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CREDIT MARKETS: Risk Off As Housing Data Shakes Confidence

By Katy Burne Of DOW JONES NEWSWIRES

NEW YORK (Dow Jones)--The corporate bond market was at a virtual standstill Wednesday, with just three high-grade issues coming to market and only one visit from the high-yield market.

Lending weight to the fears of those looking for a second big dip in the economy, new home sales for May were disappointing, down a record 32.7% to a seasonally adjusted annual rate of 300,000 units, compared to expectations of a 20.6% drop. That came on top of weak US existing home sales data reported on Tuesday.

Markit's CDX North American Investment-Grade Index, a key barometer of US credit investors' nerves, deteriorated 1.17 basis points wider to 115.75bps on the news from 114.58bps at Tuesday's close. It improved only slightly through the afternoon to 115.54 as the knee-jerk reaction began to wear off.

"In the scheme of things, new home sales aren't a big enough portion of the economy...we still believe double [economic] dip is unlikely," said Guy Lebas, chief fixed-income strategist at Janney Montgomery Scott, in a note.

John Lekas, CEO of Leader Capital Corp, which runs a short-term bond fund, said more issuers should be in the market since he believes interest rates are bound to go up and access to capital will only get tougher as the year progresses.

"If I were an issuer, I'd probably push ahead as I think the cost of borrowing is going to go up because of interest-rate risk, not because of credit risk. Earnings season is going to be sticky and soft," he said.

Investment Grade: International Flavor

Most of the action came from non-US issuers as Wednesday marked the second consecutive slump in the primary high-grade market this week following Monday's rush.

Bahrain Mumtalakat Holding Co., a sovereign wealth entity owned by the Kingdom of Bahrain, priced its debut bond issuance--raising $750 million--with a spread of 3 percentage points over midswaps on five-year notes, in line with guidance.

Mexican bakery and snacks company Grupo Bimbo SAB (BIMBO.MX) priced $800 million of 10-year bonds at 1.8 percentage points over Treasurys. And finance firm Jefferies Group launched a sale of $400 million senior unsecured bonds at Treasurys plus 3.9 percentage points.

US-marketed investment-grade volume is $9.18 billion so far this week, compared to $19.2 billion last week, according to Dealogic.

In secondary trading, risk premiums over super-safe Treasuries on Morgan Stanley's 4.1% bonds due 2015 rose 0.48 percentage points. The spread for Shell International Finance BV's recently issued 3.1% bond due 2015 fell 0.01 percentage point.

Junk Bonds: Flat To Improving

Junk bonds were fairly flat with no new deals, although the general tone of the market continues to improve. "The market seems to have settled down a little bit but there's still some underlying nervousness," said Greg Hopper, portfolio manager at Artio Global Investors, noting that recent new deals are doing fairly well in aftermarket trade. "I think we've gotten back to good solid fair value again, and as long as market participants can rest easy that there aren't any more bogeymen waiting to pop out of the floor, they want to put their money to work."

Rite-Aid bonds gained after its first-quarter loss narrowed to $73.7 million from $98.4 million a year earlier, beating analyst expectations. Rite-Aid's 9.5% notes due 2017 were the most actively traded high-yield issue, up 1.5 points to 81.5,

according to MarketAxess.

The leveraged loan market, meanwhile, showed signs of a continued revival. Interactive Data Corporation's $1.4 billion credit facility is said to be pricing at 475 basis points over Libor, with a 1.75% minimum Libor rate. The deal, run by Bank of America Merrill Lynch, UBS and Barclays, will partially finance Interactive Data's buyout by private equity firms Warburg Pincus and Silver Lake.

A shift into leveraged loans out of high-yield bonds as a hedge against default risk and rising interest rates would be premature, according to Bank of America Merrill Lynch, which calculates one-year net returns coming in 0.7% higher than loans after accounting for defaults and recoveries.

"While loans certainly offer advantages over bonds from the risk management standpoint, their valuations and default trends would make it challenging to achieve outperformance in the near term," BofA ML wrote Wednesday. "The time for such a shift in our view will come as the Fed turns its attention to tightening of monetary policy, and loan versus bond default trends equalize. We are likely to be few quarters away from such a point."

Agency Mortgages: Riding High

Agency mortgage securities scaled new heights for the second day in a row. The securities are at a 15-year high on their prices and continued to trade higher, buoyed by the Federal Open Market Committee's statement that it will hold federal-funds rates at their current lows for an extended period. Investors use this as a strategy to borrow cheaply at the short end, and buy long-term securities with the expectation that rates will remain low for a long period. The rise in price put Fannie Mae's 4% coupon as the current coupon, and this is trading at a price of 100-27.

Treasurys: Back In Black

Prices of Treasury securities rose on the Fed's cautious note and speculation rose that the Fed's low interest-rate policy may persist for a longer period than first thought.

With the prospects of the low-rate policy staying in place, the two-year note's yield fell as low as 0.657%, the lowest level in more than a month and not far from a record low 0.601%, set in mid-December 2008 following the collapse of Lehman Brothers.

Long-dated Treasurys, on the other hand, benefited from the Fed's assessment on the inflation outlook. The Fed said in its statement accompanying the rate decision that it sees underlining inflation trending lower, reducing a main threat to the value of such bonds over time. The longer the maturity, the more sensitive a bond's value to rising consumer prices.

The statement contains "extremely dovish Fed language as it relates to inflation and the economy," said Tom di Galoma, head of U.S. rates trading at Guggenheim Partners in New York. "It seems to me they are inherently worried about deflation going forward. Bond investors are taking note of the Fed's new inflation view and buying out the curve."

As of 4 p.m. EDT, the price of the 10-year note was up 15/32 and the yield was down 5.6 basis points at 3.110%. The 30-year bond was 29/32 higher, with the yield down 5.1 basis points at 4.049%. The two-year note was up 3/32 in price and its yield down 4.4 basis points at 0.676%. Bond yields move inversely to prices.

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