CMi2i RESEARCH & INSIGHTS

CMi2i CAPITAL MARKETS INTELLIGENCE

5 TRENDS THAT SHAPED THE 2021 BOND MARKET

CMi2i CAPITAL MARKETS INTELLIGENCE

5 TRENDS THAT SHAPED THE 2021 BOND MARKET

INTRODUCTION

As the year end approaches, it is time to take stock of the past year and review and assess those trends that have affected the global markets and companies' profitability. The coronavirus pandemic is likely to dominate media headlines for the foreseeable future but there are five key themes that will drive fixed income investors' decision in the medium to long term: the growth of green bonds & ESG investments; rising inflation; convertibles becoming the pandemic's capital raising instrument of choice; and sovereign wealth reducing their exposure to fixed income in favour of more risky assets.

FIXED INCOME ESG INVESTORS

2021 has been the year of ESG investments and green bonds. ESG bond issuance has increased exponentially since 2015 but in 2021 it is expected to reach a record $1 trillion, up from $745 billion in 2020. With the Bank of England announcing a change to its mandate that now includes "supporting growth aligned with environmental sustainability and net-zero transition objectives" (Source) and the ECB adding a climate scientist to its team, we expect green bonds and ESG investments growth to continue into 2022. In fact, some investors expect green bond issuance alone to reach the $1 trillion mark by the end of 2022 (Source).

Issuers should remember, however, that ESG investments are not just limited to ESG and green bonds: ESG funds already represent a significant portion of European corporate bonds. However, unlike the rest of the fixed income market, ESG AUMs are more homogeneously held with higher level of concentration (Source). This means that it is especially important for any corporate wishing to tap into this new source of capital to carefully plan their investor outreach and carry out a detailed and planned targeting exercise.

INFLATION

Since the world economy bounced back from the coronavirus-led recession, price increases have dominated headlines in the US, UK and Europe and have only gathered pace in recent weeks. In the UK, for example, supply-driven factors mainly due to Brexit border delays, natural gas prices and a HGV driver shortage have pushed the Consumer Prices Index to 4.2% in the 12 months to October 2021, up from 3.1% in September (Source). Many central bankers and market commentors dismiss inflation fears believing the current price increases are only transitory.

While it is certainly true that some of the driving forces driving inflation are temporary (pent up demand and buoyed household incomes due to furlough schemes etc. are not structural), government response to the Covid recession mimicked a wartime response and wartime spending in the past has generally led to a surge in inflation over a multi year period.

This debate is likely to continue into 2022 affecting bond markets and bond prices. The 5 year breakeven inflation rate rose to an average of about 3%, the highest it has been in over a decade, showing that investors are now coming to the conclusion that inflation might be here to stay (Source).

Higher inflation, even if only for the short to medium term, will inevitably affect issuers that are planning to refinance; that have issued variable bonds; or that are already in a distress situation. Conversely, investors will favour inflation-linked bonds and equity investments –BlackRock's investment outlook, for example, is underweight corporate bonds and overweight EM local debt and inflation-linked bonds (Source). This negative sentiment has already started to be reflected in the price of US junk bonds, which fell in November by the most in more than a year, with investors worrying about the effects of a tightening monetary policy (and new Coronavirus-linked restrictions) on these bonds (Source). Therefore, it is especially important for issuers, no matter their balance-sheet status, to proactively engage with their investors so that they are able to successfully refinance in the future.

CONVERTIBLES

As the Coronavirus pandemic sent global markets into shock, one asset class appeared to strive: convertibles. In 2020, convertible issuance doubled in size to $159 billion, a new record for this asset class, and it looks like 2021 will be another stellar year as over $100 billion worth of convertibles were issued in the first half of the year. Companies such as Airbnb, Ford, Spotify, Twitter, Tesla and Redfin have all issued convertibles in the last 18 months.

Convertibles have found a new popularity thanks to their relatively low cost for issuers (they often have lower coupons than bonds) and the flexibility they provide to investors as they offer the potential for price appreciation in rising markets like equities as well as the potential for income and value preservation in down markets like bonds.

However, with US convertibles securities issuance slowing down in the last few weeks and returns nowhere near as robust as they were last year, questions arise as to whether convertibles' popularity has reached its peak. However, the fact is that generally fast-growing companies that issued convertible bonds, coupled with their relatively short maturities and a continuing turbulent environment mean that "things are lining up for a long, extended move in this market in terms of new issuance, investor interest and performance." (Source)

Companies that have issued convertibles or that are planning to issue them, should remember that the holders of their convertibles are potential shareholders and as such knowing who holds these notes is key.

DEFAULTS & SPILL-OVERS - UK ENERGY COMPANIES & EVERGRANDE

2021 has also been the year of sequential defaults and collapse both in Europe and China. In the UK, the rising price of gas has resulted in several energy companies collapse or becoming close to defaulting. Since August this year, 26 companies have collapsed, and more are expected to do so. It will be interesting to see whether the energy crisis will be contained or whether it will cause a domino effect across other sectors and markets. Looking at the price of high yield bonds shows that investors are starting to worry about a potential domino effect.

In China, Evergrande, the largest real estate company, started to show signs of weakness causing panic in the Asian high yield market. The Evergrande saga is still ongoing and so far, it appears to have affected only the Asian high yield market. This is largely due to the People Bank of China intervening and making it clear Evergrande's distress would be a contained event.

However, if it were to decide to stop supporting Evergrande and the real estate sector going forward, this could change very quickly and could have disastrous consequences beyond the Asian high yield market. It is worth noting that Evergrande's liabilities are almost 2% of Chinese GDP so it is quite possible that its collapse will have spill-over effects across the global markets. (Source)

SOVEREIGN WEALTH MANAGERS

The Coronavirus pandemic, the rise of ESG and the relatively high bond valuations have meant that several sovereign wealth managers across the globe have reduced their exposures to fixed income.

For example, GIC Pte., the Singaporean sovereign wealth fund and one of the largest global investors, announced in July that "it is planning to cut its holdings of bonds as it prepares for a long-term future with "significantly" lower returns amid geopolitical uncertainty and rising yields." (Source). It has reduced its bond and cash holdings to about 45% of assets from 50% at the beginning of the year and it plans to reduce these further. The bondholder identification reports carried out by CMi2i since the summer already reflect this change and show that GIC not only significantly reduced its holdings in several notes, but even completely sold out in some cases, without the issuers being aware.

Norges Bank Investment Management (NBIM) also has reduced its exposure to corporate bonds – it currently has 25% of its exposure to fixed income investments when it can have up to 30% of its portfolio invested in bonds (Source). CMi2i can confirm that the recent bondholder identification reports have shown NBIM reducing their stakes and even selling out in some cases. NBIM is also known for excluding companies from their investment pool if they do not meet their ESG criteria. Only in May this year, for example, it excluded the Honeys Holdings Co Ltd due to unacceptable risk that the company contributes to systematic violations of human rights (Source).

The era of sovereign wealth funds making substantial investments in bonds and holding these securities until their maturity is long gone – engaging with them, especially on the ESG front, is not just good practice but also critical in being able to tap into this pool of capital.

CONCLUSION

As 2021 is coming to an end, coronavirus is back in the headlines due to the Omicron variant. New restrictions are coming into place making it difficult for businesses and the financial markets to navigate the future. It is for this reason that looking at medium to long-term trends is particularly important for issuers as it will enable them to intelligently engage with investors and successfully run their IR and treasury functions.

CONTACT

21-26 Garlick Hill
London EC4V 2AU

sales@cmi2i.com
+44 (0) 203 824 1450
www.cmi2i.com

AUTHOR

MASSIMILIANA SMITH
Head of Debt Intelligence Services
massi@cmi2i.com

ABOUT CMi2i

CMi2i provides unique capital markets intelligence and guidance to issuers and their advisors.

CMi2i is known for the world's most accurate share and debtholder identification service, supporting both corporates and their advisors with investor relations, M&A, shareholder activism, capital restructuring and proxy solicitation. Our team has provided intelligence and advice to over 500 of the largest, most structurally complex companies in the world, and supported numerous corporate transactions and general meetings. As a result, we offer clients a unique combination of skills, experience and methodologies within the following areas:

- Capital Market Intelligence & Investor Relations Support
- ESG & Corporate Governance Advisory
- Proxy Solicitation & Engagement

Contact info@cmi2i.com for more information on our services.

CMi2i
CAPITAL MARKETS INTELLIGENCE