

Perpetuals:

Neutral

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WongVKAM@ocbc.com**Perpetual Series 6: Picking up nickels****Is this a new norm, or would this unravel? Thankful for 3% yields while rates remain low.**

- To our surprise, the [non-call of ARTSP 4.68% PERP](#) (covered in our 5th series) was a seemingly non-event as prices corrected by a mere few points. Meanwhile, the rest of the SGD perpetuals still held up well, including WINGTA 4.35% PERP (till it became apparent that the issuer similarly skipped the call).
- Against our view that perpetuals [should not be indiscriminately priced to call](#) (3rd series) as [the chance of missing a call is non-zero](#) (2nd series), the market appears to price a number of perpetuals to call still – though investors are right in certain cases where replacement perpetuals could be priced around the 3% handle, which is a record low range for perpetual coupons.
- The suppressed interest rate environment coupled with lack of supply has starved investors of alternatives, driving yield-hungry investors to chase down the capital structure. Had investors chosen not to sacrifice on structure, we believe a higher grade SGD bond portfolio with Neutral (4) Issuer Profile would likely yield just above 2% in today's environment.
- In today's environment, yields around 2-3% in SGD compare very well against peers globally. For tenors not exceeding 10Y, BBB-rated corporates in the US trade lower than 2%; Europe fares worse at lower than 1%. Meanwhile, rates of some of the safest assets (e.g. government bonds) are turning negative.
- As such, SGD perpetuals could remain supported if interest rates and spreads remain suppressed globally. For now, the 3% handle appears to be the new norm for higher grade SGD corporate perpetuals.
- The chase for yield is good news for existing perpetuals, especially ones which are issued earlier with wider spreads, as replacement perpetuals could be priced tighter or at similar levels. If spreads on straight bonds continue to grind tighter, perpetuals may tag along.
- Due to technical factors, we turn **Neutral** on perpetuals as non-call risks have reduced given the potential to refinance at similar initial spreads or cheaper despite shifts in fundamentals. We favour perpetuals which were issued earlier and/or issued with wider spreads, which may see higher chances of call.
- That said, we remain somewhat cautious on newer or replacement perpetuals in general, including ones which may price following the outbreak of COVID-19. We believe that non-call risks are higher for corporates which cannot refinance cheaper, as we observe that [issuers which exercise the call typically do so based on economics](#) (2nd series) and maintain access to the market in view of their still sound fundamentals. One reason for [Ascott REIT to miss the call was because the economics did not work out](#).
- Despite the strong market technical environment, we caution against chasing perpetuals if the spreads compress too close to the seniors. Historically, while certain perpetuals trade at smaller senior-sub spreads, the vast majority of [senior-sub spreads traded around 100bps](#) (3rd series). Versus straight bonds, investors should think if the spread pickup between perpetuals and straight bonds adequately compensates for increased risks, including (1) subordination, (2) non-call and (3) distribution deferral. Aside from [increased risk of inflation](#), a significant uptick in supply (if any) may also limit further compression in spreads. Macroeconomic uncertainties remain with no firm visibility on the pace of any economic recovery, though it looks increasingly like a ['K'-shaped one](#) with the haves coming out ahead relative to the have-nots.

Explanation of Issuer Profile Rating / Issuer Profile Score

Positive (“Pos”) – The issuer’s credit profile is either strong on an absolute basis, or expected to improve to a strong position over the next six months.

Neutral (“N”) – The issuer’s credit profile is fair on an absolute basis, or expected to improve / deteriorate to a fair level over the next six months.

Negative (“Neg”) – The issuer’s credit profile is either weaker or highly geared on an absolute basis, or expected to deteriorate to a weak or highly geared position over the next six months.

To better differentiate relative credit quality of the issuers under our coverage, we have further sub-divided our Issuer Profile Ratings into a 7 point Issuer Profile Score scale.

| | | | | | | | |
|-----|----------|---|---------|---|---|----------|---|
| IPR | Positive | | Neutral | | | Negative | |
| IPS | 1 | 2 | 3 | 4 | 5 | 6 | 7 |

Please note that Bond Recommendations are dependent on a bond’s price, underlying risk free rates and an implied credit spread that reflects the strength of the issuer’s credit profile. Bond Recommendations may not be relied upon if one or more of these factors change.

Explanation of Bond Recommendation

Overweight (“OW”) – The bond represents **better relative value** compared to other bonds from the same issuer, or bonds of other issuers with similar tenor and comparable risk profile.

Neutral (“N”) – The represents **fair relative value** compared to other bonds from the same issuer, or bonds of other issuers with similar tenor and comparable risk profile.

Underweight (“UW”) – The represents **weaker relative value** compared to other bonds from the same issuer, or bonds of other issuers with similar tenor and comparable risk profile.

Other

Suspension – We may suspend our issuer rating and bond level recommendation on specific issuers from time to time when OCBC is engaged in other business activities with the issuer. Examples of such activities include acting as a joint lead manager or book runner in a new issue or as an agent in a consent solicitation exercise. We will resume our coverage once these activities are completed.

Withdrawal (“WD”) – We may withdraw our issuer rating and bond level recommendation on specific issuers from time to time when corporate actions are announced but the outcome of these actions are highly uncertain. We will resume our coverage once there is sufficient clarity in our view on the impact of the proposed action.

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