Fixed Income Update
Week 13

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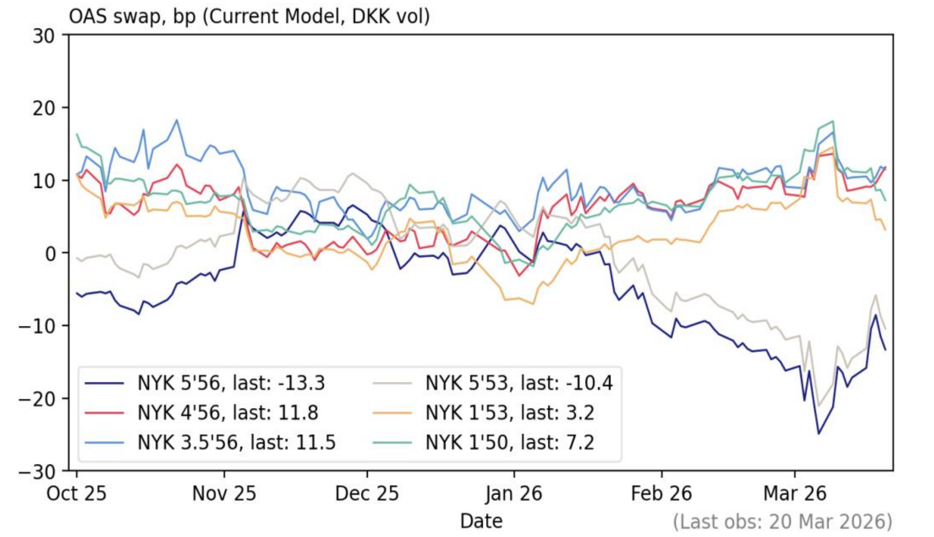
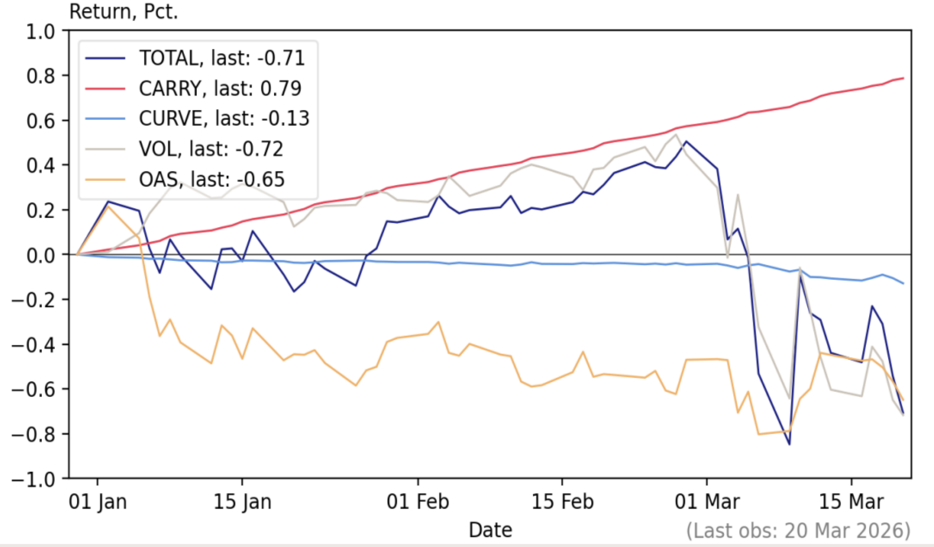
Brace yourself!

- Just as we saw last week, volatility eased on Tuesday before rebounding back.
    - In line with our expectations on Monday (read here), 4'56 bonds were unable to maintain their OAS level in the absence of an actual decline in volatility across the week as a whole.
- Compared with the movements in volatility, iTraxx Main and EU Financials (AA), the widening in OAS since the end of February has been remarkably muted – at least up until Friday.
    - Callables opened Monday with strong OAS widening (of up to 5-7bp). Right now, the OAS widenings have reversed into outright performance, although this must be seen in the context of volatility being marked significantly higher. This suggests that callables may still have some overdue adjustment to absorb before they fully reflect the unfavourable market backdrop.
    - 4Y bullets also start the day with slight OAS widening (currently around 1bp).
- Despite fundamentally supportive factors (see overleaf), our impression is that callables have thus far benefited from an expectation that the war in Iran will prove relatively short-lived.
    - However, market developments are beginning to undermine that assumption. In the absence of any signs that the conflict will indeed be short in duration, callables may face additional headwinds in the coming weeks, particularly once we move beyond the current payment date.

OAS of selected callables



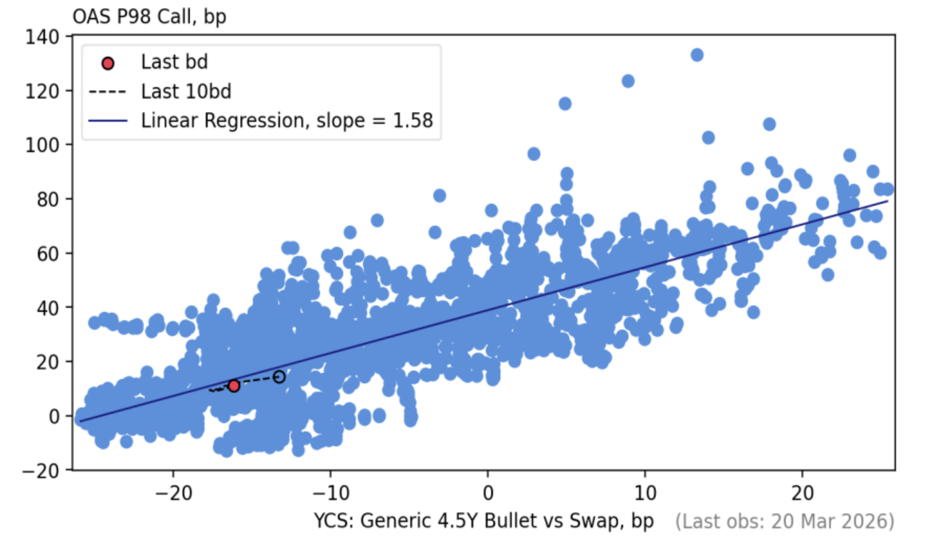
4'56: Delta(vector)hedged return



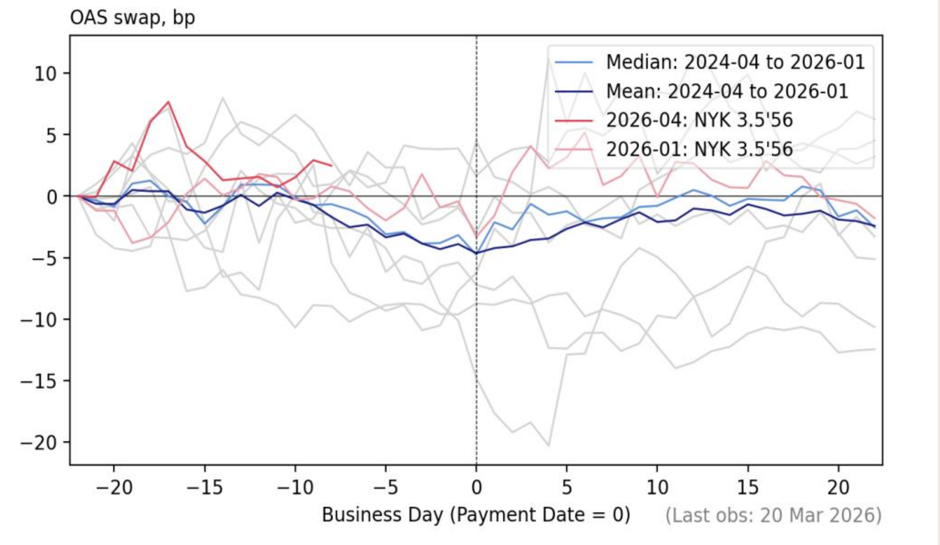
Brace yourself (continued)

- As mentioned above, a number of factors continue to offer support to the callables segment and have likely contributed to the (so far) only moderate OAS widening since the beginning of March:
  - Much like EUR covered bonds, bullets have also navigated March without any severe OAS widening. For now, callables do not appear expensive relative to, for example, 5Y bullets. That said, end-of-quarter issuance and a reduced net position may generate headwinds for bullets in the coming week (see also below)
  - There will be payment flows in the system next week. We are at the point where the accompanying reinvestment performance in OTR callables typically begins to materialise. Even if we do not expect strong performance at this stage, it may help counter the widening pressure on OAS
  - The issuance of callables remains low, and the recent market movements have, if anything, reinforced expectations of subdued issuance for the foreseeable future.
  - The increase in rates and volatility means that the YTM of 4'56 is now more than 25bp higher than in November, reaching its highest level – except for one day in March 2025 – since mid-2024. Outright investors have therefore experienced an improvement in the absolute return potential in callables (despite the limited OAS widening).
- In the absence of any signs of improvement in the situation surrounding Iran, we do not believe that these factors will be strong enough to prevent further OAS widening in the coming weeks – particularly once we are past the payment date.

Callables vs 4.5Y bullets



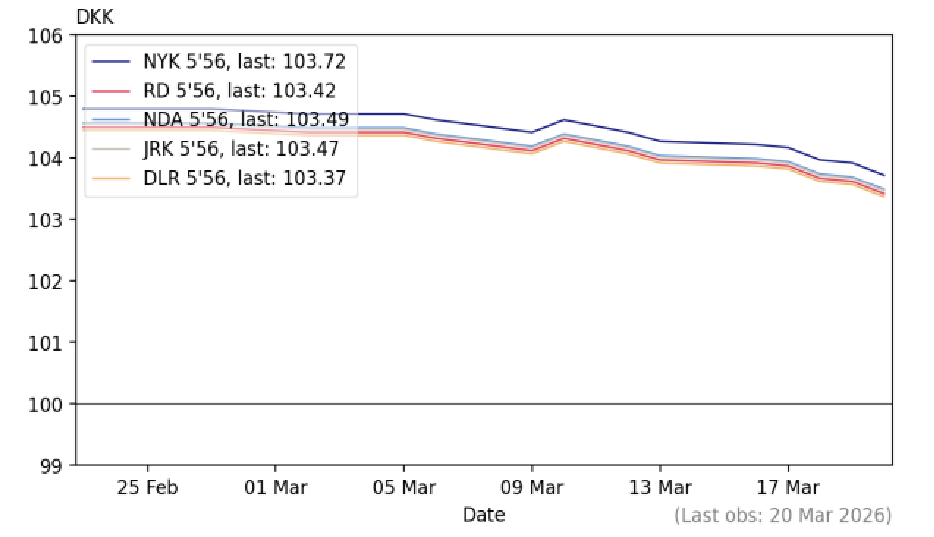
Reinvestment performance in sight?



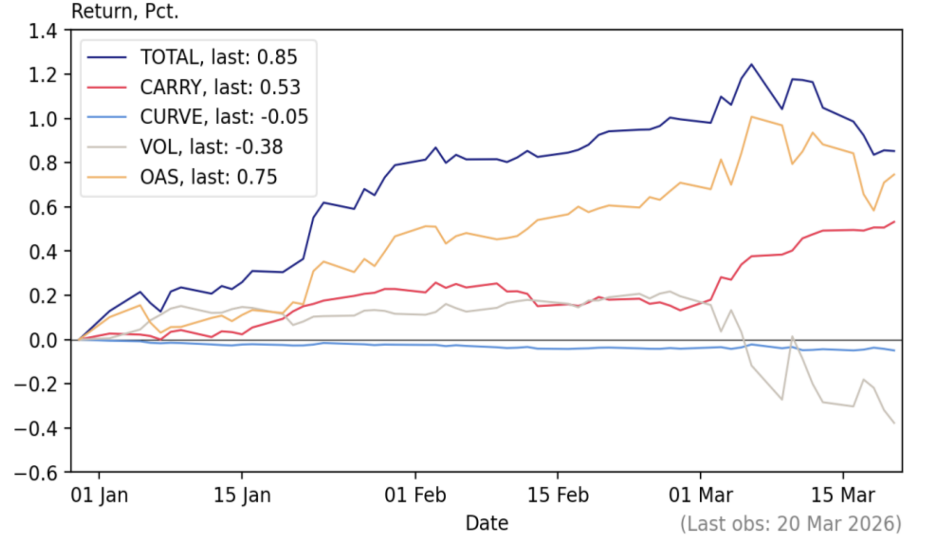
5% bonds show signs of weakness

- 5% bonds – which have otherwise shown considerable resilience to market fluctuations – have begun to display signs of weakness.
  - With break-even prepayments relative to duration-equivalent bullets hovering around 10%, the expected excess carry is now becoming increasingly thin.
  - Although prepayments in 5% bonds are unlikely to exceed 10% at the July payment date (see also overleaf), they are also unlikely to fall much below that level. Combined with a more imminent risk of a price correction, 5% bonds currently appear expensive.
- The risk of such a price correction must also be seen against the backdrop of recent market movements, which have brought 5'59 bonds closer to becoming relevant.
  - Assuming that the hypothetical 5'59A and 5'59IO were to trade with an OAS equivalent to that of 4'56 bonds – or up to 4bp higher – their present prices would be around 101.3-101.4 and 100.7-100.8, respectively.
  - A parallel yield rise of (an additional) 25bp, or an increase in short-term rates of 25bp combined with a 10bp OAS widening would now be sufficient to push a hypothetical 5'59 IO below par!

Price of 5'56A



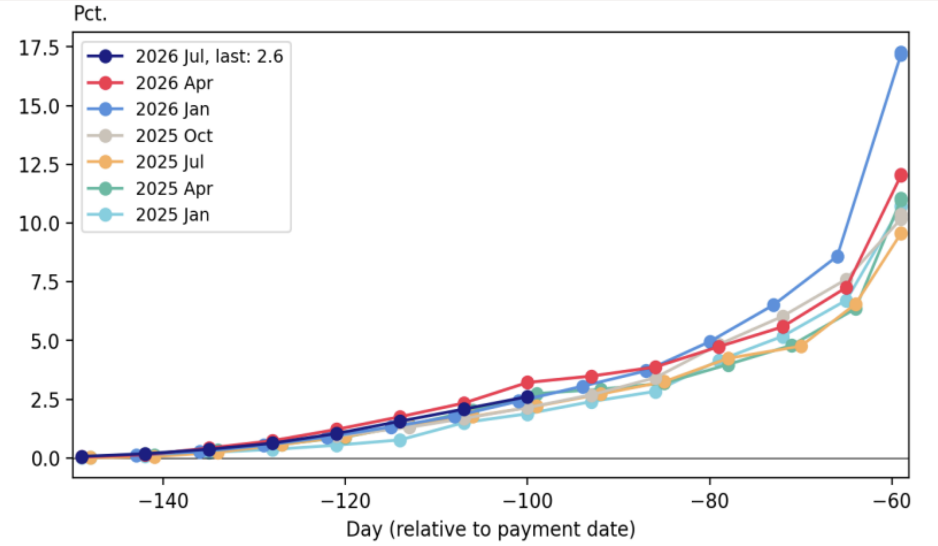
NYK 5'56 A: Delta(vector)hedged return



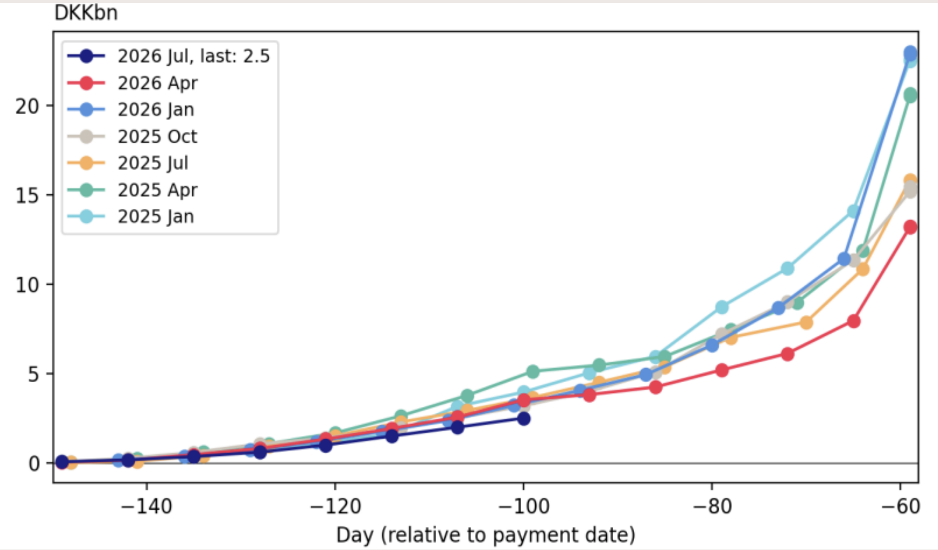
CK93: Nothing to see here...

- Today's data continue to show that prepayments in 5% bonds remain firmly on track towards around 10%.
- The reduced outstanding volume of 5% bonds means that the corresponding redemptions, measured in DKK billion, are on the low side compared with recent payment dates.

Preliminary prepayments in 5% callables (%)



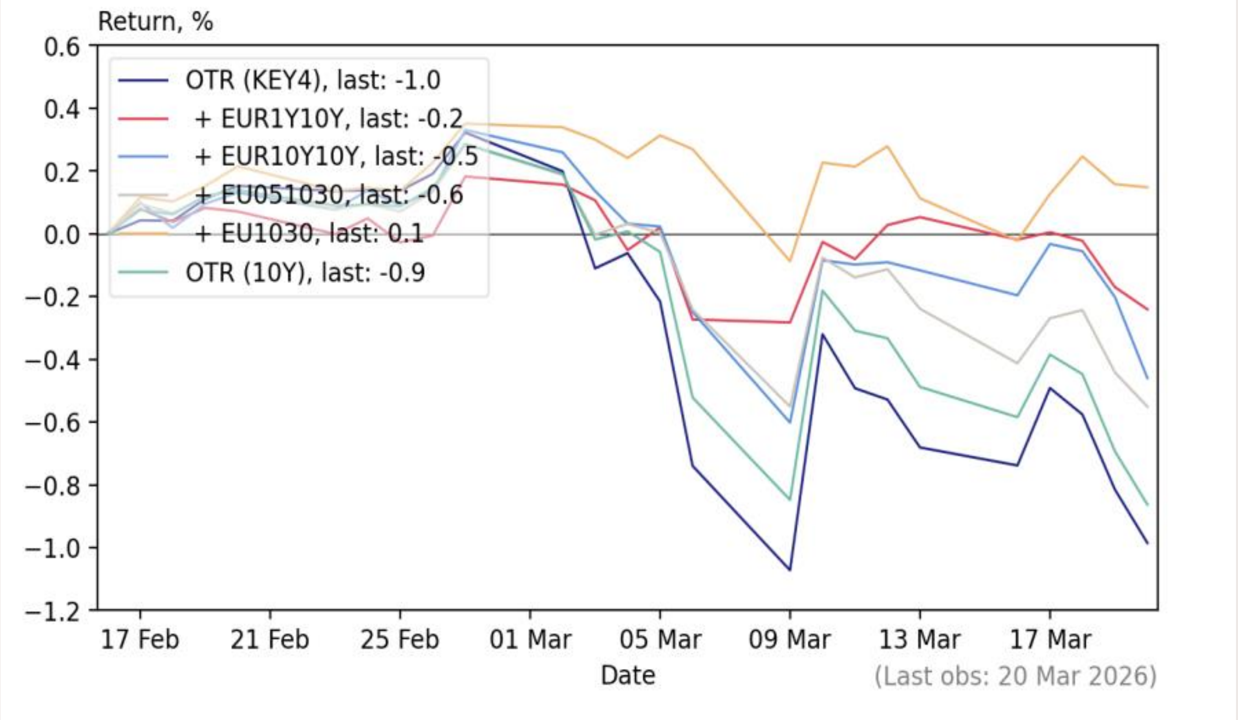
Preliminary prepayments in 5% callables (DKKbn)



Market turbulence and curve flattening

- A "10-30 curve-flattener" overlay continues to be super efficient to mitigate the losses on a delta vector-hedged callable that current market movements otherwise give rise to.
  - The return on a delta vector-hedged OTR callable with a 10-30 curve-flattener (to the extent considered in a research note from before the war broke out, read here), has roughly gone sideways through the war – and has thus avoided a loss of more than 1% (see chart)
  - A EU051030 swap barbell as well as EUR1Y10Y or EUR10Y10 swaption straddles would also have helped – but not to the same extent.

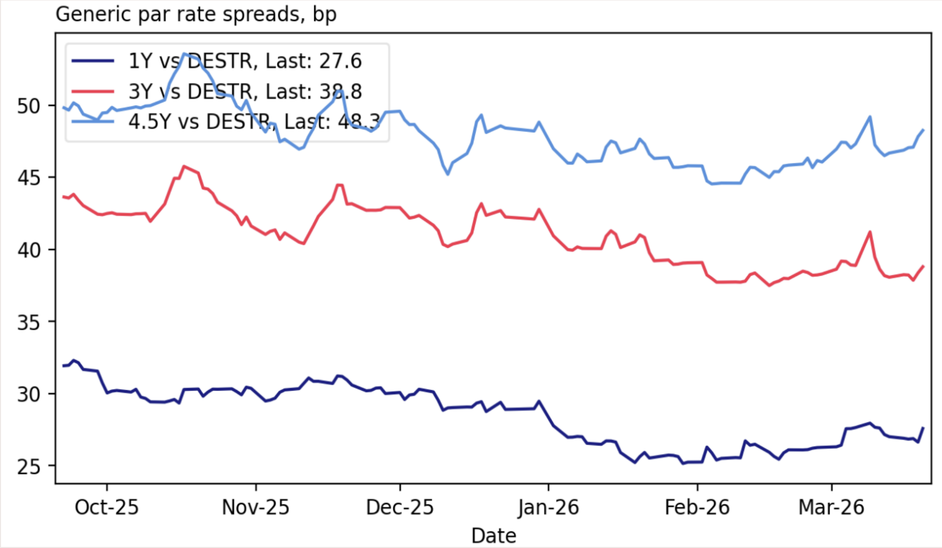
Return on delta (vector) hedged callable incl/excl overlays



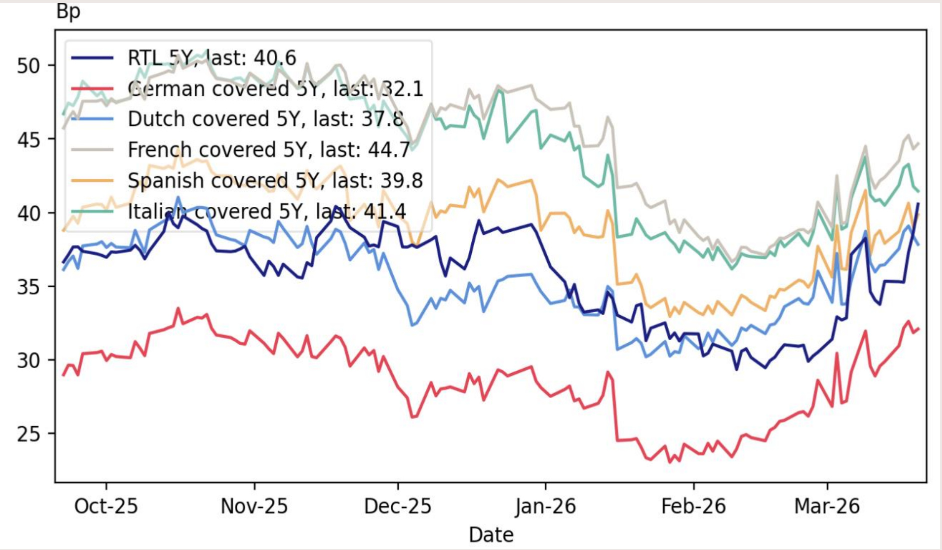
War, net position and end-of-quarter issuance – not much is in favour of bullets

- The war in the Middle East gave rise to decent spread widening across the bullet curve last week, and it is our expectation that this will continue this week.
  - Escalation of the conflict in the Middle East over the weekend will probably give bullet spreads a bad start to the week.
  - At the same time, we expect end-of-quarter issuance towards the end of the week of DKK 14-16 billion in bullets, which usually gives rise to spread widening of 1-2bp in 3Y-5Y bullets.
- It is also this week that the net position is set to take a larger decline (see also below) – just over DKK 45 billion to around DKK 260 billion – which we have previously pointed out should bring the spreads on short-dated bullets closer to the levels that prevailed before they performed in early January.
  - Even with the spread widening we saw last week, this could give rise to an additional 2-3bp.
- Thus, there is not much to be said in favour of the bullets at the moment.
- However, the bullet segment can be supported by investors who are more concerned about the callables than about bullets and therefore choose to reinvest in this segment.

Bullets: Spreads vs DESTR



Bullets and EUR covered bonds: Spread vs DGB/DBR



End-of-quarter issuance just around the corner

- We expect end-of-quarter issuance in the region of DKK 20 billion, with the majority in bullets.
- This is because it is primarily RD and secondarily NDA and JRK that have outstanding funding need from the refinancing auctions in February.
- NYK should only have an outstanding end-of-quarter issuance need from housing transactions and ordinary remortgaging without fixed-price agreements. We therefore expect a smaller portion of FRNs (a total of DKK 6-8 billion across issuers).
- The last chance to trade subject to settlement on 1 April is on Monday next week. The question is whether issuers will start their end-of-quarter issuance early this week due to the Easter holidays next week.
- In connection with the end-of-quarter issuance in December, the majority came on Monday and Tuesday (22-23 December) despite the Christmas holidays.
- It is our expectation we'll see end-of-quarter issuance on Friday this week and Monday next week.

Expected end-of-quarter issuance (DKKbn)

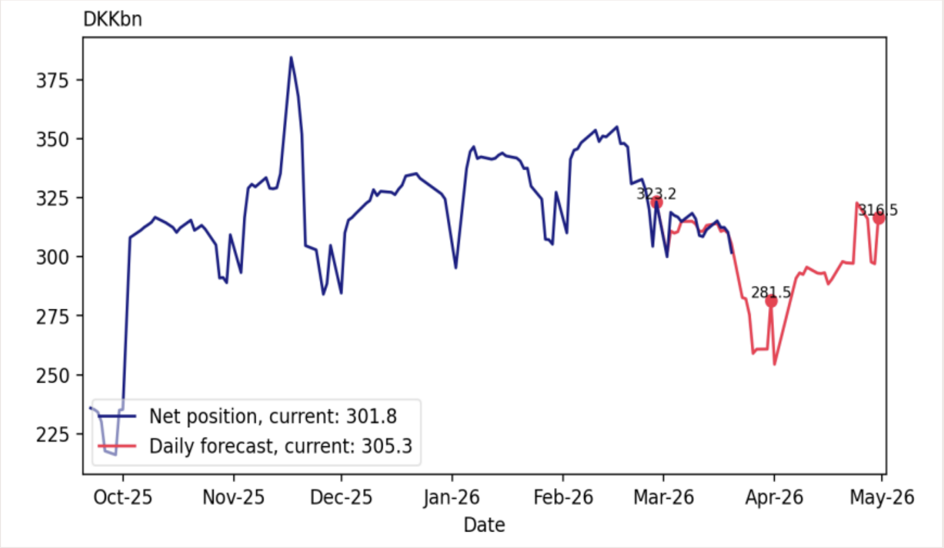
Bullets	FRNs	Callables	Total
12-14	6-8	2-3	18-20

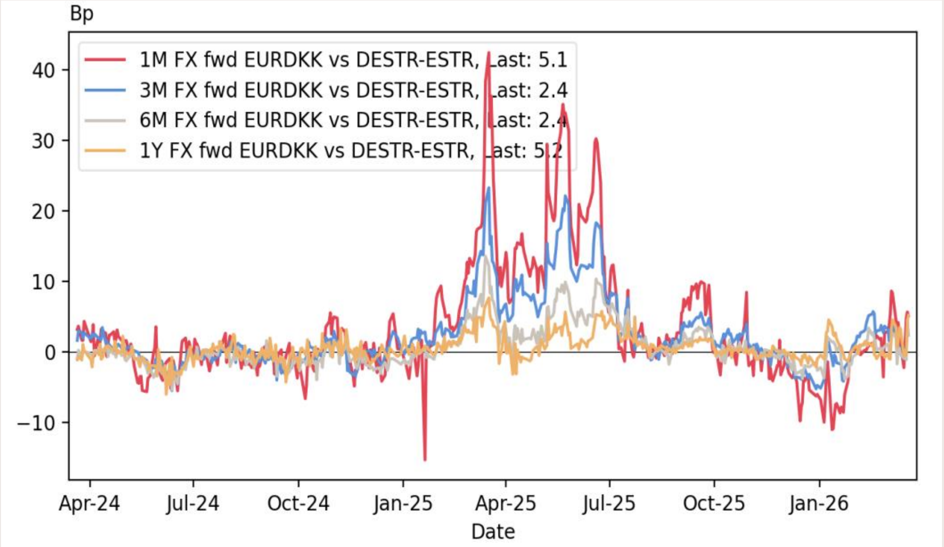
Net position: Now the descent has started!

- It is this week that the net position really falls towards the expected trough this year
  - Today, the net position is set to fall by approx DKK 22.5 billion, and by a further approx DKK 23 billion during Wednesday and Thursday – for the week as a whole, this is a decline of approx DKK 44.5 billion.

- The level will not be decidedly low, and FX forwards are far from showing the same signs of liquidity scarcity as last spring (see bottom chart)
  - However, we expect some headwinds to the shorter-term RTL bonds, and the declining liquidity may also have an impact on how the end-of-quarter issuance will go.

Net position incl daily forecast



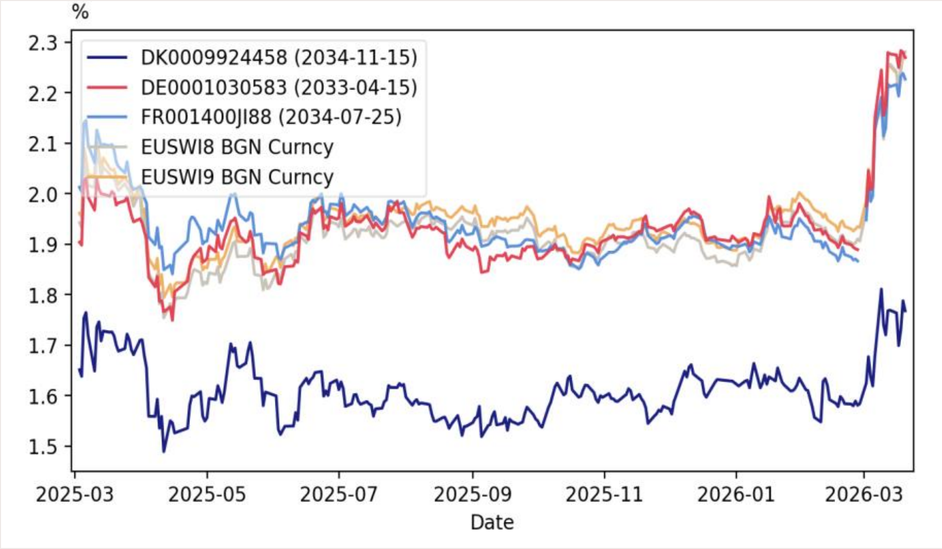


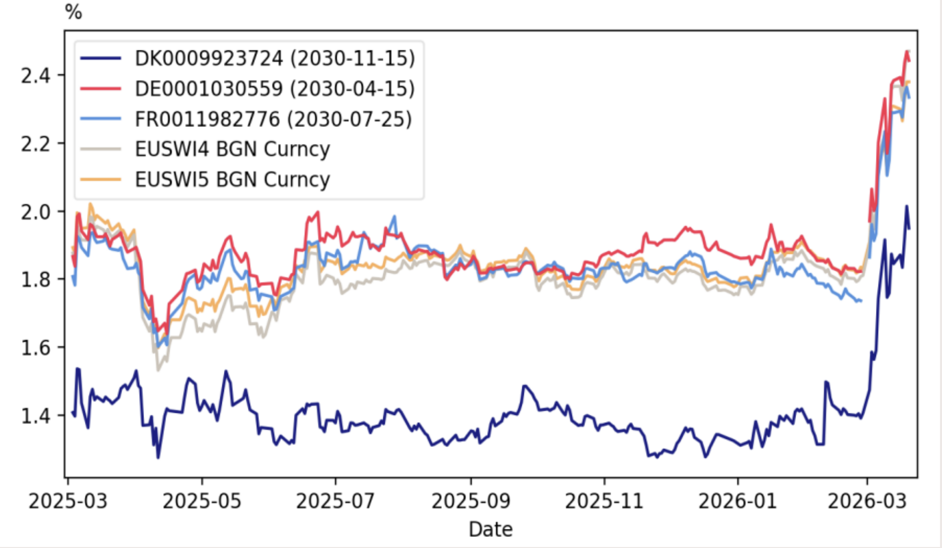
DGBi’34: Relatively cheap?

- After last week's auction, DGBi'34 is still trading at a (seasonally adjusted) BEI, which has increased less than for corresponding EUR linkers and inflation swaps (see top chart)

- This is in contrast to DGBi'30, where seasonally adjusted BEI has risen in line with corresponding EUR linkers and inflation swaps (see bottom chart)

- In this light, DGBi'34 offers relatively cheap inflation hedging in the current situation





Nykredit markets

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Recommendation	
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Sell	50%

As at 13.12.2024

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

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