Time for reinvestment performance

Yes, please, but where and when?

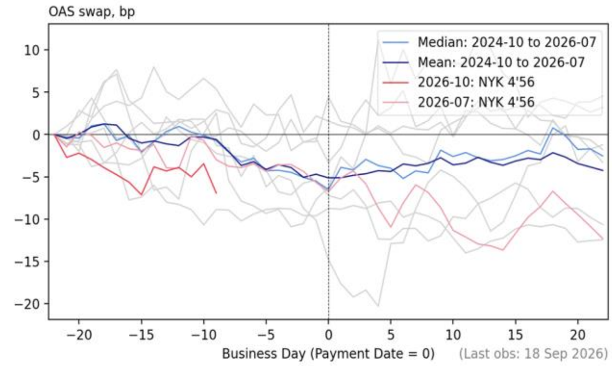
21 September 2026 10:50 | Marketing communication

Jacob Skinhøj, Chief Analyst, jsi@nykredit.dk, +45 44 55 11 27
Peter Bache, Chief Analyst, pbac@nykredit.dk, +45 44 55 13 63
Veronica Bergstrøm, Senior Analyst, vbm@nykredit.dk, +45 44 55 12 24

- Time for reinvestment performance?
- But are the October prepayments too small to generate performance? At first glance, yes, but ...
- we believe 4'56 will be the primary winner over the following weeks and expect at least a further 4bp of performance.

Since 2016, a recurring pattern has emerged in Danish mortgage lending: OAS of OTR bonds has tightened ahead of the payment dates, only to widen again afterwards. We have not seen reinvestment performance at every payment date, but it has occurred in the vast majority of cases. As such, our initial expectation is that the October payment date will generate performance. Read more below.

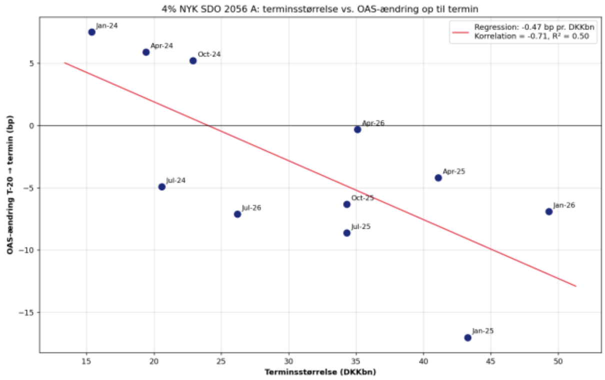
Reinvestment performance in callables



Time for reinvestment performance

Source: Nykredit Markets

Correlation between the size of prepayments and OAS performance



Correlation between the size of prepayments and OAS performance

Source: Nykredit Markets

The October payment date is now no more than ten trading days away, bringing us into the period when we would normally begin to see reinvestment performance in on-the-run issues. This time, however, the picture is complicated by several factors:

1) The October prepayments are small, and this limits the reinvestment need. Just DKK 14.6 billion in prepayments and principal payments needs to be reinvested, bringing October prepayments to the lowest level since 2024 (see the top chart overleaf).

2) September saw significant increases in interest rates and volatility which in itself impacted risk premiums. Two opposing OAS movements are thus at play simultaneously: the usual reinvestment performance and the pressure from higher interest rates and volatility.

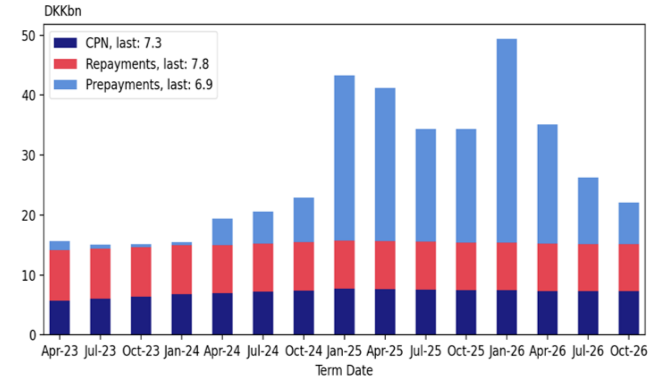
3) The increases in interest rates and volatility have also been so pronounced that the resulting price declines have prompted issuers to announce the opening of new ISINs. Consequently, there is currently some uncertainty as to which bonds are actually OTR.

The uncertainty about which callable is currently OTR also appears to have affected advisers and borrowers. Current issuance is, in fact, even lower than usual, which supports the case for reinvestment performance. See the chart overleaf.

Are the October prepayments too small to generate reinvestment performance?

At first glance, the answer is yes. The chart at the bottom of this page shows the size of each of the past 11 payment dates against the change in OAS over the final 20 days leading up to the payment date. It shows a certain correlation between the size of the payment date and the degree of reinvestment performance.

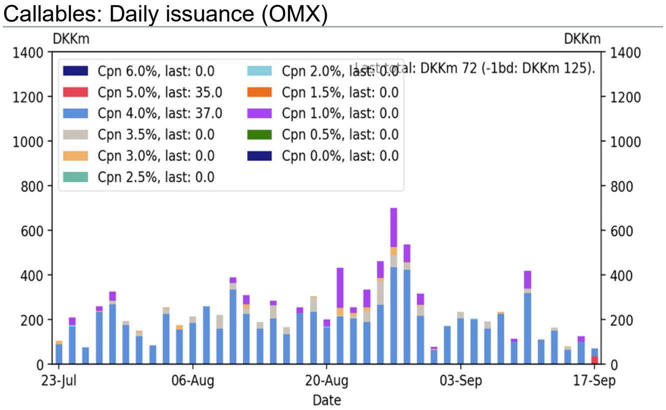
Size of previous payment dates



Interest rates, principal payments and prepayments. We have to go back to 2024 to find payment dates as small as the one in October.

Source: Nykredit Markets

Callables: Daily issuance (OMX)



The issuance of 5'59 last Thursday is just visible in the bottom right-hand corner of the chart.

Source: Nykredit Markets

If the historical pattern of the past three years holds, a payment date of just under DKK 15 billion should actually result in spread widening of around 4bp. However, we do not interpret this result as suggesting that a small payment date in itself leads to spread widening, but rather that reinvestment need in 2024 was so limited that it was insufficient to offset the general spread widening seen over the course of the year.

Nevertheless, we expect some reinvestment performance this time, as current issuance is simply too low relative to reinvestment need. Assuming average daily issuance of DKK 200 million around the payment date and that all redemptions are reinvested, it would take around 75 days of issuance to meet the reinvestment demand. This is slightly more than the approx 60 days seen back in 2024.

This calculation is, of course, illustrative, as some issuance takes place ahead of the payment date when borrowers enter into fixed-price agreements.

Looking at the quarter as a whole, net issuance of callables is once again set to end up close to zero. Although prepayments have declined over the past few payment dates, ongoing issuance net of buybacks has fallen by roughly the same amount. This must, of course, also be taken into account when assessing the potential for reinvestment performance.

Which segment will deliver the performance?

We normally measure reinvestment performance in the highest coupon trading below par 20 trading days before the payment date, which in this case is 4'59. However, as both issuance and outstanding amounts in 4'59 are negligible, we expect most investors to opt for 4'56, even if it is expensive relative to 4'59. This is mainly due to its better liquidity and continued inclusion in the index.

DISCLOSURE
This material was produced by Fixed Income Research, which is part of Nykredit Bank A/S ("Nykredit Bank" or "the Bank"). Nykredit Bank is a financial undertaking subject to the supervision of the Danish Financial Supervisory Authority.

Nykredit Bank participates in market-making schemes for Danish government and mortgage bonds and can, in its capacity as market maker, hold positions in Danish government and mortgage bonds.

Over the previous 12-month period, Nykredit Bank or companies of the Nykredit Group may have been lead manager or co-lead manager of any publicly disclosed offering of Danish government or mortgage bonds. Further information is available on request.

Nykredit Bank or companies of the Nykredit Group are not involved in corporate finance activities or any other investment services or activities or ancillary services for companies referred to in the material.

This material contains information recommending or suggesting an investment strategy and was not produced by an independent analyst. Instead, it was produced by strategic analysts, whose recommendations are based on their experience or knowledge in the financial area. It was not produced in accordance with regulation aiming to promote the independence of investment research and is therefore considered marketing material and not investment research. No prohibition applies to trading in any financial instruments referred to in the material prior to its dissemination.

Nykredit Bank and companies of the Nykredit Group have not entered into any agreement with the issuer on the production of this material. This material has not been presented, in full or in part, to the company.

This material was finalised and released for distribution for the first time on the date and time stated at the top of the material.

<u>Financial models and methods used</u>
Calculations and presentations are based on ordinary econometric and financial tools and methods as well as publicly available sources. Assessments of Danish callable mortgage bonds are modelled using a proprietary model consisting of a stochastic yield curve model and a statistical prepayment model calibrated to borrowers' historical prepayment behaviour.

<u>Recommendation and risk assessment structure for government and mortgage bonds (incl covered bonds)</u>
Nykredit Bank typically focuses on isolating relative value in fixed income and derivatives markets. Therefore, the interest rate and/or volatility risks of the strategy are typically hedged through other bonds or derivatives (swaps, swaptions, caps, floors etc).

BUY: In our view, the bond pricing is fairly cheap relative to comparable alternatives in either the bond or the derivatives market. We expect that the bond will offer a higher return than any alternatives on a horizon of typically three months.

SELL: In our view, the bond pricing is fairly expensive relative to comparable alternatives in either the bond or the derivatives market. We expect that the bond will offer a lower return than any alternatives on a horizon of typically three months.

Risk warning
Any assessments and recommendations made in this material may involve substantial risk. Such risk, including a sensitivity analysis of the relevant assumptions, is stated in the material. All investors should consider the purpose of their investment and make their own decisions as regards any kind of investment in financial instruments referred to in this material.

Regular updates of the recommendation are not scheduled, and any updates will therefore be on an ad-hoc basis.

Unless otherwise stated, all price information in this material is as at the trading day prior to the date stated on the front page.

For a list of all Nykredit Bank's government and mortgage bond recommendations in the last 12 months, including specific information on the individual recommendation, please see here.

Nykredit Bank has significant financial interests in relation to Nykredit Realkredit A/S in the form of general banking services and investments in bonds issued by Nykredit Realkredit A/S.

Nykredit Bank is a wholly-owned subsidiary of Nykredit Realkredit A/S. The material may contain a recommendation to buy bonds issued by Nykredit Realkredit A/S. This entails a conflict of interest between Nykredit Bank and customers, as Nykredit Bank has a particular interest in selling bonds issued by companies of the Nykredit Group.
<u>Information about Nykredit Bank</u>
Nykredit Bank has adopted internal rules to prevent and avoid conflicts of interest in the preparation of research and to ensure effective communication barriers. Analysts at Nykredit Bank are obliged to refer any communication that may affect the objectivity and independence of investment research to the Head of Research and the Compliance unit. Employees of Nykredit Bank must at all times be alert to any potential or actual conflicts of interest between Nykredit Bank and customers, between customers, and between an employee on the one hand and Nykredit Bank

or customers on the other, and must endeavour to avoid conflicts of interest. Nykredit Bank has adopted a conflicts of interest policy on the identification, management and disclosure of conflicts of interest in connection with securities trading and related services provided by Nykredit Bank for customers. If becoming aware of circumstances that may constitute a conflict of interest, Nykredit Bank's employees are obliged to disclose such information to their line manager and to the Compliance unit, which will then determine how to proceed.

Fixed Income Research in Nykredit Markets operates independently of the units Debt Capital Markets & Sustainability and Financial Institutions Group and is organised independently of, and does not report to, any other business units of the Nykredit Group. Employees are remunerated partly based on Nykredit Bank's overall performance, which includes income from investment banking transactions, but do not receive bonuses or other remuneration directly related to specific corporate finance or debt capital transactions. Persons involved in the production of the material do not receive remuneration related to investment bank transactions conducted by companies of the Nykredit Group.

Distribution of recommendations

The table below shows the distribution of Nykredit Bank's direct investment recommendations in investment research on government and mortgage bonds in the most recent quarter. No significant investment firm services have been provided to issuers in the period. Current distribution of direct investment recommendations:

Recommendation	
Buy	50%
Sell	50%

As at 13.12.2024

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

DISCLAIMER

This material was produced by Nykredit Bank for the personal information of the investors to whom the Bank has distributed the material. The material is based on information available to the public and own calculations based on such information.

Nykredit Bank does not accept any liability for the correctness, accuracy or completeness of the information in the material. Recommendations are not to be considered as offers to buy or sell the financial instruments in question, and Nykredit accepts no liability for transactions based on information presented in the material.

Information on previous returns, simulated previous returns or future returns presented in the material cannot be used as a reliable indicator of future returns, and returns may be negative. Information on price developments presented in the material cannot be used as a reliable indicator of future price developments, and price developments may be negative. If the material contains information on a specific tax treatment, investors should bear in mind that the tax treatment depends on the investors' individual situation and may change in future. If the material contains information based on gross returns, such returns may be reduced by fees, commissions and other costs.

Nykredit Bank and/or other companies of the Nykredit Group may buy, sell or hold positions in securities referred to in the material, and these companies may be involved in corporate finance activities or other activities for companies referred to in the material.

Special rules on crisis management in banks (bail-in):

Special rules apply to crisis management in banks. The rules prevent the use of taxpayers' money in times of crisis, meaning that banks will not be bailed out by rescue packages paid by the public. Instead, losses will be borne by the shareholders and bondholders of crisis-stricken banks. This is called "bail-in".

It may be difficult for investors to predict the implications of the complex rules, and a crisis may hit very suddenly. If you invest in bank shares or securities issued by a bank, be aware of the special risk of a write-down or a complete loss of your investment. A potential or current banking crisis will also have a huge impact on the liquidity of your investments.

Nykredit Bank A/S – Sundkrogsgade 25 – DK-2150 Nordhavn – Tel +45 44 55 10 00 – Fax +45 33 12 04 34