

Markit Recap – 4/16/2018

THE LEAD | April 19, 2018

iTraxx Europe – options can influence volumes



Fundamental factors rightly garner the most attention when investors try to ascertain why markets move. Even if one regards markets as perfectly efficient and favour index tracking, it would be foolhardy to completely ignore real world influences when managing money.

But the credit markets, in particular, warrant analysis of technical undercurrents that can shape spread direction. Credit indices are tradeable instruments are therefore subject to their own supply and demand dynamics. Most are familiar with the semi-annual roll of the indices, which typically causes higher than average trading volumes and spread movements that can deviate from the underlying credit risk. Perhaps less well known, however, are the trading patterns that typically occur around the monthly option expiry.

Options on CDS indices (sometimes known as swaptions) have gained in popularity over the last two to three years. End users now regard them as an important tool in tailoring their credit exposure, and their application as an instrument to hedge tail risk is well established. But the increase in swaption usage has had a consequential impact on volumes of the referential indices.

On the third Wednesday of the month credit swaptions expire, and this can trigger higher volumes in the underlying index. How much volume is a function of where the index is trading and how much open interest is

in the particular option with a strike closest to the underlying. For example, on this month's expiry the Markit CDX .NA.IG Series 30 was trading around 59bps, a level close to the 60bps "pin". This will result in trading activity in the index that is highly technical and can cause movements that deviate from constituents.

The Markit iTraxx Europe Series 28 saw about \$15bn in notional traded on April 18. This was several multiples of the typical daily volume since the index went off-the-run on March 20, demonstrating how option expiry can affect the index market. We can expect usage of CDS index options to increase as investors position for further episodes of volatility in the months ahead.

Contact: Gavan Nolan

Gavan.Nolan@ihsmarkit.com