

Selling credit - Is the Fed setting an example?

The Federal Reserve will begin selling off its corporate holdings under its Secondary Market Corporate Credit Facility (SMCCF). At first glance, this seems insignificant as the Fed is only holding the small amount of US\$13.8bn. However, this is an extra addition into the cocktail of our slight bearish outlook for the second half of the year



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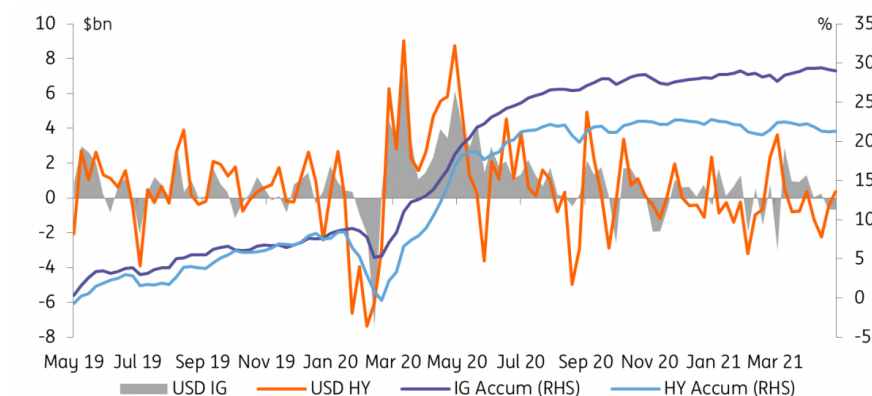
The Fed has announced that it will not just taper off its corporate holdings, but actively sell holdings under its Secondary Market Corporate Credit Facility (SMCCF). This did come as a surprise, however in the grand scheme of things, the amount is relatively small at just US\$13.8bn. Of this, just US\$5.2bn is in corporate bonds and US\$8.6bn is in ETFs. This includes both investment grade and high yield ETFs. For comparison, the European Central Bank's holdings of corporate bonds extend to a substantial €275bn. Therefore, the selling of US\$13.8bn by the Fed should not have any detrimental effect on spreads or funding levels.

Furthermore, this is fully outweighed by mutual fund (& ETF) inflows. Over the past 12 months, USD investment grade inflows have amounted to a substantial US\$44bn. On a year-to-date basis, USD investment grade inflows have accumulated to US\$5.2bn. Bear in mind, fund flows so far this

year have been positive but relatively low. This comes after the substantial inflows seen in 2020 and 2019. Looking at this year alone, the technical picture, in this sense, is now flat.

All of that said, the Fed's move does add weight to our slight bearish outlook. It is a signal that while it's not all out tapering, it is the start of a different phase.

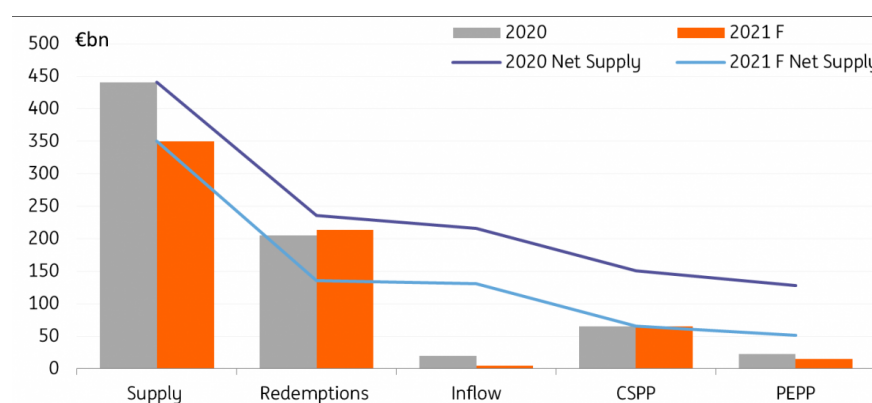
USD Fund Flows



On Thursday, USD spreads did push about 1bp wider in places but remained unchanged for the most part. If anything, the high yield market may be affected marginally more but all in all, we do not expect any significant pressure. In saying that, we do still remain somewhat bearish on spreads for the second half of this year. As inflationary fears increase, matched with continued tapering talks coming to the forefront and a rise in rates, we do expect to see softness in credit spreads, and a widening from these current tight levels. And we expect USD spreads to underperform against EUR spreads. In both USD and EUR, the technical picture in credit remains strong, however the technicals in EUR are certainly more supportive, namely because of the ECB. The lack of corporate bond holdings by the Fed may act as an additional minor catalyst for USD underperformance and could provide another reason for a little softness in spreads in the second half of this year.

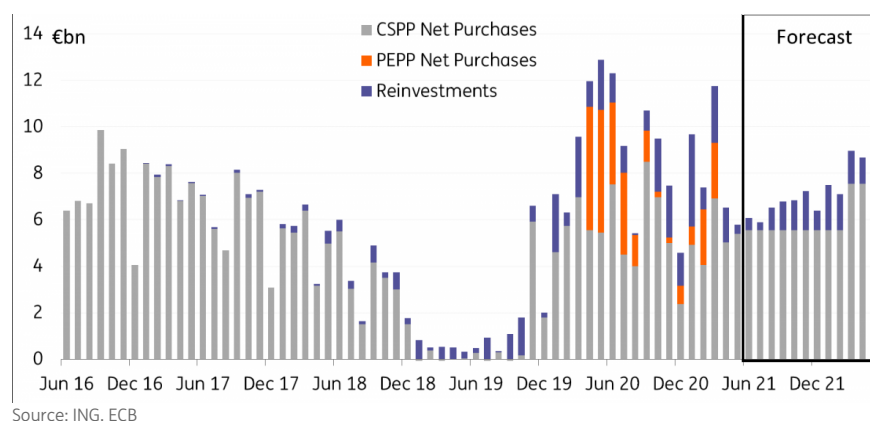
Strong Technical Picture in EUR credit

Forecast net supply after demand (CSPP, PEPP & Inflows) comes to just €50bn



The ECB is a notable driving factor in the strong technical picture in EUR credit. The central bank has been buying €5.5bn of corporate bonds per month, on average, under its Corporate Sector Purchase Programme. It also makes a significant amount of reinvestments each month. In fact, looking long term, when the ECB does decide to end its purchases under the CSPP, the reinvestments will be so significant, we do not expect to see any taper tantrum. We do not expect the ECB to follow the Fed's lead in selling its holdings. However, if the Fed's move is successful, the ECB may want to consider something similar to ensure its holdings are sustainable. In our report: [To green or not to green: What it means for Credit if ECB becomes greener](#), we outlined the ECB's options to make its holdings more sustainable. One of these is to sell carbon intensive holdings. While this is less likely, it remains an option nonetheless.

ECB corporate purchases



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