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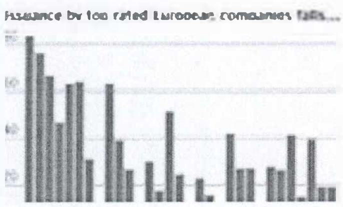
# High grade corporate debt feels euro heat

By Robin Wigglesworth

Highly rated bonds sold by European companies have provided a relatively safe haven for investors fleeing riskier assets for most of the year. But the spreading rot of the eurozone's debt crisis has begun to infect even the grandees of Europe's corporate world.

The increased nervousness is particularly apparent in the derivatives market, where investors speculate on the creditworthiness of companies, or hedge against the risks of default.



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The iTraxx Europe Main index of credit default swaps on European investment grade bonds rose to 209 basis points earlier this week, close to the record 216bp touched in December 2009. The Crossover high yield CDS index is still far away from its financial crisis peaks.

"The lower end of the credit spectrum has been under pressure for some time, but over the past two weeks we've seen panic-selling focused on the high end," says Jamie Hamilton, a senior credit fund manager at M&G.

French companies have come under particularly heavy pressure. France Telecom's benchmark 10-year bond yield has soared more than 100 basis points since November 14, to a peak of 4.43 per cent on Thursday. Vivendi's 2021 euro-denominated bond has added 123bp over the same period to yield 5.54 per cent.

The French rout has mainly been driven by the rise in the country's sovereign borrowing rate. However, some fund managers say they are under pressure from investors to reduce exposure to France overall due to fears that it may get dragged further into the periphery's turmoil.

Corporate bonds in other "core" European countries have been less affected, but yields have been climbing across the continent.

Siemens' 2018 euro-denominated bond has added 47bp since November 14 to yield 2.81 per cent, and Anheuser-Busch InBev in Belgium has seen the yield of its 2021 notes climb 39bp to 3.77 per cent over the same period.

The euro-denominated bonds of European companies have performed the worst over the past two weeks.

"Investment grade has looked very solid for some time, but in the last few weeks we've started to look more closely at the credit lines and liquidity positions of European companies," says Julian Marks, a bond fund manager at Neuberger Berman. "The question is how exposed European companies are to the worst-case scenario."

Worsening sentiment has weighed on issuance. High grade company debt sales rebounded to $35bn in October, but have dropped to under $26bn so far this month, according to Dealogic. Last November, European investment grade companies borrowed $36.8bn from bond investors.

Frazer Ross, a managing director of corporate bond syndicate at Deutsche Bank, argues that the fact that companies have been able to borrow even these sums in recent months – at a time when the eurozone crisis has sparked growing concerns in global markets – is a testament to the perceived safety of high grade corporate bonds.

"The market is clearly looking more closely at an issuer's country of origin, where the sovereign is trading and the stresses for that sovereign, but we are not seeing risk aversion in any way for corporates from 'core' Europe," Mr Ross says.

Indeed, bankers and fund managers argue that the health of corporate balance sheets, coupled with often broad-based international operations and lean work forces, should support investment grade company debt even if Europe dips into a painful recession.

They point out that borrowing costs remain low in absolute terms, and argue that the slowing pace of issuance is driven mainly by companies' already ample funding, rather than a lack of demand.

"We don't see any companies in desperate need for funding and those companies that want to fund, can fund," Mr Ross says. "The safe haven status has been a little bit eroded, but not fundamentally."

Some investors argue the recent rout is a buying opportunity, after falling yields for much of the year eroded the returns on offer. "We've been taking advantage of the panic-selling," Mr Hamilton says.

Still, many fund managers, bankers and analysts concede that a sovereign "sword of Damocles" still hangs perilously over the market.

"Some high-quality, diversified non-financials in 'true' core countries may offer sanctuary to some degree, but regardless of fundamentals the broader credit market will remain at the mercy of the prevailing mood in the government bond market," Hans Lorenzen, a strategist at Citi, wrote in a note.

"Until there is unequivocal confirmation [of a lender-of-last resort for Italy and Spain] in sight, the market remains a 'sell' in our eyes," he argued.