



## Bond Market 2010 – The Courage to Step Back

This issue's special topic is about "Bond Market 2010 – The Courage to Step Back" by Dr. Harald Preißler.

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## Bonds: Record issuance volume

Against the backdrop of the tremendous credit market upheaval in 2008 and subsequent return to relative tranquility in 2009, the year saw a record volume of new issues in the CHF bond market: 242 initial listings of bonds took the total issuance volume to CHF 83.8 billion (prior year: CHF 71.7 billion). The number of trades in CHF-denominated bonds rose in 2009 by 10% versus the previous year, whereas total turnover fell by 14% to CHF 163.4 billion.



## Counterparty risk a thing of the past

Since October 2009, the CHF bonds traded on SIX Swiss Exchange have been channeled to SIX x-clear for obligatory clearing. As a result, this trading segment as well now benefits fully from the protection offered by a central counterparty in the event of a member's default.

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# Bond Market 2010 – The Courage to Step Back

by Harald Preißler, Chief Economist of BANTLEON BANK AG

Financial investors will long remember 2009 as a year packed with pleasant surprises: the global economic depression prophesied by the merchants of doom failed to materialize; the global economic cycle rebounded from its collapse much sooner and above all much more powerfully than even the most fervent optimists had predicted. The meteoric recovery in the equity, commodity, and credit markets under the protective shield of fiscal and monetary policy probably also amazed many of those involved.

However, the greatest surprise was without doubt the fact that in this environment even top-rated government bonds were able to produce attractive gains. This holds not least for Swiss Confederation bonds, whose yields fell to new historical lows across the entire curve and thus brought investors returns of more than 4.00% for the year as a whole.

Thus, not a single asset class recorded a negative performance. Against this backdrop there was only one mistake that investors could be guilty of: excessive caution. The inevitable question for 2010 concerns the right strategy for the year ahead. Will fortune continue to favor the brave? Or is it time to step back and adopt a risk-averse investment strategy?

The fact is that against the background of low yields the bond market – and in particular the market for Confederation bonds – is exposed to an exceptionally high degree of risk at present. At the beginning of 2010 the yield on 10-year Confederation bonds was 1.96%. Even a marginal increase to 2.20% would be enough to ensure that an investor's total return for the year as a whole dropped below zero.

Given the positive outlook for the economic environment and expectations of modest tightening in monetary policy, current market consensus sees 10-year Confederation yields rising to 2.50% by the end of the year, trending toward a level of 2.75% in early 2011. Therefore, even taking coupon payments into account, investors would face the risk of appreciable losses on their government bond positions.



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**Figure 1: Leading economic indicators about to peak**  
Source: Bloomberg, BANTLEON BANK AG

As a logical consequence most strategists recommend avoiding government bonds (including eurozone and US paper) and instead investing in corporate bonds, mortgage-backed bonds, and emerging market bonds. Although the returns on the last three will be markedly lower than in 2009, they should at least be positive.

Although we share the assessment that government bonds carry enormous risks in the first half of 2010 and that an increase in yields is overdue, as the year progresses more and more cracks will appear in the economic outlook that to date has been unfailingly positive. The BANTLEON proprietary leading indicators, which are three to four quarters ahead of the official barometers, already turned down in the third quarter of 2009, thereby predicting a reversal in the purchasing managers' index in mid-2010 (see Figure 1).

The main reason for this change in direction is the diminishing effect of the massive monetary stimuli. By that time, the well-advanced correction in companies' inventories and higher prices for commodities and preliminary products will have a dampening effect on GDP growth. Although this development does not signal a recessionary double-dip, it is obvious that the economic outlook for the second half of 2010 is noticeably muted.



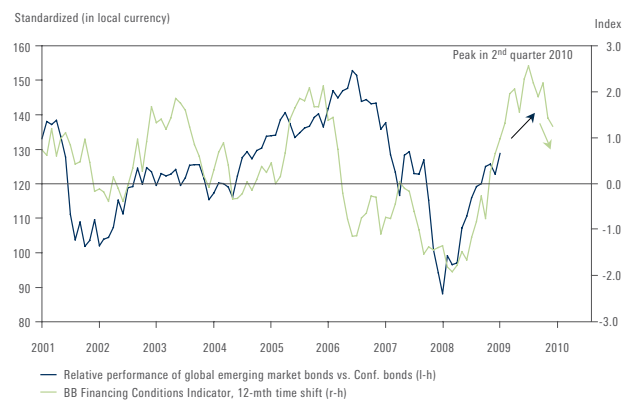
**Figure 2: The cycle will be directly reflected in the bond yield profile**  
Source: Bloomberg, BANTLEON BANK AG

In contrast to the market consensus, we are working on the premise that this weaker growth trend will indeed make itself felt in the bond markets. We are

convinced that yields on 10-year Confederation bonds, which may well have reached 2.50% by the mid-year, will peak sometime in the summer and then follow the economic trend downward (see Figure 2). That the SNB will start raising its key rates at about the same time is not a contradiction. Instead, the sluggishness in the leading indicators will encourage market participants to expect only a cosmetic correction in refinancing rates and not a lengthy cycle of rising policy rates. Rates at the longer end of the curve will probably not fall back to the levels of the beginning of the year, but in our opinion the total return on longer-dated Confederation bonds will be positive.

The situation at the short end of the curve is less favorable. Traditionally, this section of the yield curve is more closely aligned with the SNB's monetary policy. As a result, yields of short-term bonds will probably rise disproportionately, thereby causing the yield curve to flatten noticeably.

Thus, one of the surprises of 2010 could be another comparatively good performance by long-dated government bonds. Among corporate and emerging market bonds, by contrast, risks will be rising from the second quarter onward – after the stunning gains of the past 12 months the stage is set for a disappointment (see Figure 3).



**Figure 3: In the second half of 2010 Confederation bonds will outperform emerging market and corporate bonds**  
Source: Merrill Lynch, BANTLEON BANK AG

Our conclusion: in the current year the rewards will go to investors with the courage to step back and adopt a risk-averse investment strategy that avoids risks associated with high spreads.

## The three most active companies

### Sell side (Q4/2009)



**Zürcher  
Kantonalbank**

Turnover EUR 352,628,638

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Head Eurobond Trading  
Head Eurobond Sales

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## The three most active companies

Buy side (Q4/2009)



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**UBS**

Turnover EUR 70,315,546

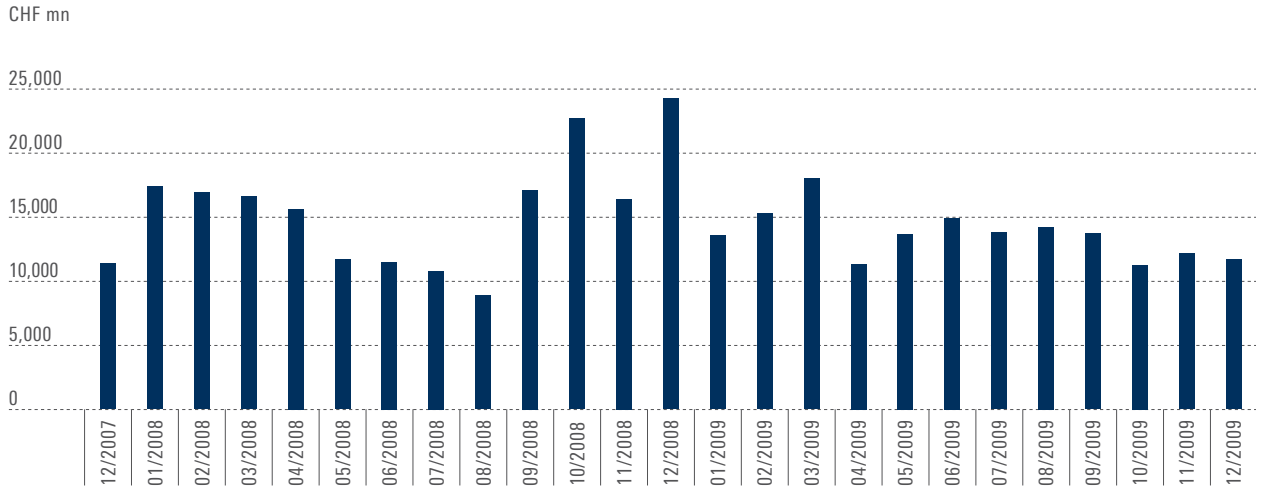
Head Fixed Income Trading non CHF

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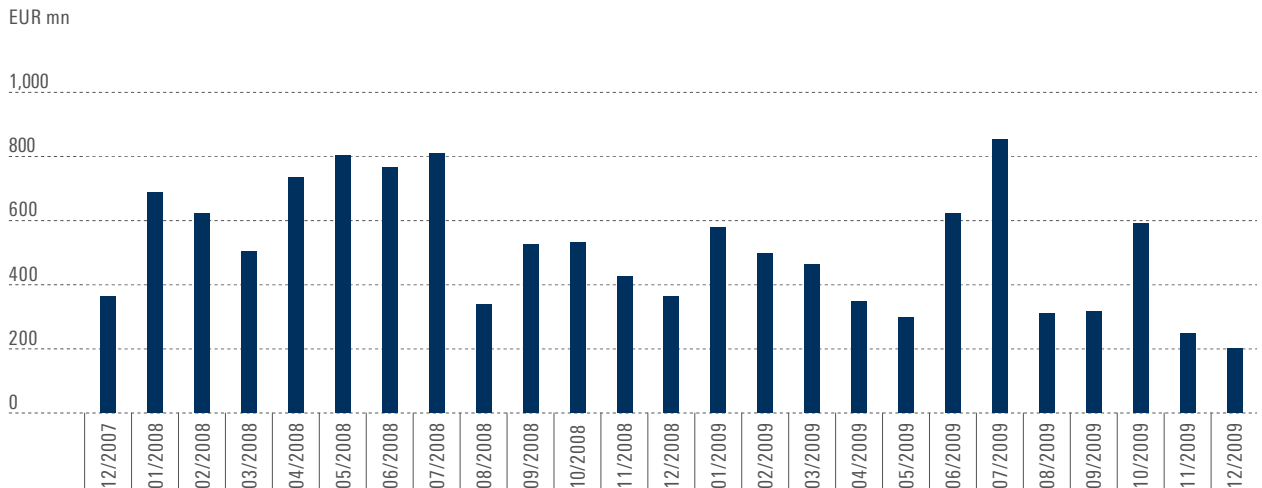
## Turnover CHF bonds

SIX Swiss Exchange-listed CHF bonds (government, sovereign, corporate etc., Swiss and non-Swiss issuers)



## Turnover international bonds

SIX Swiss Exchange-listed and non-listed bonds (including all types of international bonds in all currencies except CHF)



# Turnover international bonds

## Most traded currencies (16 last months)

Turnover (in millions) of all types of international bonds, calculated per currency in the original currency

Date	EUR	USD	GBP	AUD	CAD	HUF	ISK	NOK	NZD	SEK	TRY	ZAR
09/2008	334.55	143.65	14.64	52.38	4.67	1,574.99	491.32	94.61	23.63	41.62	1.60	20.89
10/2008	348.87	143.45	21.79	31.84	3.78	416.72	128.62	73.25	23.53	32.57	0.17	16.34
11/2008	265.17	140.24	14.86	20.86	4.00	143.84		47.58	19.71	8.07	0.04	2.53
12/2008	210.54	115.21	30.49	22.44	5.57	84.86		24.06	26.94	8.35	0.19	3.42
01/2009	350.31	222.75	18.59	32.36	6.76	218.22		34.40	26.18	29.60	0.28	5.63
02/2009	290.23	178.88	15.51	47.09	4.79	732.38	1.51	77.21	21.39	18.27	1.18	11.32
03/2009	302.95	135.90	16.32	40.71	2.97	165.35		37.59	18.89	21.08	1.60	13.71
04/2009	214.58	105.37	7.20	37.38	2.36	65.74	45.09	40.69	20.66	38.83	6.22	22.85
05/2009	151.94	145.22	6.98	21.26	2.90	81.34	20.60	45.43	9.66	14.79	1.80	18.70
06/2009	394.70	189.53	23.10	63.19	6.48	156.11	203.35	74.13	15.93	20.79	2.73	23.38
07/2009	569.45	226.98	22.14	35.68	8.07	980.3	16.52	254.5	58.92	27.52	2.27	11.10
08/2009	168.58	90.52	7.57	66.44	5.55	49.64	9.27	30.03	24.69	2.40	14.58	24.72
09/2009	142.71	140.34	15.46	54.90	5.64	539.45	36.12	40.38	27.75	9.50	2.86	30.48
10/2009	132.27	573.4	11.99	58.06	1.93	51.7	27.69	68.39	14.2	20.81	2.2	16.64
11/2009	112.42	67.6	7.18	100.9	1.76	90.09	23.73	26.5	22.14	2.32	2.22	15.68
12/2009	89.39	68.2	13.88	51.72	2.58	32.36	19.08	38.75	18.5	6.59	1.09	19.42

## Number of trades international bonds Most traded currencies (16 last months)

Number of trades of all types of international bonds per trading currency

Date	EUR	USD	GBP	AUD	CAD	HUF	ISK	NOK	NZD	SEK	TRY	ZAR	Total
09/2008	3,779	1,828	448	992	97	144	221	319	478	103	18	77	8,504
10/2008	5,068	2,023	1,179	756	64	95	74	267	541	91	4	44	10,206
11/2008	4,674	1,823	569	496	83	38		114	343	28	2	17	8,187
12/2008	3,806	1,740	1,160	505	115	23		90	496	23	5	17	7,980
01/2009	5,554	1,880	639	661	146	44		196	451	107	8	38	9,724
02/2009	4,775	1,968	503	1,049	89	99	1	282	355	62	22	59	9,264
03/2009	5,182	1,767	592	886	94	41		181	300	54	40	36	9,173
04/2009	4,455	1,160	462	659	51	8	18	160	369	163	61	60	7,626
05/2009	3,290	1,269	243	509	43	12	16	188	170	54	14	45	5,853
06/2009	3,618	1,133	399	610	116	20	33	141	350	38	23	66	6,547
07/2009	4,376	1,178	614	587	118	17	14	114	1,349	25	23	44	8,459
08/2009	2,659	919	287	1,207	110	8	9	117	487	17	40	66	5,926
09/2009	3,153	1,343	680	1,112	131	16	35	186	707	28	34	83	7,508
10/2009	2,850	1,178	491	1,215	56	12	18	344	316	20	33	67	6,600
11/2009	2,189	853	260	2,034	49	10	26	132	428	15	16	55	6,067
12/2009	1,751	684	574	1,100	60	8	16	157	426	21	13	66	4,876

## SIX Swiss Exchange – Listed international bonds

Valor	ISIN	Short Name	Name	Currency	Maturity
2266757	XS0229097034	CS VAR 09/20-15	CRED SUISSE GP FIN (US)	EUR	14.9.2020
2266763	XS0229097208	CS 3.125 09/14/12	CRED SUISSE GP FIN (US)	EUR	14.9.2012
2287149	XS0230955642	EXIMUK 6.8 10/12	CSFB INTL (EXIM UKRAINE)	USD	4.10.2012
2318991	US225407AA34	CITKIE8 11/06/15	CRED SUISSE (CITY KYIV)	USD	6.11.2015
2319106	XS0233620235	CITKIE8 11/06/15	CRED SUISSE (CITY KYIV) (LPN)	USD	6.11.2015
2332843	US515110AP96	RENTEN4.875 11/15	LANDWIRTSCH. RENTENBANK	USD	16.11.2015
2427680	XS0242939394	PRBANK Var 02/16	STANDARD BK (PRIVATBANK) (LPN)	USD	9.2.2016
2439019	XS0243733127	EXIMUK 8.4 02/16	CS INTL (EXIM UKRAINE) (LPN)	USD	9.2.2016
2441720	US515110AR52	RENTEN4.875 02/11	LANDWIRTSCH. RENTENBANK	USD	14.2.2011
2466292	XS0246205495	BIC Var 03/16-11	BANCO INDUSTRI E COM	USD	3.3.2016
2467032	US05961HAB42	BIC Var 03/03/16	BANCO INDUSTRIAL E COMERC	USD	3.3.2016
2476226	XS0247168130	PFG Float 03/11	PRINCIPAL FIN GLOBAL FND	GBP	30.3.2011
2545131	XS0252915813	ABB4.625 06/06/13	ABB INT FINANCE LTD	EUR	6.6.2013
2598510	US515110AT19	RENTEN5.25 07/11	LANDWIRTSCH. RENTENBANK	USD	15.7.2011
2691640	XS0267147881	EXIMUK7.65 09/11	CSFB (EXIM UKRAINE) (LPN)	USD	7.9.2011
2746638	XS0271772559	CITMOS 5.064 16	DRESDNER (CITY OF MOSCOW) (LPN)	EUR	20.10.2016
2774739	US515110AU81	RENTEN5 11/08/16	LANDWIRTSCH. RENTENBANK	USD	8.11.2016
2896430	US515110AV64	RENTEN5.125 02/17	LANDWIRTSCH. RENTENBANK	USD	1.2.2017
2900915	XS0285182266	PRBANK8 02/06/12	UK SPV CREDIT FINANCE PL	USD	6.2.2012
2919139	XS0286686356	DEXGRP2.375 02/12	DEXIA CREDIT LOCAL	EUR	23.2.2012
2922365	XS0287015787	FIUKR 9.75 02/10	STANDARD BANK PLC (1ST UKR)	USD	16.2.2010
2926600	XS0286235774	USCBUZ8 02/22/10	CRD SUISSE (UKRSOTS BANK) (LPN)	USD	22.2.2010
3132009	XS0303241615	VABANK 10.125 10	CREDIT SUISSE (VAB BANK) (LPN)	USD	14.6.2010
3140803	XS0304232753	TOYOTA5.125 06/10	TOYOTA MOTOR FINANCE BV	USD	21.6.2010
3184737	US515110AX21	RENTEN5.25 07/12	LANDWIRTSCH. RENTENBANK	USD	2.7.2012
3222360	XS0307202530	NADRA 9.25 10	HSBC BANK PLC (BANK NADR) (LPN)	USD	28.6.2010
3278555	XS0310791107	PIVDE10.25 08/10	STANDARD BANK PLC (JSC P) (LPN)	USD	3.8.2010
3542821	CH0035428215	KFW Float 11/10	KFW	EUR	26.11.2010
3542825	CH0035428256	KFW Float 11/10	KFW	USD	26.11.2010
3571392	XS0332748077	CITKIE8.25 11/12	CRED SUISSE (CITY KYIV) (LPN)	USD	26.11.2012
3572561	US22546CAL28	CITKIE8.25 11/12	CRED SUISSE (CITY KYIV) (LPN)	USD	26.11.2012
3603417	XS0334534699	NADRA9.375 12/17	DCM GLOBAL FINANCE	USD	5.12.2017
3756936	US515110AY04	RENTEN3.25 03/13	LANDWIRTSCH. RENTENBANK	USD	15.3.2013
3922883	XS0356908086	NADRAFloat 04/18	DCM GLOBAL FINANCE	USD	10.4.2018
3969016	XS0343915137	BIC 7 04/23/10	BANCO INDUSTRI E COMRCL	USD	23.4.2010
4285588	US515110AZ78	RENTEN4.125 07/13	LANDWIRTSCH. RENTENBANK	USD	15.7.2013
10532585	CH0105325853	PPHNSW4 10/15	PETROPLUS FINANCE LTD	USD	16.10.2015
10540524	XS0451748080	ZURNVX3.25 09/13	ZURICH FIN LUXEMBOURG SA	USD	30.9.2013
10572639	US515110BA19	RENTEN1.875 09/12	LANDWIRTSCH. RENTENBANK	USD	24.9.2012
2407820	XS0241241180	CS 3.625 01/18	CRED SUISSE GP FIN (GRN)	EUR	23.1.2018
10892026	US515110BB91	RENTEN 3.125 07/15	LANDWIRTSCH. RENTENBANK	USD	15.7.2015

(Not including the list of SIX Swiss Exchange-registered programmes)

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### Further information on this topic can be found at:

[www.six-exchange-regulation.com/regulation/listing\\_rules\\_en.html](http://www.six-exchange-regulation.com/regulation/listing_rules_en.html)

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