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Markit Recap – 7/7/2014

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Credit spreads remain close to their recent tight levels, but the onset of earnings season could trigger a shift in sentiment.

The Markit CDX.NA.IG index traded at 57.5bps on July 8, nearly 25bps tighter than the March 20 roll spread. Monetary policy is still accommodative in the US, and the ECB could well ease policy further in the coming months. This ongoing support from central banks should act as a bulwark for current valuations.

However, while the tone of the market is positive, adverse newsflow could cause a reversal. Banks have already signalled that persistently weak fixed-income trading revenues will result in poor second-quarter earnings. The profit warnings may temper the disappointment, though the results will nonetheless be very closely watched.

The ongoing saga in Argentina is another potential catalyst for change. A US court blocked an interest payment due on June 30, meaning that it has until July 30 (the bond has a one-month grace period) to avoid default. The Argentine government is in mediation talks with holdout investors, and many expect a compromise agreement to be reached. The sovereign's five-year CDS are trading about 35 points upfront, which is an improvement from the 50 points in mid-June, but still indicative of considerable credit distress. Argentine is a unique case and its problems are unlikely to have a systemic effect, but it is possible that there will be some impact on emerging market sentiment.

Contact: Gavan Nolan

Gavan.Nolan@markit.com