5'59s are closer than we thought ...

Or are they?

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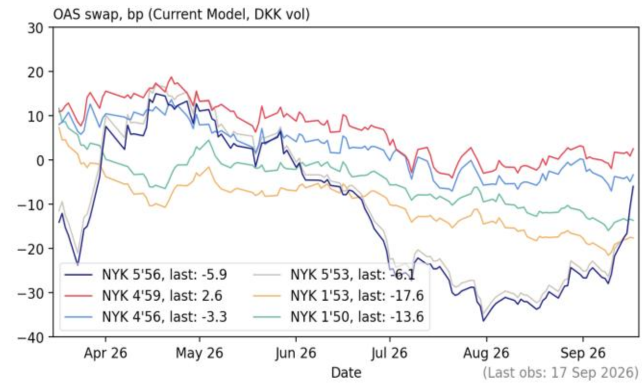
- All issuers (except DLR) announced the opening of 5'59'ers at the beginning of this week
- Yesterday, JRK issued the first tap in 5'59 non-IO at a price of 100.30, and this morning, even 5'59 IO is nearing the price of 100
- We believe that the current uncertainty warrants a higher OAS on both 5'59 and 4'59

We wrote last week that the opening of 5'59 would require something close to a perfect storm. At the beginning of this week, yields and vol had risen so much that 5'59 non-IO/IO would trade below the price of 100, which led all issuers (except DLR) to announce the opening of new 5'59s. While we have been waiting for ISINs and the first taps, yields and volatility have ticked down again. The first tap in 5'59 non-IO from JRK was thus trading at a price of 100.30, and this morning, a NYK 5'59 IO would trade at a price of about 100. So perhaps it will all be over before it has even begun?

The old 5% bonds have been loss-making following the opening of new 5% bonds



Shows OAS swaps on selected 30Y callables.

Source: Nykredit Markets

ISINs of the newly opened bonds

	5'59	5'59 IO	5'59IO30	4'49
NYK	955620	955639	955647	955655
RD	463566	463574	N/A	463558
NDA	206660	206679	206687	206695
JRK	942081	942103	942111	942138

ISINs are still missing from NYK and RD.

Source: Nykredit, Nordea Kredit and Nykredit Markets

Now they MAYBE are coming after all

After a week of significant yield and vol rises, NYK, JRK and NDA announced on Monday that they are opening all three 5'59s (non-IO/IO/IO 30), while RD is only opening non-IO and IO initially. All issuers have also announced ISINs (can be seen in the table on this page), and yesterday, JRK reported their first tap in 5'59 non-IO. It traded at a price of 100.30, which, according to our calculations, corresponds to an OAS of just under 2 bp, approximately equivalent to the OAS of 4'59 non-IO.

Fair OAS on any new 5% bonds

At first, it seems intuitive that the new 5% bonds should have the same OAS as the equivalent new 4% bonds. They are both new series with equivalent uncertainty about debtor distribution, cash flows and liquidity. However, there are arguments both for them trading at a lower as well as a higher OAS than the new 4% bonds.

On the one hand, we still believe that there may be greater demand for the new 5% bonds, driven by the success of the old 5% bonds. We believe that there are several investors who expect any upcoming prepayments in new 5% bonds to ultimately be moderate, similar to what we have seen in the old 5% bonds.

On the other side, the current market turmoil means greater uncertainty about where issuance will take place in the future. It is possible that the issuance in the period ahead may shift back and forth between 5'59 non-IO/IO (for the issuers that also use IO series to finance repayment loans) and 4'59 A. In that case, it will take longer to build up the new series, and it will also take longer for them to achieve index representation. Other things being equal, it should increase the "maturity class premium" on all three series. For 5% bonds, this also means that they can end up as small series with a large proportion of large loans, and consequently high prepayment risk.

It is our assessment that this uncertainty will initially carry greater weight, and we therefore expect the new 5% bonds to come with a marginally higher OAS than the new 4% bonds. In that case,we see the 5% as a good buy, as long as investors are aware of the actual debtor distributions, which may quickly prove to be the final debtor distributions.

What will happen with the old 5% bonds?
The old 5% bonds have gradually lost about 15-20 bp in OAS terms over the past week and a half. We had projected that the 5% bonds would lose value by around 10 bp solely because of the opening of the 5'59s (see also more here). However, we have also seen spread widening in callables generally, which has probably also affected the 5% bonds. We think the current spreads of the old 5% bonds look reasonable and do not expect any major changes from here, unless the new 5% bonds more permanently close for issuance. The pricing of the 5% bonds is, however, an uncertain matter, as it is our view that a relatively small number of investors dominate the 5% flow.

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As at 13.12.2024

Note: Distribution of our recommendations, which therefore add up to 100%.

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