the year, to the tune of 89bps.

Covered bonds buck the trend

Covered bonds have been a relative success story however as the asset class is the only subset of the bond market to post positive total returns in the opening eight months of the year, according to the Markit iBoxx monthly bond [report](#).

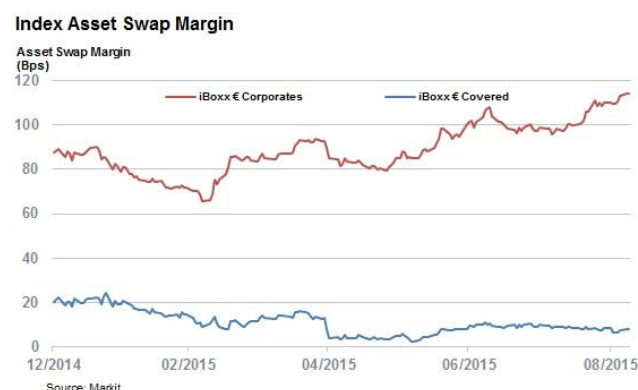


The asset class, as measured by the Markit iBoxx € covered index, briefly dipped into negative total return territory for the year during the worst of the recent volatility but returned to positive territory since the closing week of July. The corresponding corporate

bond index has so far been unable to match this achievement.

Covered bonds have traded in positive territory ever since July and the recent commodities slump saw the year to date total return differential between conventional and covered investment grade bonds surge to new highs with the latter now 1.5% ahead of its less secure peer.

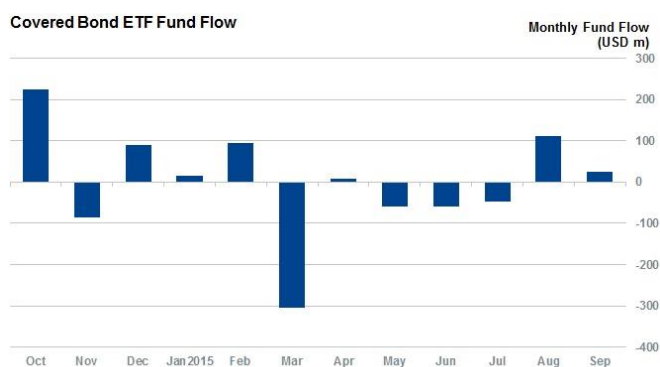
This trend looks to have been driven by increased credit risks priced into conventional euro denominated bonds as the asset swap margin of the Markit iBoxx € Corporates index, which measures the extra yield demanded by investors to hold the asset class over benchmark securities, has surged to a new yearly high of 114 bps as of latest count.



But covered bonds, which still benefit from their inclusion in the ECB's asset purchase program, have not seen the same trend as their asset swap rate stands at a very low 8bps, down from 20bps at the start of the year.

ETF investors pile in

The return differential between the two asset classes looks to have been noticed by ETF investors as covered bond ETFs have reversed the outflows which they [experienced](#) earlier in the year. This change in fortunes, which saw investors pull \$300m in the opening six months of the year, means that the 16 covered bond ETFs have are on track for their first quarterly inflow of the year in the third quarter after investors bought \$74m of exposure so far in the third quarter.



Investor demand to gain exposure to the relatively safer asset class has accelerated in the wake of the recent market volatility as last three weeks has seen investors pile over \$100m of assets into these ETFs.

Simon Colvin

Analyst

Markit

Tel: +44 207 260 7614

Email: simon.colvin@markit.com

For further information, please visit www.markit.com

The intellectual property rights to this report provided herein is owned by Markit Group limited. Any unauthorised use, including but not limited to copying, distributing, transmitting or otherwise of any data appearing is not permitted without Markit's prior consent. Markit shall not have any liability, duty or obligation for or relating to the content or information ("data") contained herein, any errors, inaccuracies, omission or delays in the data, or for any actions taken in reliance thereon. In no event shall Markit be liable for any special, incidental, consequential damages, arising out of the use of the data. Markit is a trademark owned by the Markit group.

This report does not constitute nor shall it be construed as an offer by Markit to buy or sell any particular security, financial instrument or financial service. The analysis provided in this report is of a general and impersonal nature. This report shall not be construed as providing investment advice that is adapted to or appropriate for any particular investment strategy or portfolio. This report does not and shall not be construed as providing any recommendations as to whether it is appropriate for any person or entity to "buy", "sell" or "hold" a particular investment.