



# Tabula iTraxx IG Bond UCITS ETF

An innovative concept in the EUR Corporate  
ETF Ecosystem





In January 2020, Tabula Investment Management launched its first cash bond Exchange-Traded Fund, the Tabula iTraxx IG Bond UCITS ETF. The fund references the iBoxx iTraxx Europe Bond Index, published by IHS Markit, and trades on the London Stock Exchange (and Xetra) under the ticker TTRX (and TABX).

The fund has already grown to over EUR 100 million in assets under management. It recorded a 53% AUM growth in April (including EUR 20 million of net flows) and added a further EUR 41 million in July, attracting investors due to its high concentration of bonds eligible for the European Central Bank (ECB) pandemic bond-buying program. This fund is a perfect fit for investors seeking a pure-play position in European corporate investment grade bonds with a consistent and stable duration profile, while also offering an effective investment vehicle to facilitate the trade of CDS bonds basis.

### Index overview

The TTRX fund is linked to the iBoxx iTraxx Europe Bond Index (IBXXITX1). This new index has been designed to reflect the performance of a basket of EUR corporate investment grade bonds replicating the credit risk profile of the iTraxx Europe Index. The latter is the most liquid European investment grade corporate credit instrument, covering 125 liquid European investment grade entities and used as a reference for both long and short credit default swap positions.

The iBoxx iTraxx Europe Bond Index selects up to three of the most liquid bonds for each entity\* in the current iTraxx Europe series. It includes only bonds with a minimum outstanding amount of EUR 500 million and remaining time to maturity of 3-7 years (extended to 1-10 years if an issuer has no bonds satisfying the 3-7 years range). The index is rebalanced semi-annually in March and September in line with the iTraxx Europe Index roll dates. Bonds are weighted such that each entity has equal notional weighting and the Index has an average maturity of 5 years.

Over the past years, the iBoxx iTraxx Europe Bond Index has performed well, with an annualized total return of 3.78% (Figure 1). The iBoxx iTraxx Europe Bond Index outperformed its relevant benchmark the iBoxx EUR Corporates Index, both in terms of average return and risk, with a Sharpe ratio at 1.42% (vs. 1.35% for the benchmark). The two indices have a low historical tracking error at 0.88%, while the iBoxx iTraxx Europe Bond Index experienced only half the max drawdown of the iBoxx EUR Corporates Index during the 2008 crisis (Table 1).

\*Due to the bond selection criteria, the Index may not include all entities in iTraxx Europe.

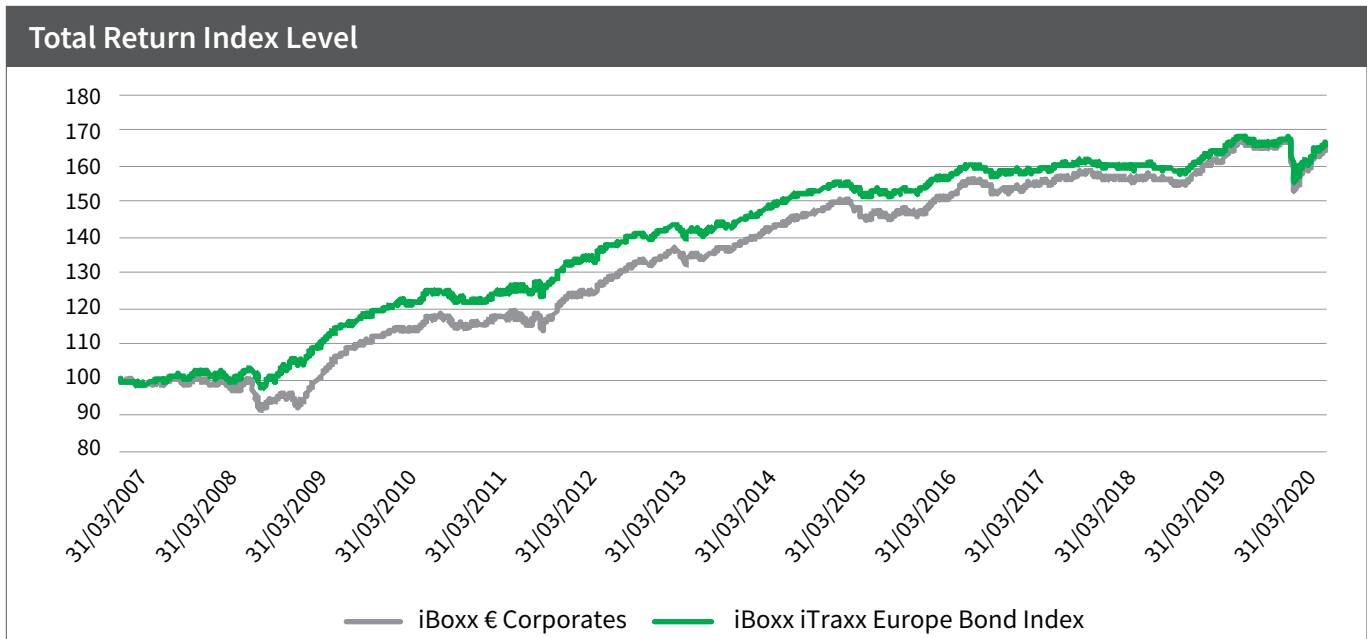


Figure 1 - Indices Performance (Total Return Index Level)

	iBoxx € Corporates	iBoxx iTraxx Europe Bond Index
Vol	2.77%	2.66%
Annualized Return	3.73%	3.78%
Sharpe Ratio	1.35	1.42
TE	-	0.88%
Max Drawdown	-8.34%	-4.96%
Max Drawdown Date	10/13/2008	10/15/2008
Number of bonds (as of 6/30/2020)	3056	268

Table 1 - Indices Performance

## TTRX compared to its peers

The COVID-19 pandemic has had a significant impact on the global economy, shaking financial and economic stability. The corporate bond ETF market was not spared, seeing funds trading at large discounts to net asset value (NAV) as traders struggled to price some of the less liquid securities. Some EUR corporate IG funds reached discounts of 6.5%. Because of its focus on the most liquid bonds, TTRX saw a maximum discount of only 3.9% (Figure 2), smaller than its peers.

As well as liquidity, there are some important differences between TTRX and other corporate bond ETFs that could have contributed to its resilience in the crisis:

### 1. High percentage of TTRX bonds part of the ECB bond bond-buying program

In response to this global economic crisis and resulting liquidity issues, the ECB announced their EUR 750 billion Pandemic Emergency Purchase Program (PEPP) to buy corporate bonds and ETFs as part of many measures to calm the markets. The ECB's announcement was well received by the market with equity prices recovering almost all their losses and credit spreads tightening to close to pre-pandemic levels. The iTraxx Europe Index spread is back to 72bps after a high at 135bps, and the liquidity in the investment grade corporate bond market has been reestablished (especially for bonds included in the PEPP).

Purchases of bonds under the PEPP are subject to eligibility criteria based on the asset categories. Because of its focus on the most liquid bonds, 80% of TTRX's holdings are part of the PEPP compared to 52% for the iBoxx EUR Corporates Index (Figure 3). This puts TTRX among the European corporate bond ETFs with the highest concentrations of bond supported by the PEPP and has contributed to investors' decision to move their assets in favor of TTRX fund.

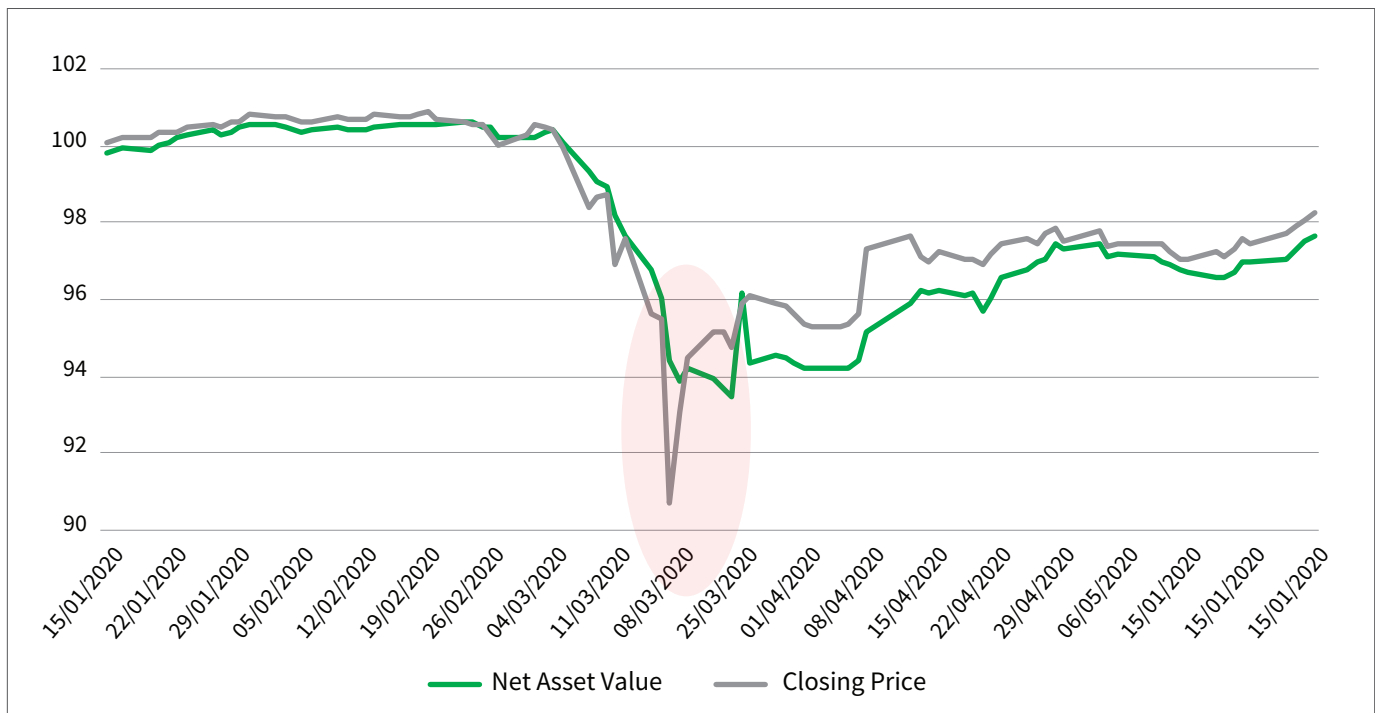


Figure 2 - Tabula iTraxx IG Bond UCITS ETF (Premium/Discount to NAV)

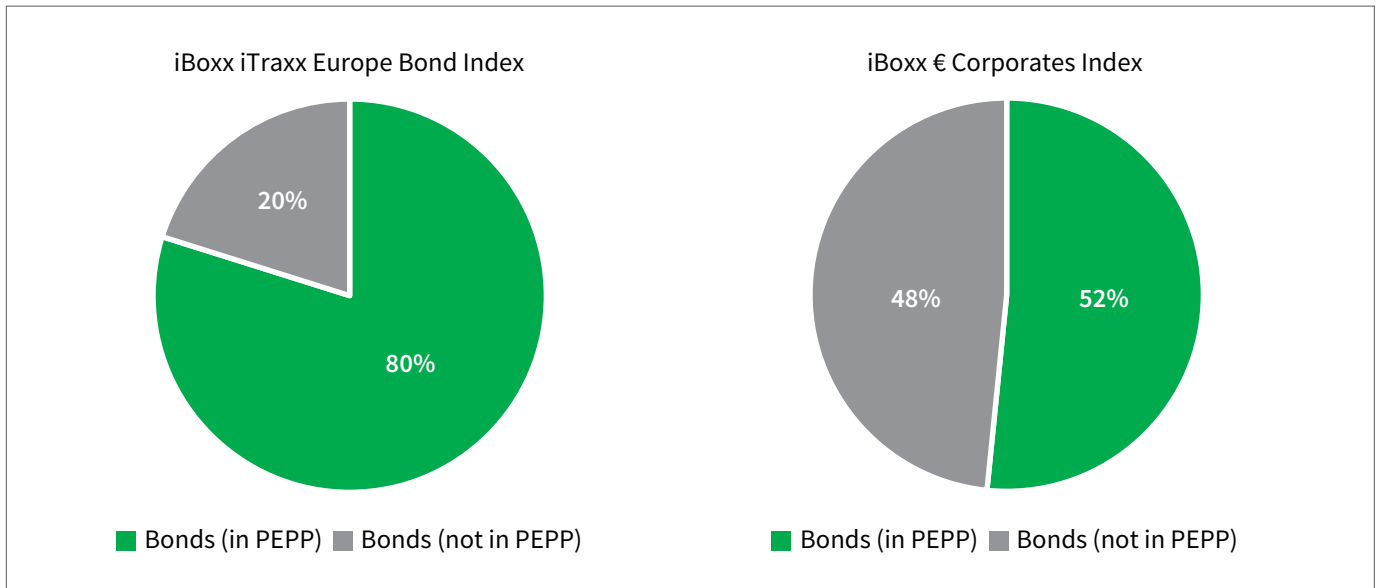


Figure 3 - Number of bonds part of the PEPP per index (as of May 31st, 2020)

## 2. Sector and issuer distribution

The iBoxx iTraxx Europe Bond Index is built to mirror the credit risk of the iTraxx Europe Index, including its supersector exposures across autos & industrials, financials, consumers, energy and TMT. The financial sector was one of the most impacted sectors in the COVID-19 crisis, experiencing negative momentum (in line with the flattening yield curve and lower interest rates). One long-term consequence of the pandemic is rates staying lower for longer, therefore tilting the outlook to a more negative bias. Looking at the latest composition, as of June 30<sup>th</sup>, the iBoxx iTraxx Europe Bond index was made up of 27% financials compared to the broad iBoxx EUR Corporate Index with 39% (Figure 4). The caps applied to supersectors in iBoxx iTraxx Europe Bond Index give it greater diversification and avoid the high exposure to financials seen with other corporate bond indices.

In line with the iTraxx Europe Index, the TTRX ETF also limits its exposure to issuers located in Europe. Other corporate bond ETFs invest typically invest according to currency, e.g. the iBoxx EUR Corporates Index has exposure to EUR-denominated corporate bonds with issuers from any region and, as a result, has 25% exposure to non-European countries, including 17% to the US (Figure 5). For investors with a view on the health of European corporates, these non-European issuers are less relevant as well as a source of additional risk.

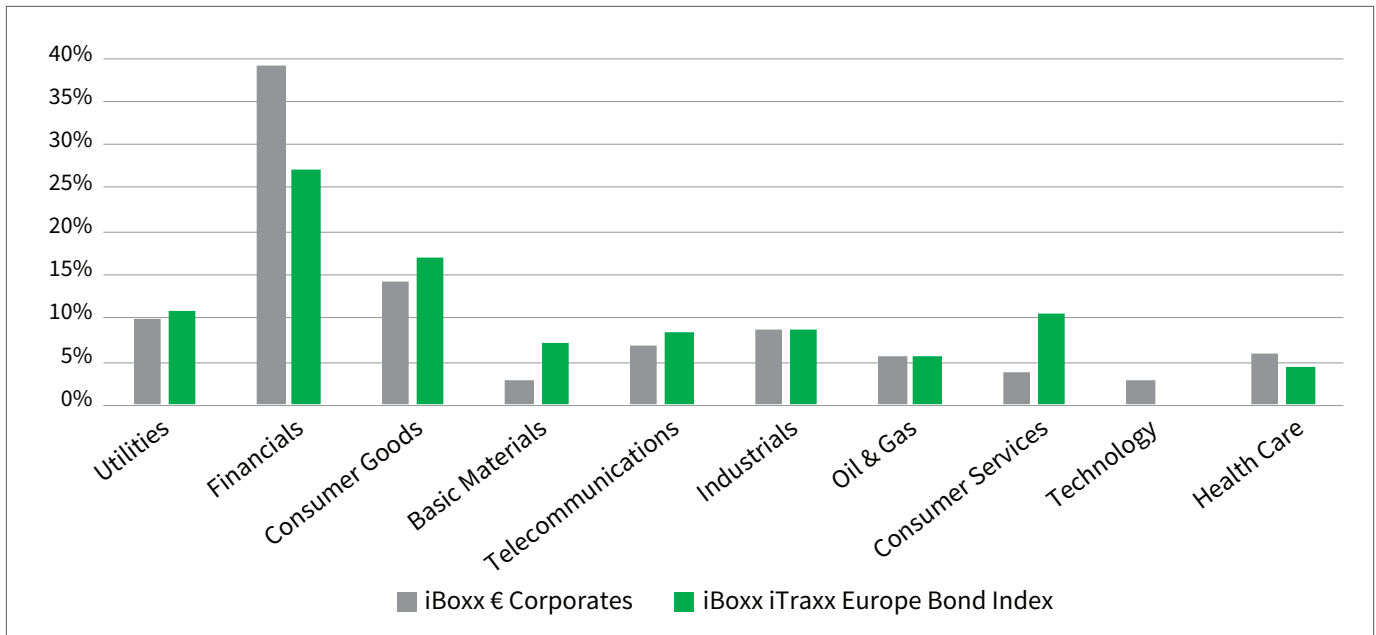


Figure 4 – Distribution by sectors (as of June 30<sup>th</sup>, 2020)

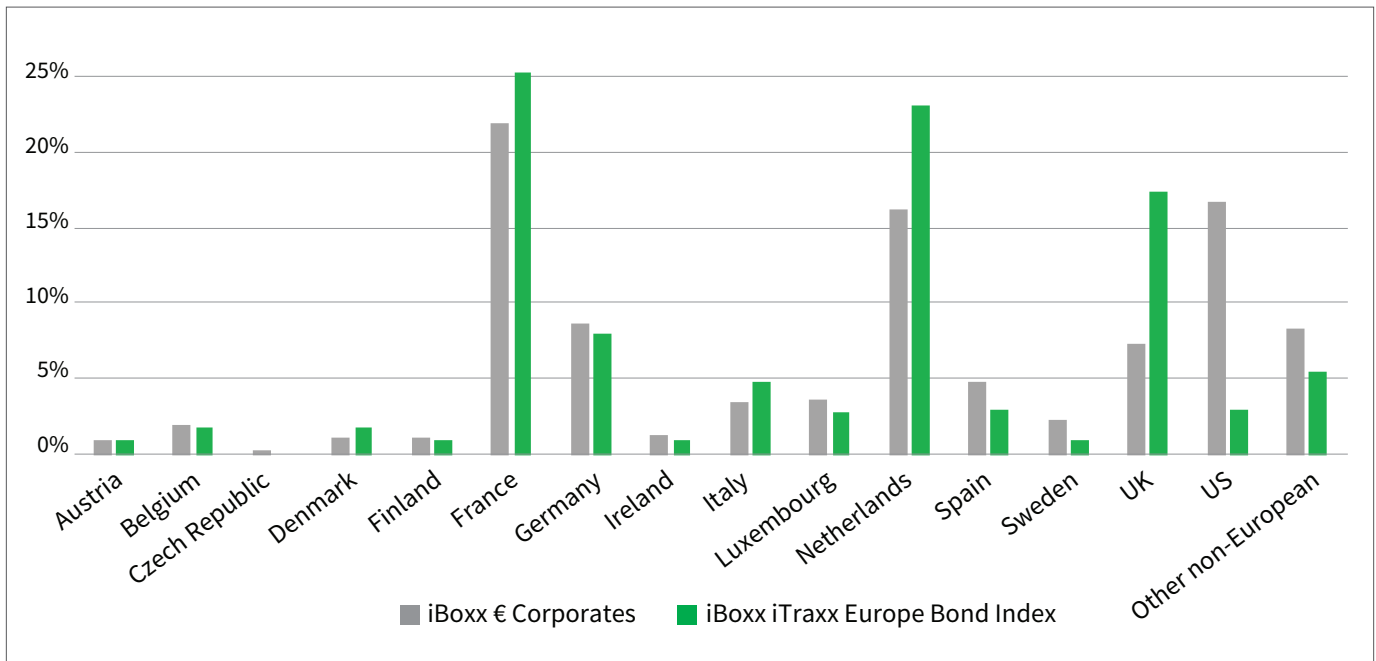


Figure 5 – Distribution by issuers (as of June 30<sup>th</sup>, 2020)

### 3. Mid-month vs. month-end rebalancing

Periodically, indices adjust their constituents to bring them back in line with the market or sector exposure they are tracking. The rebalancing process often takes place at the end of the month, however the iBoxx iTraxx Europe Bond Index is rebalanced semi-annually in March and September on the roll dates of the iTraxx Europe Index (March 20th and September 20th, or the business day immediately thereafter in the event that date is not a business day). At this point, the index assigns an equal notional weighting to each entity and has an average maturity of 5.25 years.

The iBoxx iTraxx Europe Bond index, by its specific design, benefits from having the iTraxx Europe Index as a natural hedging instrument; thus rather than liquidate the underlying bonds of the index in case of market turmoil, credit exposure can easily be hedged with the iTraxx Europe Index. Similarly, TTRX offers an effective investment vehicle facilitating the trade of CDS bonds basis. It's common to see financial institutions using some of the larger Euro corporate bond ETFs as a proxy bond basket when executing basis trades between bonds and CDS instruments. However, in a choppy market, these ETFs can see divergences between CDS and bond indices not driven by basis. From a performance and correlation standpoint, TTRX is more representative offering a better correlated Z-spread to the iTraxx Europe (85% vs. 81% for iBoxx EUR Corporates Index) and is structured in such way to significantly mitigate the tail-risk for investors trading the basis (Figure 6).

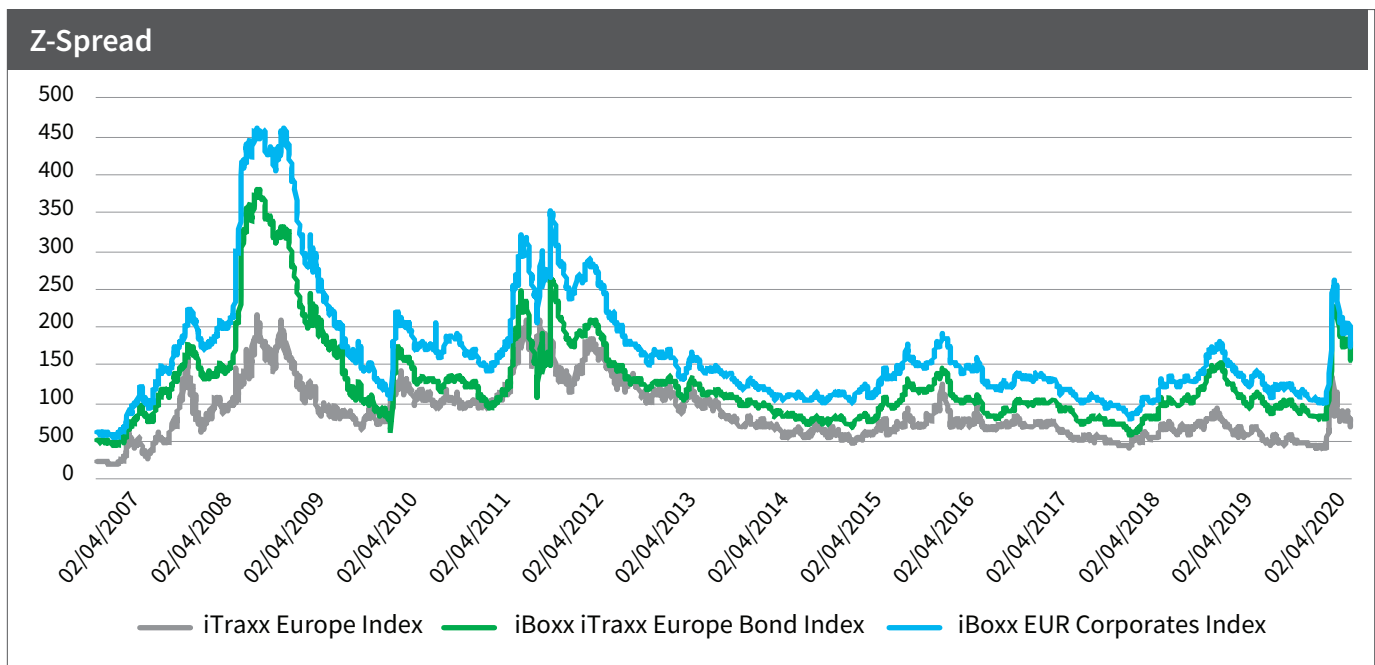


Figure 6 - Indices Performance (Z-Spread)

## What economic recovery shape? And what impact on the corporate bond market?

The COVID-19 pandemic hurt dramatically the global economy and financial markets. The depth and speed of the decline rivals previous great recessions. Governments' measures (including lockdown) helped to slowdown the spread of the virus. However, amid all the unknown and uncertainty of the pandemic impact, the question is what will the recovery look like once the pandemic has passed?

Amid all possible recovery scenarios (Z-shaped, V-shaped, U-shaped, W-shaped, L-shaped and even the Nike Swoosh), consensus seems to be forming around two:

- The economy is gradually recovering supported by policymakers' aggressive response. If a second wave of the outbreak is avoided we should see a V-shaped recovery (Figure 7).
- The path to a sustained economic recovery remains highly uncertain and vulnerable to a second wave of infections before the end of 2020, in which case the recovery could be W-shaped (Figure 7).

With or without a second outbreak, economists still view the economy as vulnerable. The consequences of relapse could be severe and long-lasting without government intervention. However, more than ever, European institutions are aware of the situation and made it clear that they are "all-in" to counteract the impact of the COVID crisis. In support of the corporate bond market, the ECB even surpassed market expectations at its June policy meeting by raising the size of its bond buying-program by EUR 600 billion to reach a total of EUR 1,350 billion, helping to maintain a downward trend of spreads. Moreover, purchases under the PEPP will be re-invested at least until the end of 2022. This announcement increased the demand for corporate bonds, securing a floor on bond prices in the market.

In conclusion, a relapse of the bond market seems unlikely as the ECB is committed to use full ranges of tools for as long as it takes to support and maintain a rapid recovery of the European economy. In either a V or W shaped recovery, TTRX, by its structure, is well placed to take advantage of both recovery scenarios.

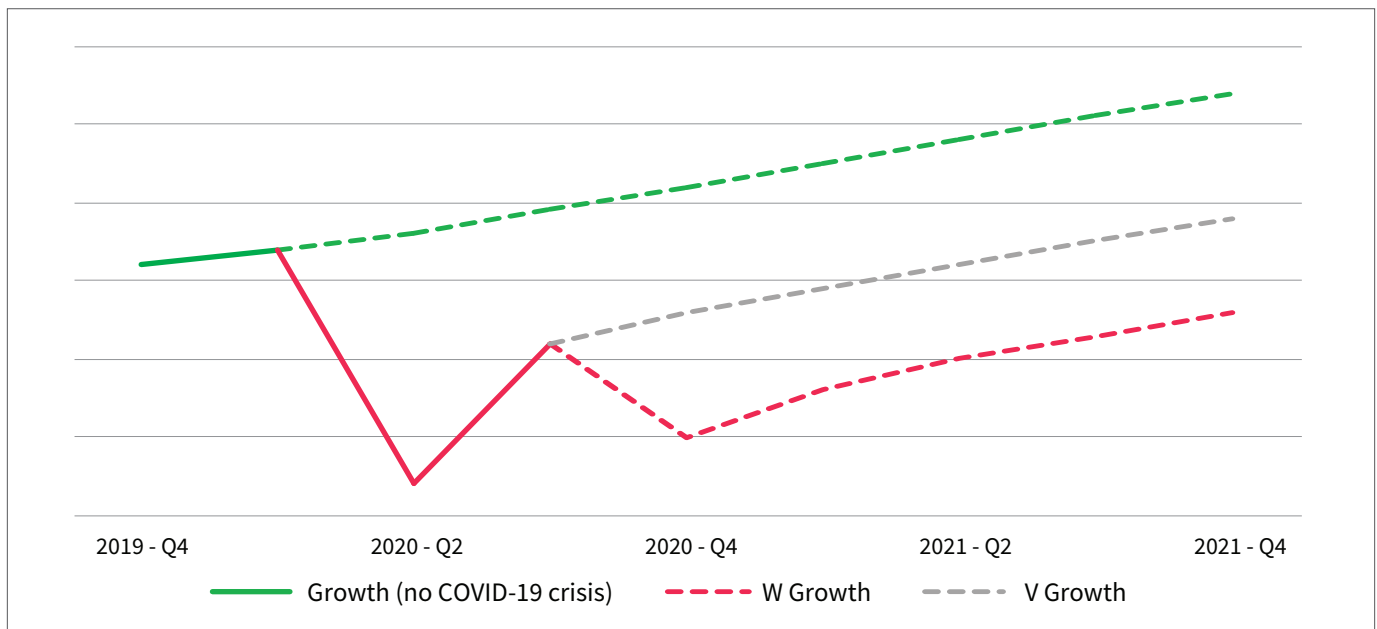


Figure 7 - Recovery scenarios of the economy





## Conclusion

TTRX is a one of a kind instrument in the EUR corporate investment grade ETF ecosystem. Its design, reflecting the sector and geographic exposure of the iTraxx Europe Index, sets the stage for multiple investment strategies while mitigating risks during periods of market stress. TTRX is underweighted in the potentially volatile financials sector and invests mainly in bonds of issuers located in Europe. It also has the highest concentration of bonds supported by the PEPP, resulting in investors moving their assets in favor of TTRX.

Ultimately, the choice of TTRX over other EUR corporate counterparts depends on the market environment and investors' objectives. Investors searching for pure exposure in the EUR corporate credit space find TTRX very compelling as it offers a diversified product with duration and risk controlled. TTRX's unique design also provides a more suitable tool for investors trading CDS bond basis.

According to economists, Europe is primed for either a sharp cyclical upturn or a double dip recession induced by a second lockdown. However, the ECB is fully committed to use its full range of tools, for as long as it takes, to support a rapid recovery of the European economy. Sending a clear message that "no matter what" the corporate market will be supported; this should improve liquidity and support the price stability in the fixed income market.



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