

# Covered Bonds: Where is the added value for investors?

**Ted Packmohr**

ted.packmohr@drkw.com

+49 (0)69 7131 5086

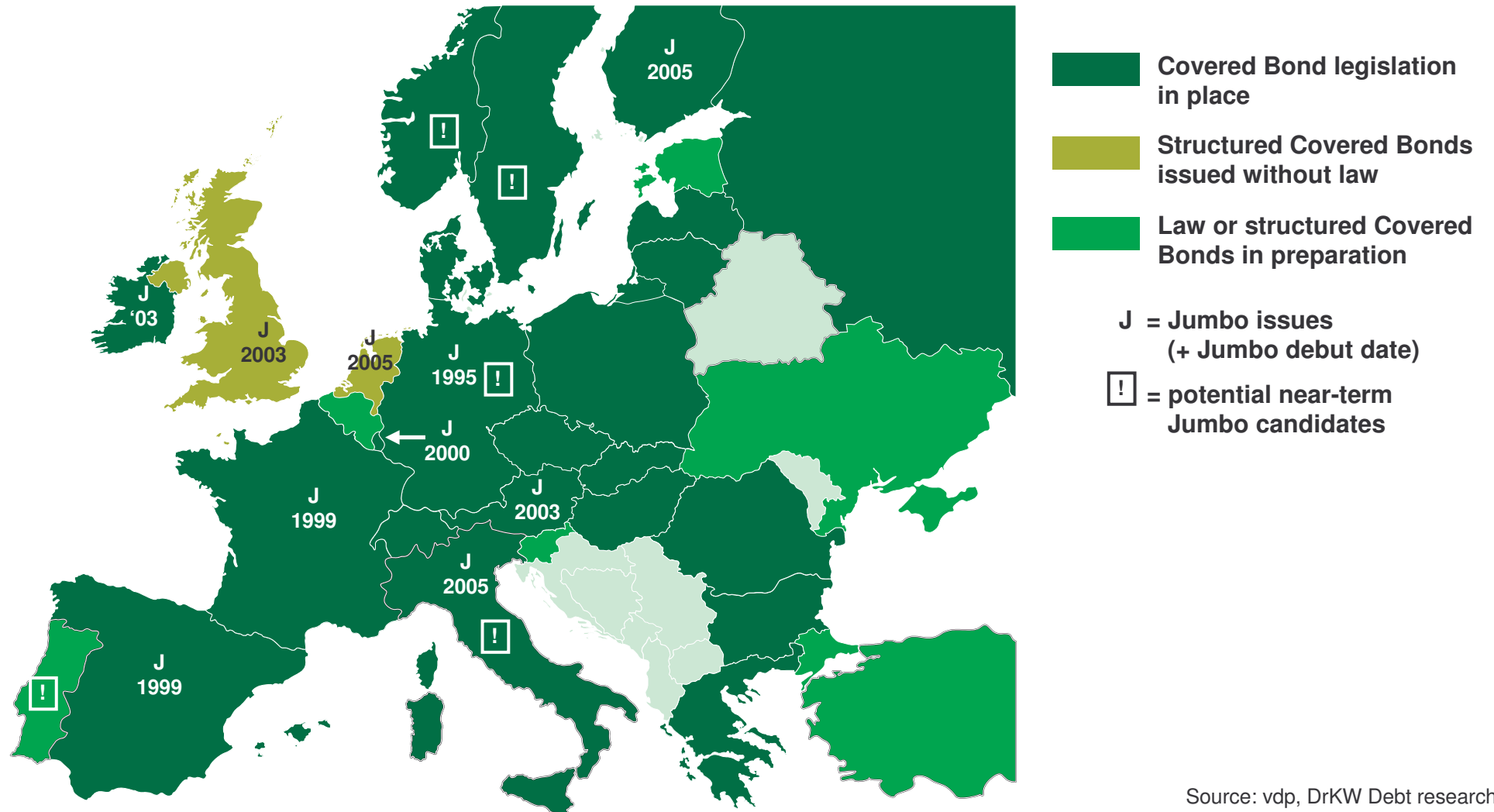
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Dresdner Kleinwort Wasserstein Research GmbH, Theodor-Heuss-Allee 44-46,  
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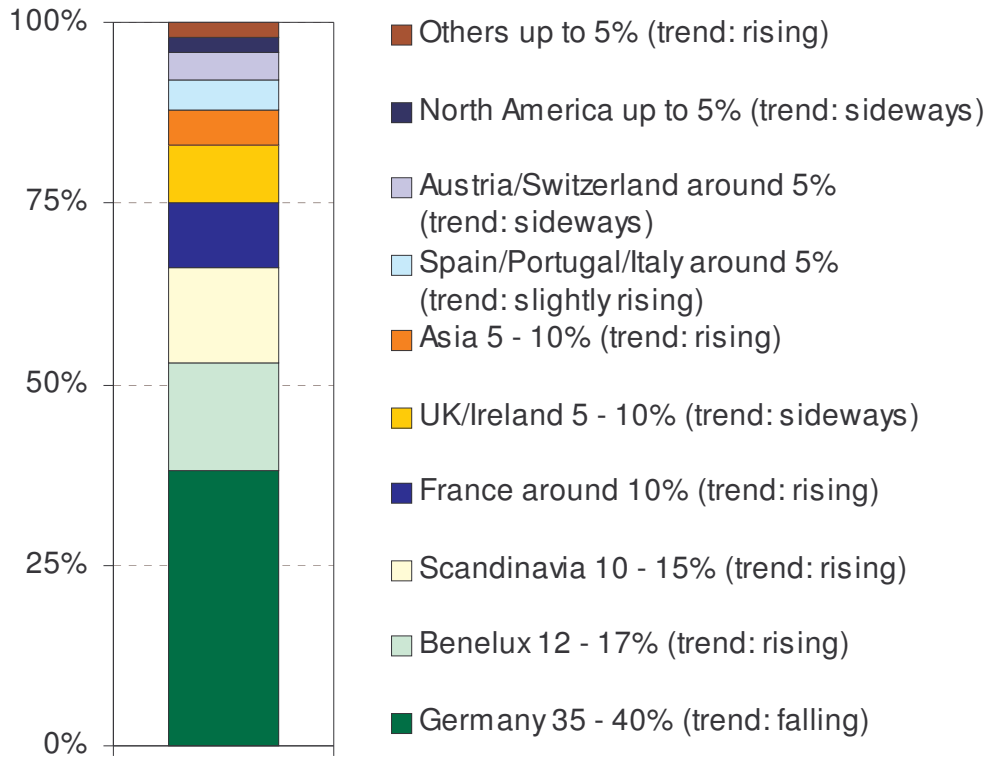
# A pan-European product

## Covered bonds expanding across Europe – and beyond ...

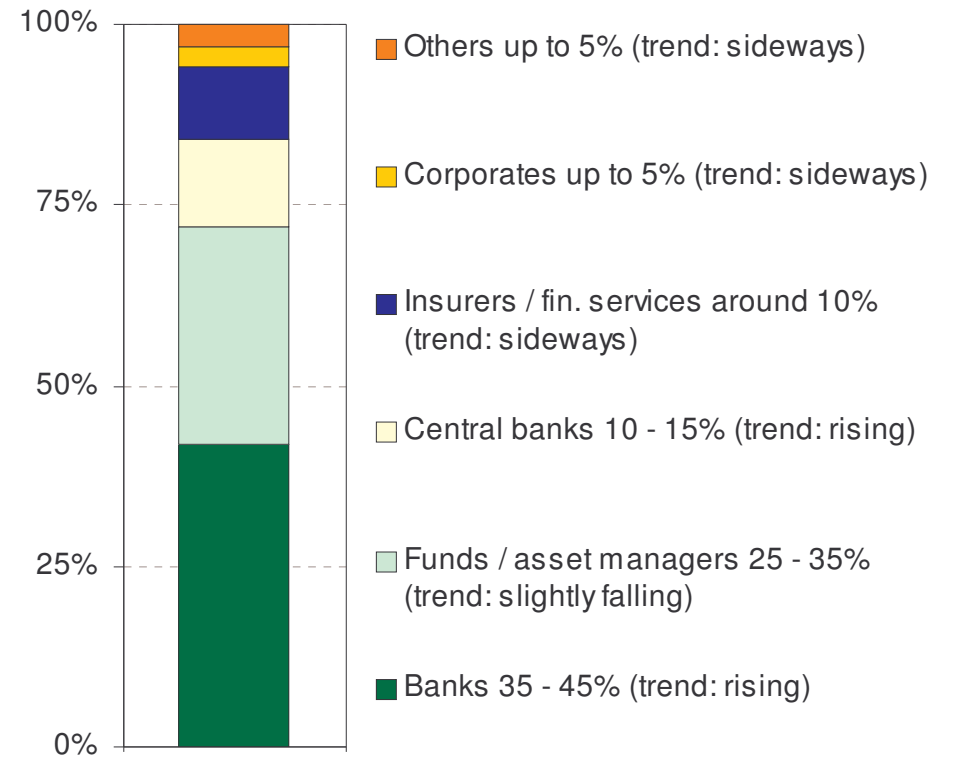


# Who buys covered bonds?

## Jumbo placement by investor country



## Jumbo placement by investor type



Source: DrKW Debt research

# What do international investors look for?

## FAQs

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**Credit quality:**

- High and stable issue rating?
- Good issuer rating?
- Conservative stable framework?

**Strategic fit:**

- Currency?
- Macro risks?
- Index?
- Maturities?

**Liquidity:**

- Critical mass: Issue size?
- Regular market appearances?
- Bid-offer?

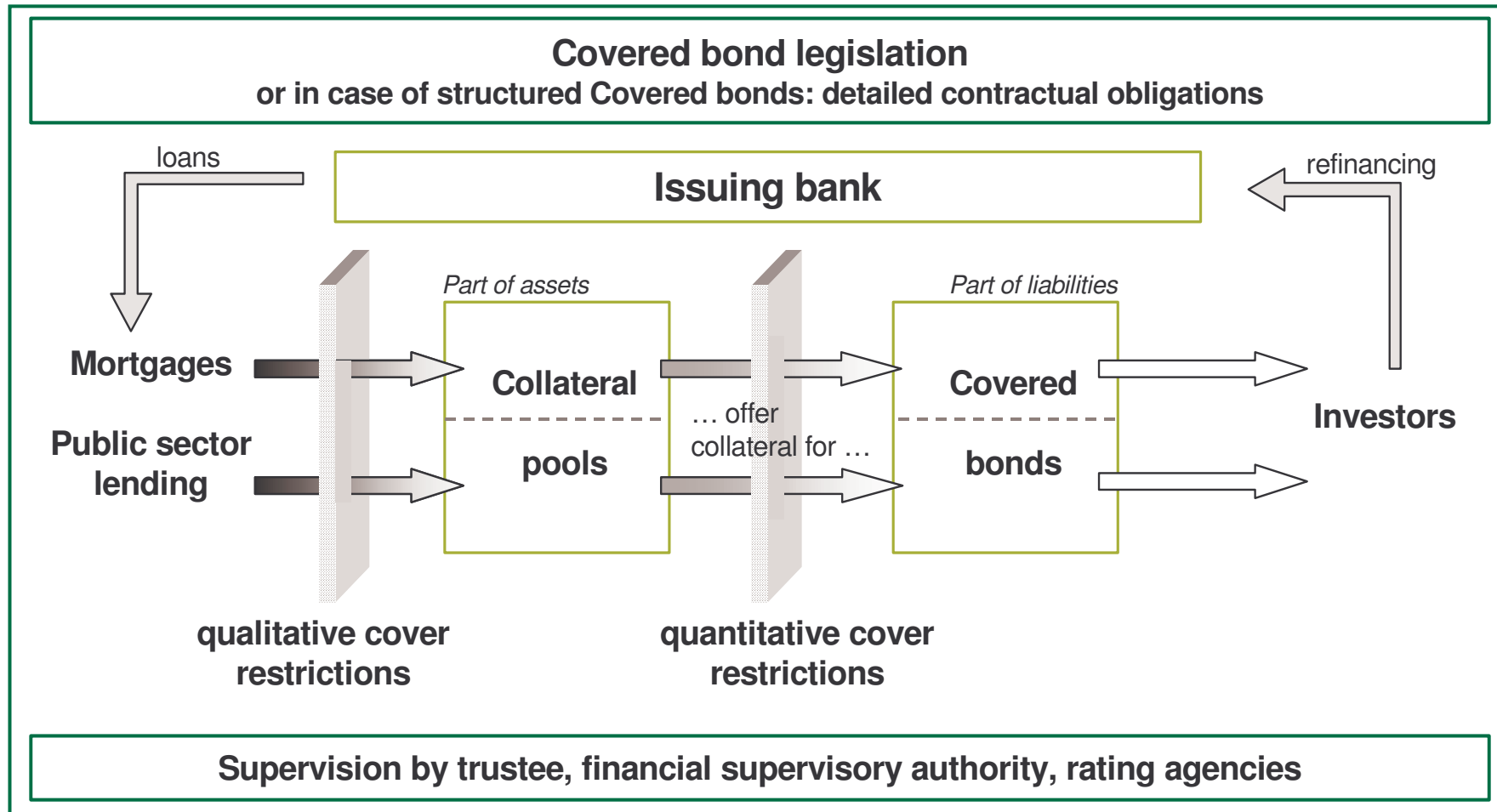
**Added value:**

- Diversification?
- Pick-up?
- Performance potential?

Credit quality

# Covered bonds: A high-quality investment

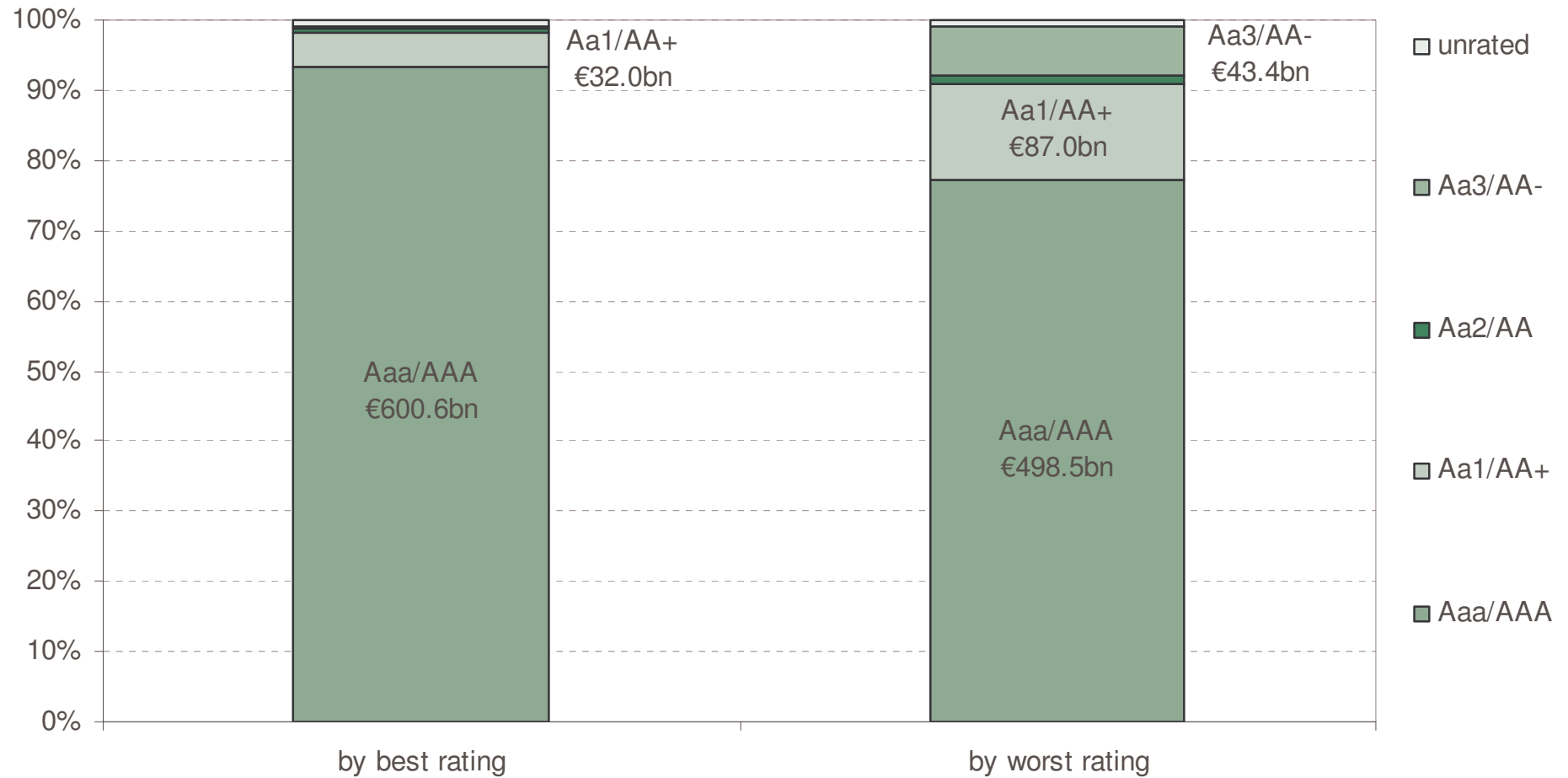
## Basics



Credit quality

# Rating distribution in the Jumbo market

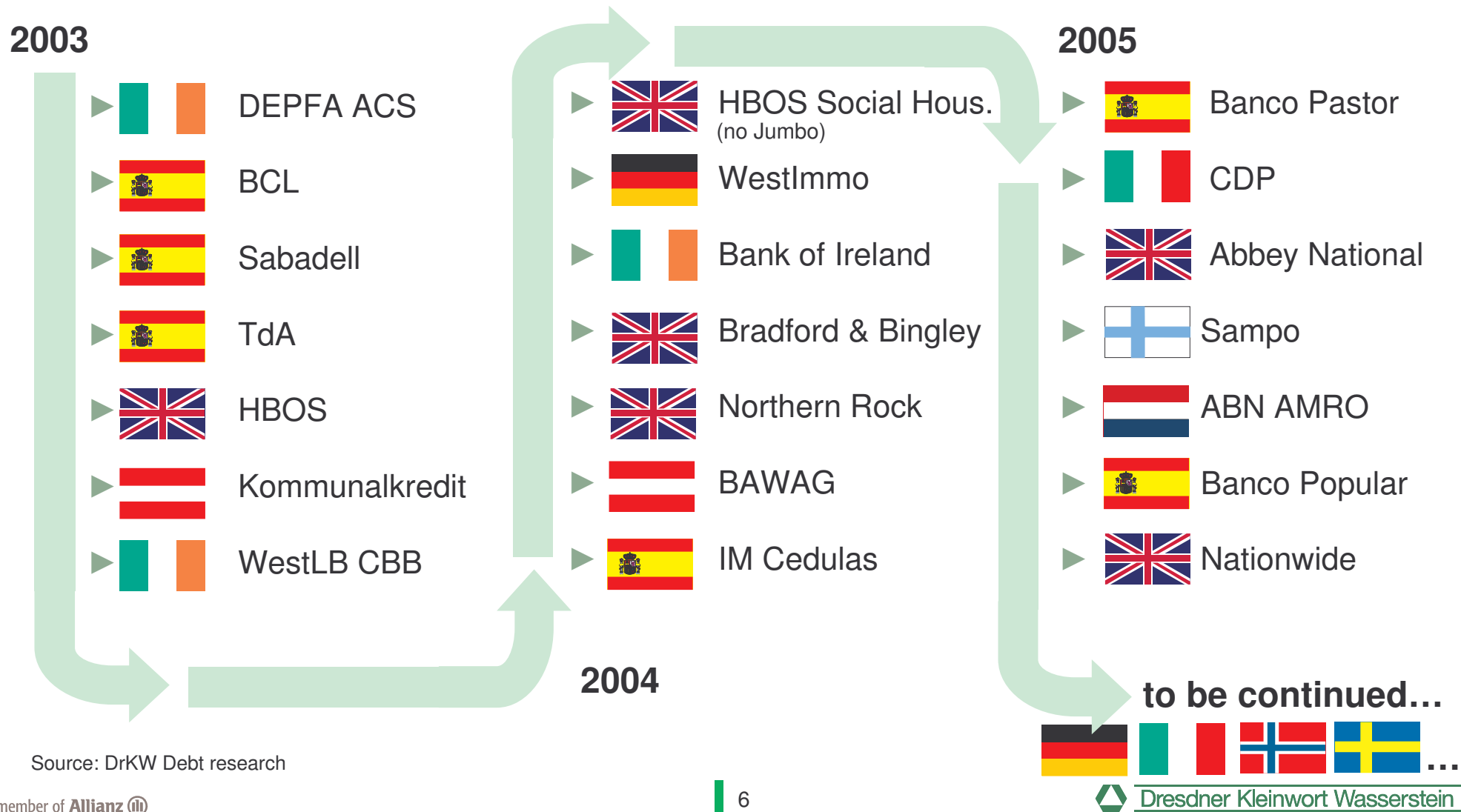
**Jumbo triple-A share in excess of 75% – trend increasing**



Source: DrKW Debt research

Diversification  
**Me too!**

**Numerous Jumbo newcomers give evidence of high market dynamics**

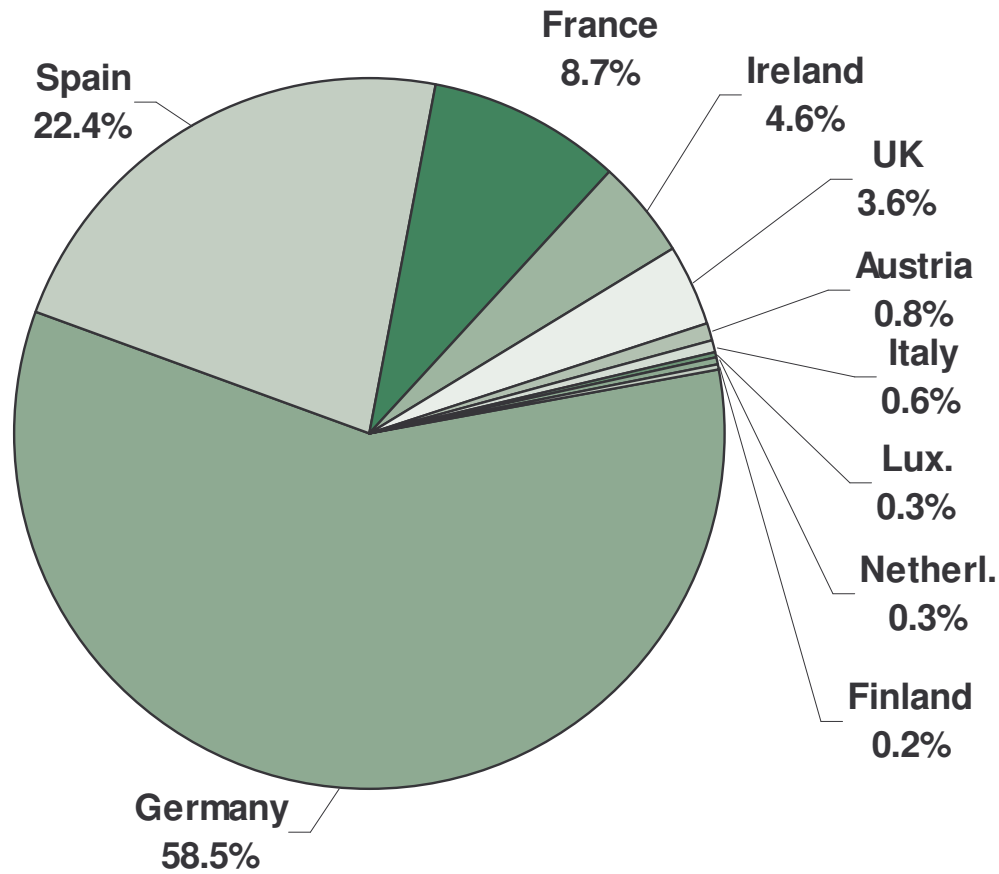


Diversification

# German issuers still dominating in terms of outstanding volume...

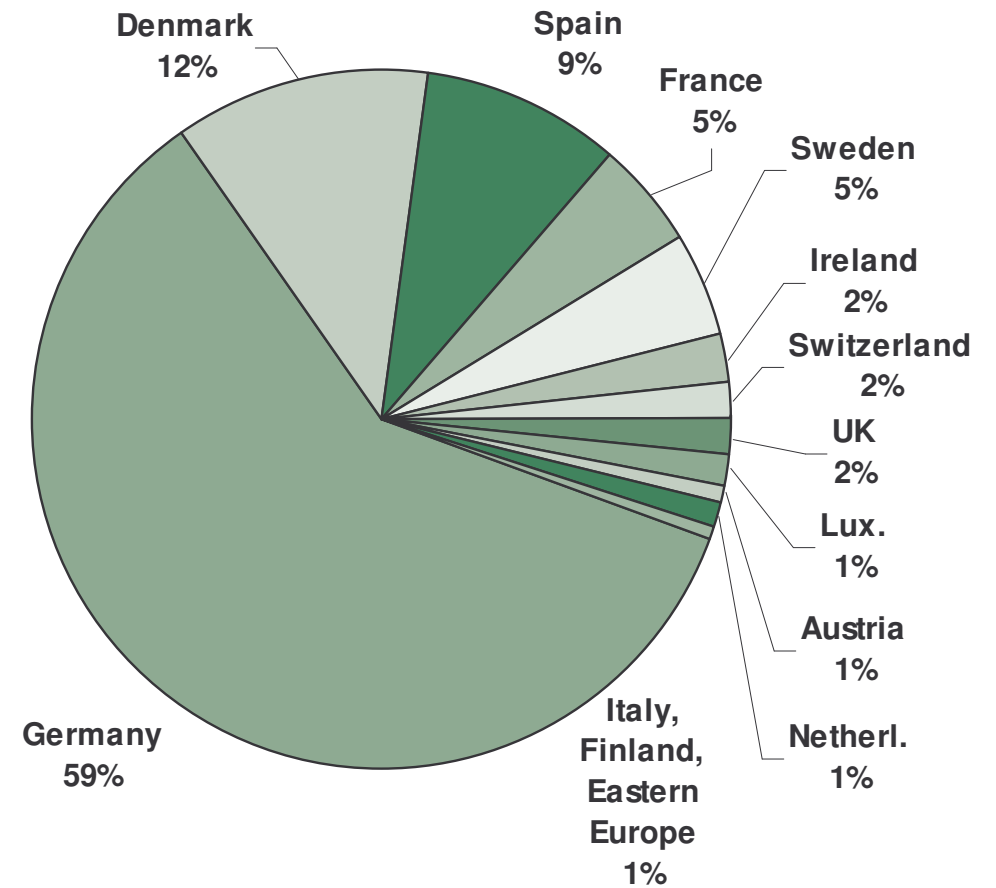
## Share of Jumbo market

▶ Total volume approx. €645bn



## Share of overall covered bond market

▶ Total volume in excess of €1,600bn

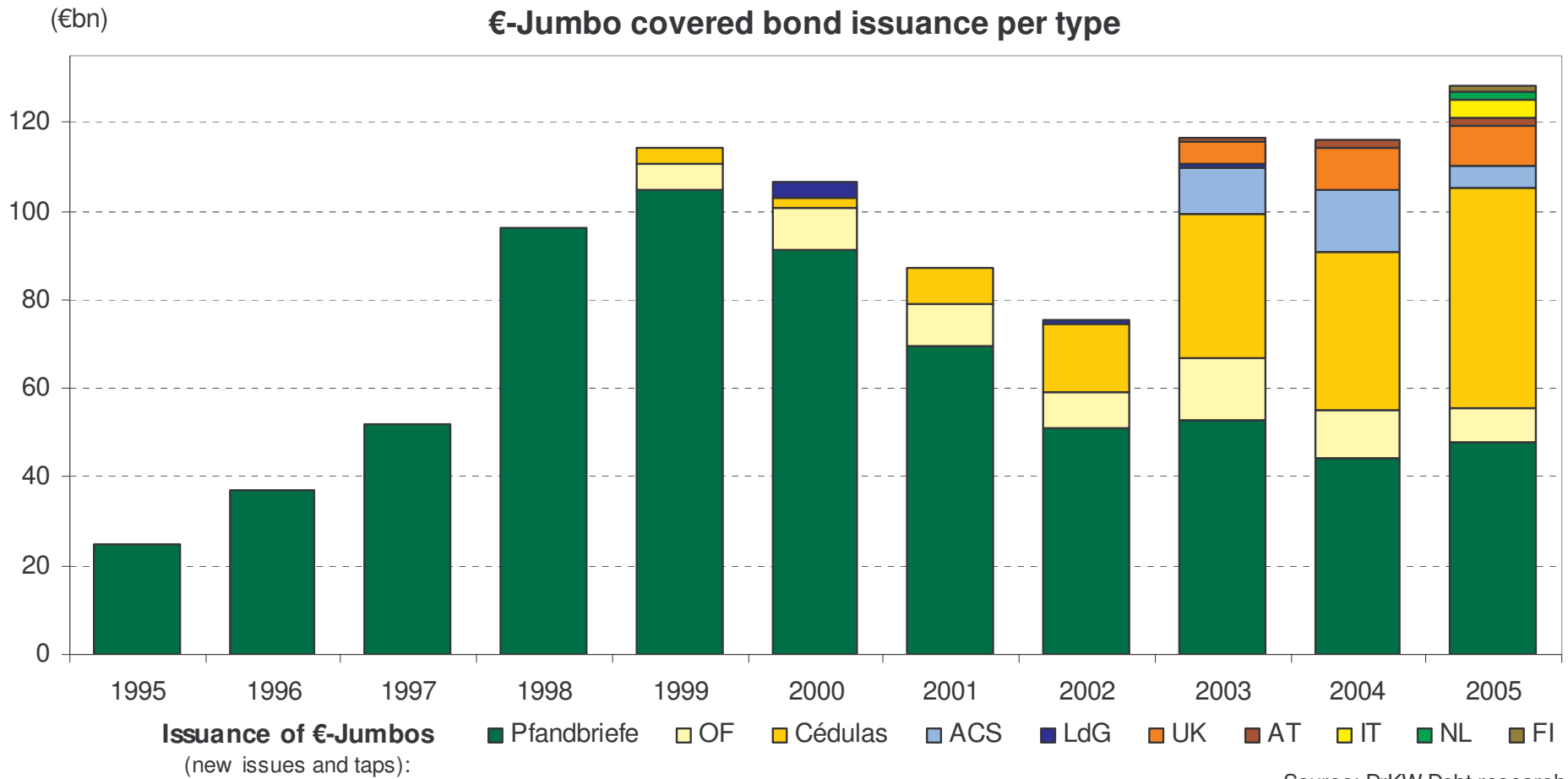


Source: DrKW Debt research

Diversification

... but increasingly a mixed bag on the new issue front

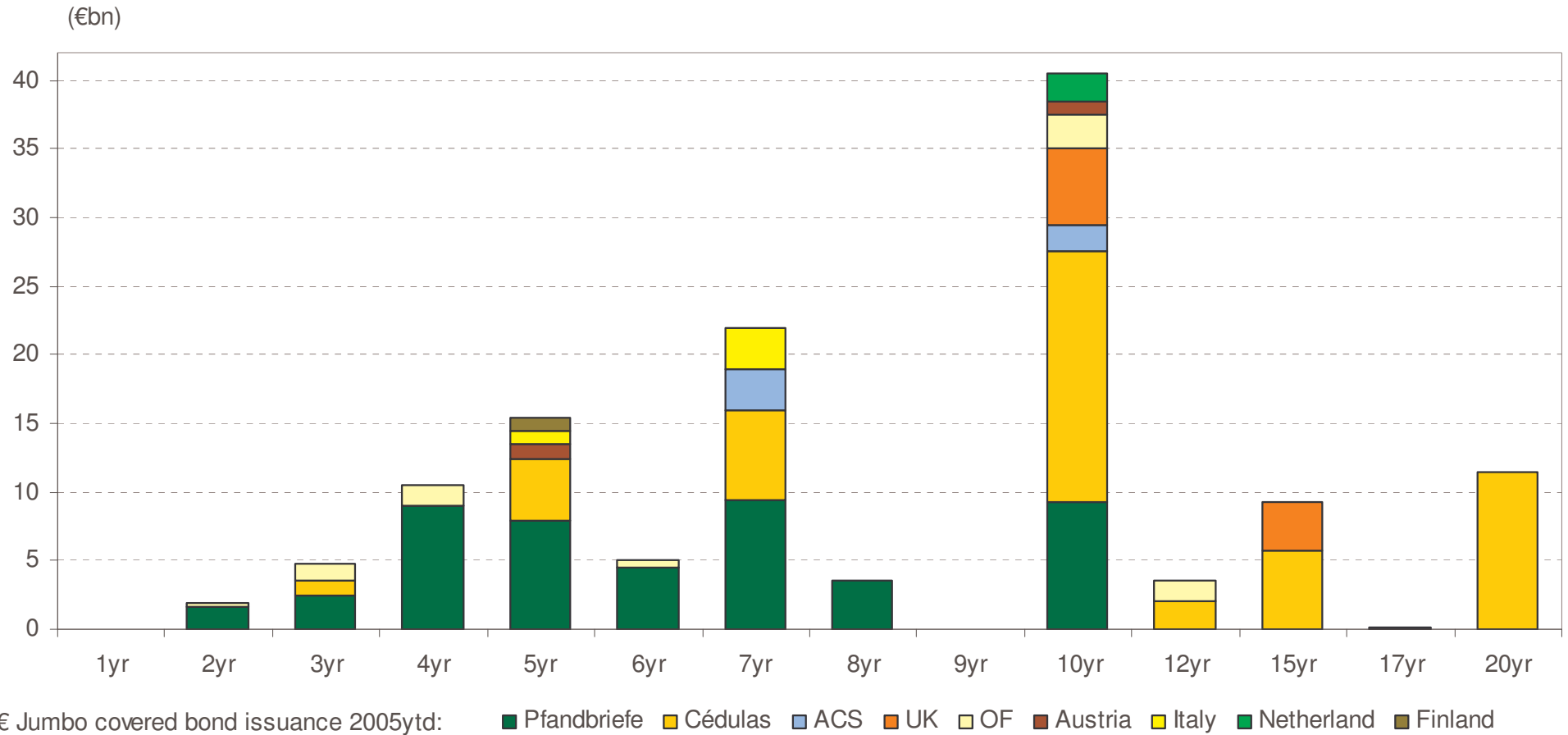
**German share in new Jumbo issuance has fallen to well below 40%**



Diversification

# Maturity profile stretching into the long-dated sector

## Jumbo issuance 2005: Spanish Cédulas strongest at the long end



Source: DrKW Debt research

Diversification/Liquidity

# A broad choice of issuers and bonds

## The most active Jumbo covered bond issuers

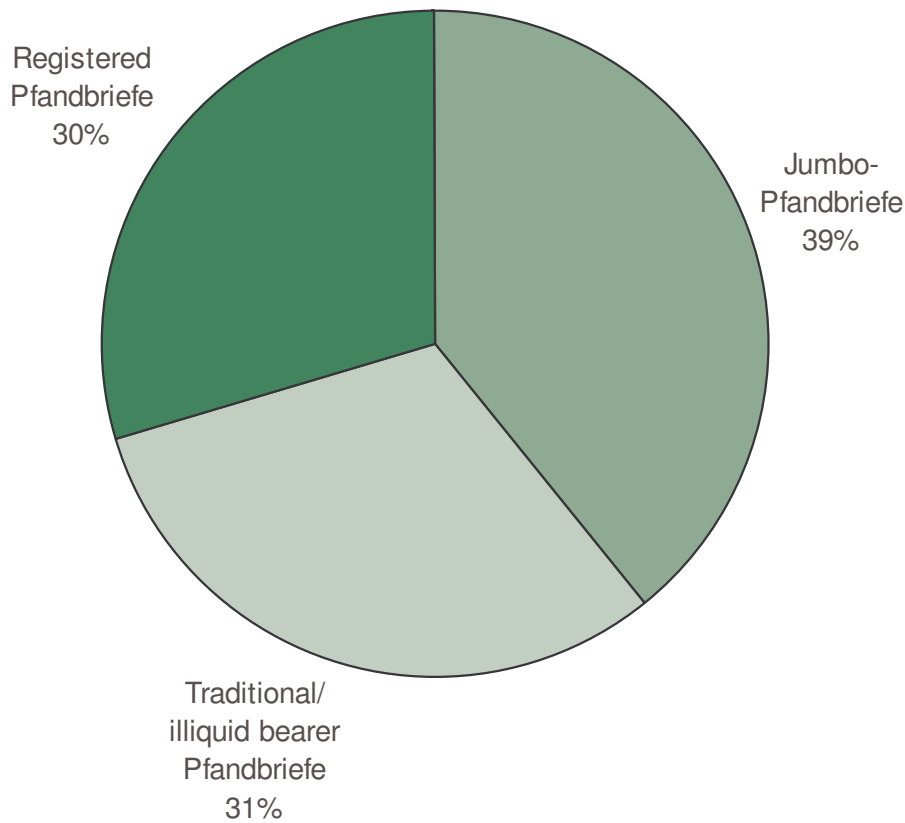
Issuer	Country	Jumbo vol. outstanding (€bn)	No. of Jumbos	Avg. volume (€bn)	Market share
Eurohypo	Germany	57.6	25	2.3	8.9%
Hyp Essen	Germany	37.7	19	2.0	5.9%
AHBR	Germany	34.4	20	1.7	5.3%
DePfa Dt. Pfandbriefbank	Germany	31.9	14	2.3	5.0%
AyT	Spain	30.7	13	2.4	4.8%
DG Hyp	Germany	30.4	18	1.7	4.7%
HypoVereinsbank	Germany	27.4	15	1.8	4.3%
BBVA	Spain	26.0	11	2.4	4.0%
CFF	France	22.6	14	1.6	3.5%
DexMA	France	21.5	13	1.7	3.3%
DEPFA ACS	Ireland	20.5	6	3.4	3.2%
SCH	Spain	18.5	10	1.9	2.9%
Hypo Real Estate	Germany	18.0	14	1.3	2.8%
LBBW	Germany	17.8	9	2.0	2.8%
Berlin Hyp	Germany	14.8	12	1.2	2.3%
La Caixa	Spain	14.3	7	2.0	2.2%
Münchener Hyp	Germany	13.8	10	1.4	2.1%
TdA	Spain	13.8	8	1.7	2.1%
WürttHyp	Germany	12.3	9	1.4	1.9%
CIF Euromortgage	France	12.3	10	1.2	1.9%
Caja Madrid	Spain	12.0	8	1.5	1.9%
HBOS	UK	11.8	6	2.0	1.8%
NRW.BANK	Germany	10.8	5	2.2	1.7%
Banesto	Spain	10.3	6	1.7	1.6%
BayernLB	Germany	8.4	5	1.7	1.3%
...	...	...	...	...	...
<b>Total: 54 issuers</b>		<b>644.5</b>	<b>373</b>	<b>1.7</b>	<b>100%</b>

Liquidity

# Jumbos vs. tailor-made issues

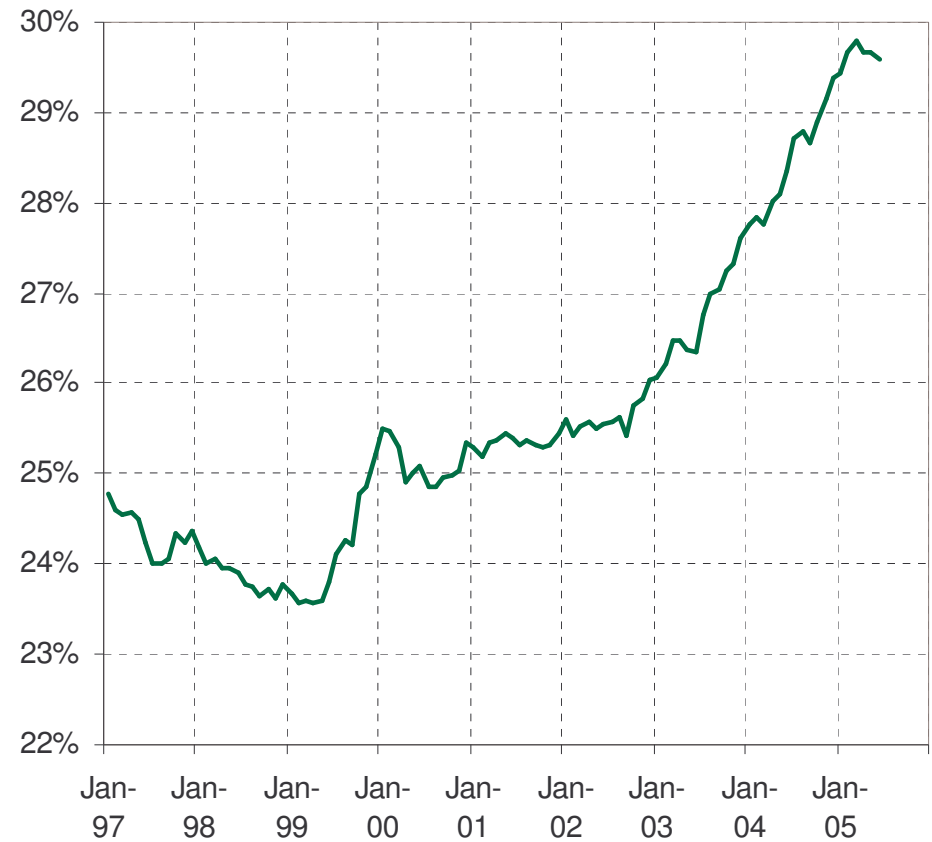
## German product mix

Total Pfandbrief volume outstanding by product



## A successful domestic market

Share of registered Pfandbriefe in total Pfandbrief volume outstanding

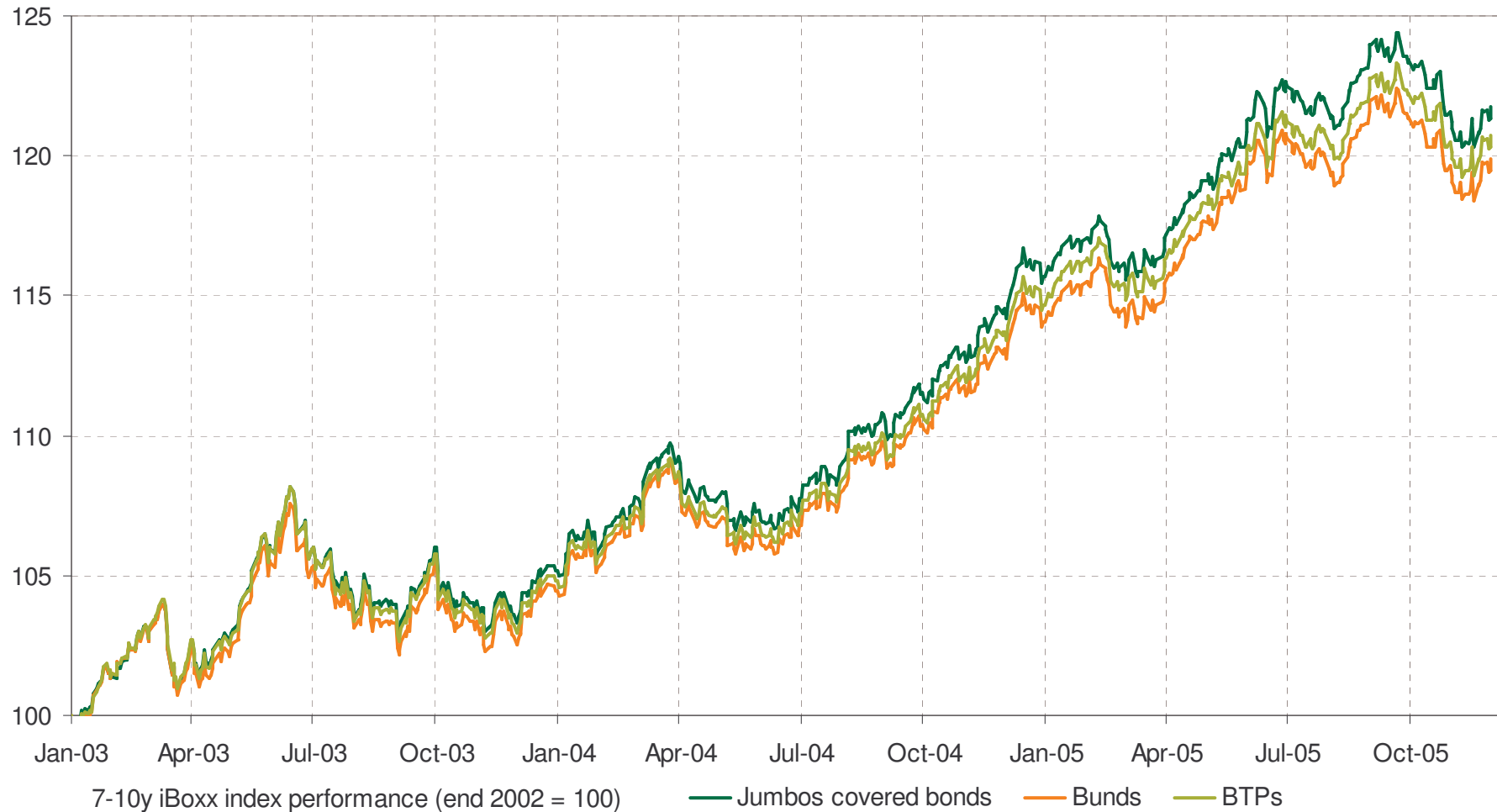


Source: DrKW Debt Research, Deutsche Bundesbank

Performance

# Low yields have supported outperformance vs. governments

## The hunt for pick-up has benefited spread products

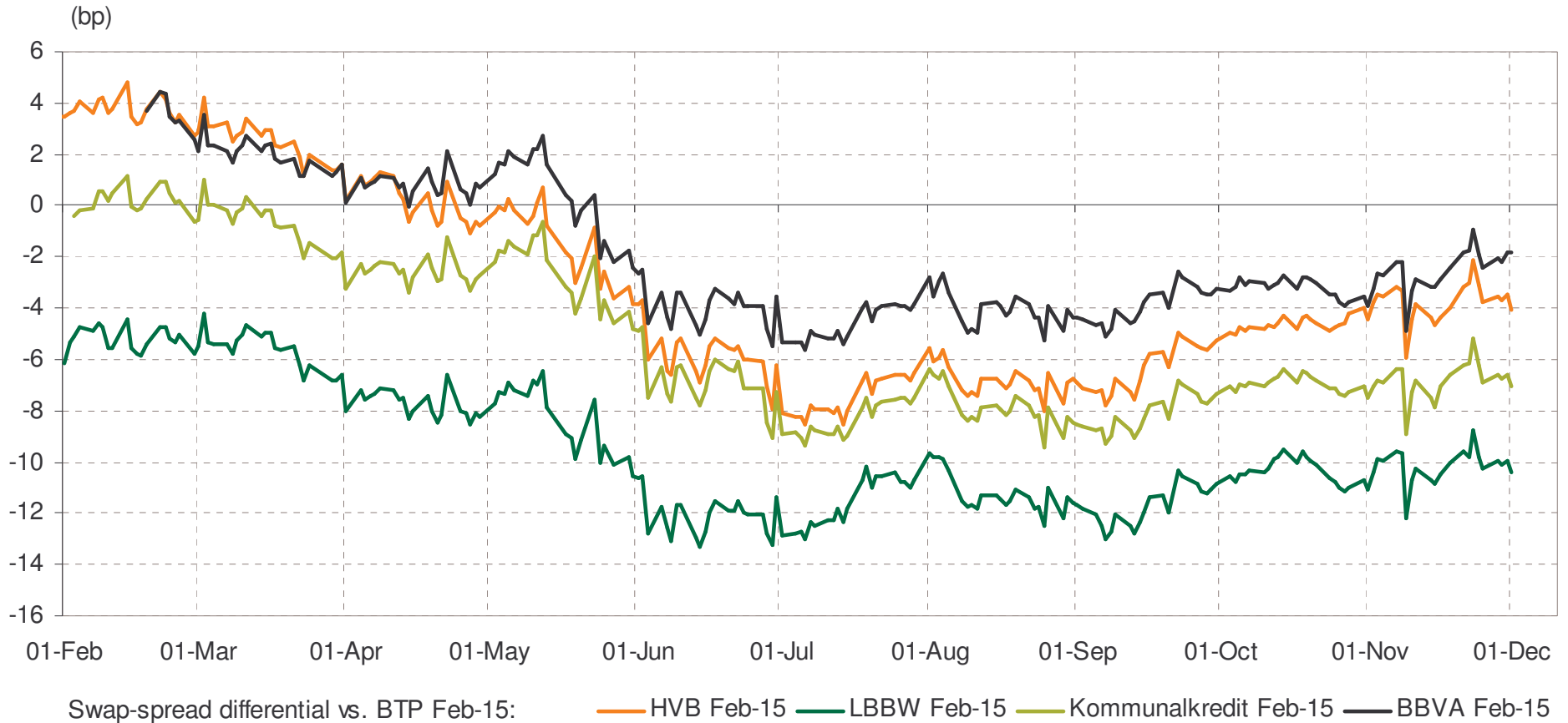


Source: DrKW Debt research

Performance

# Jumbos stronger than BTPs

## BTPs underperforming in H1-05

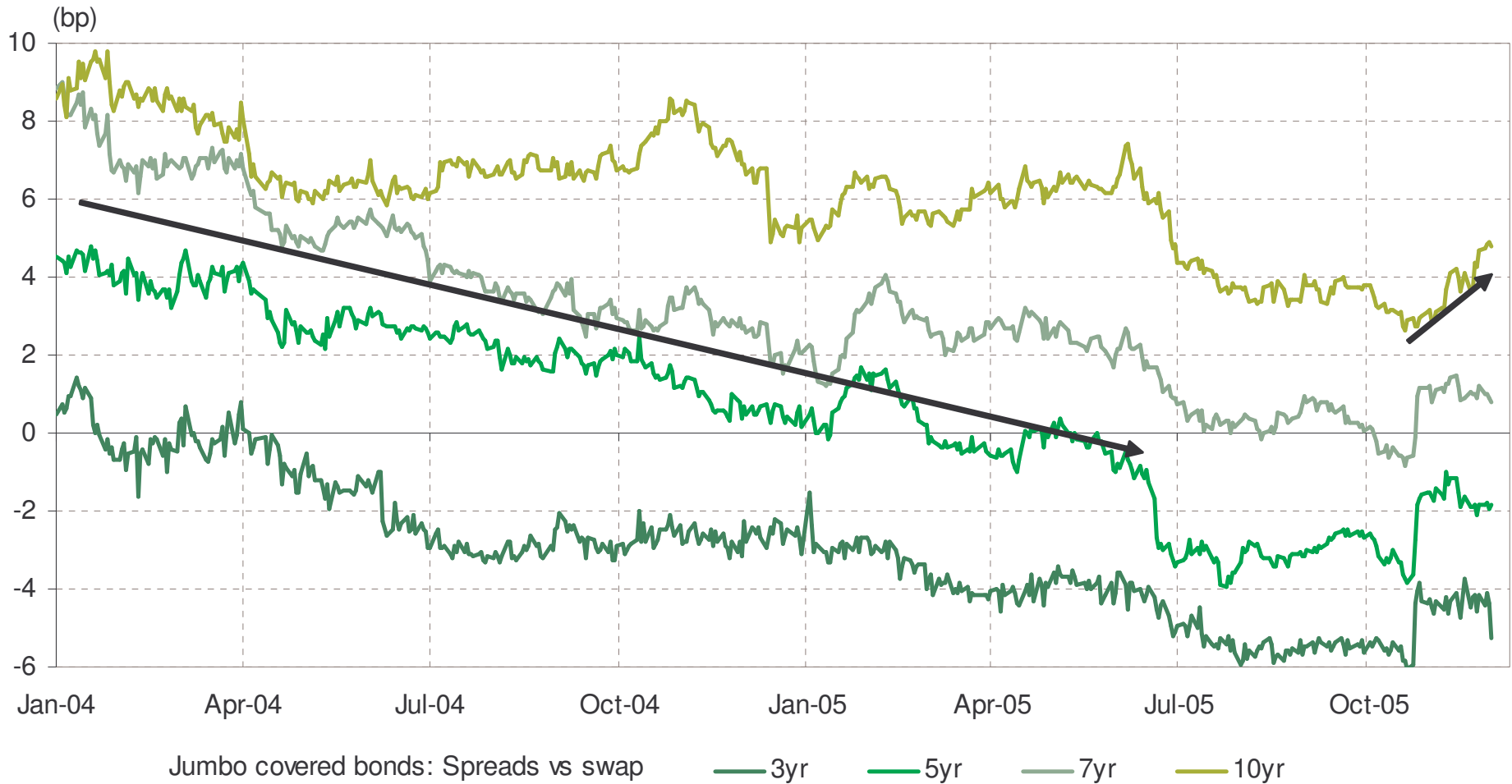


Source: DrKW Debt research

Performance

# Spread tightening coming to a hold?

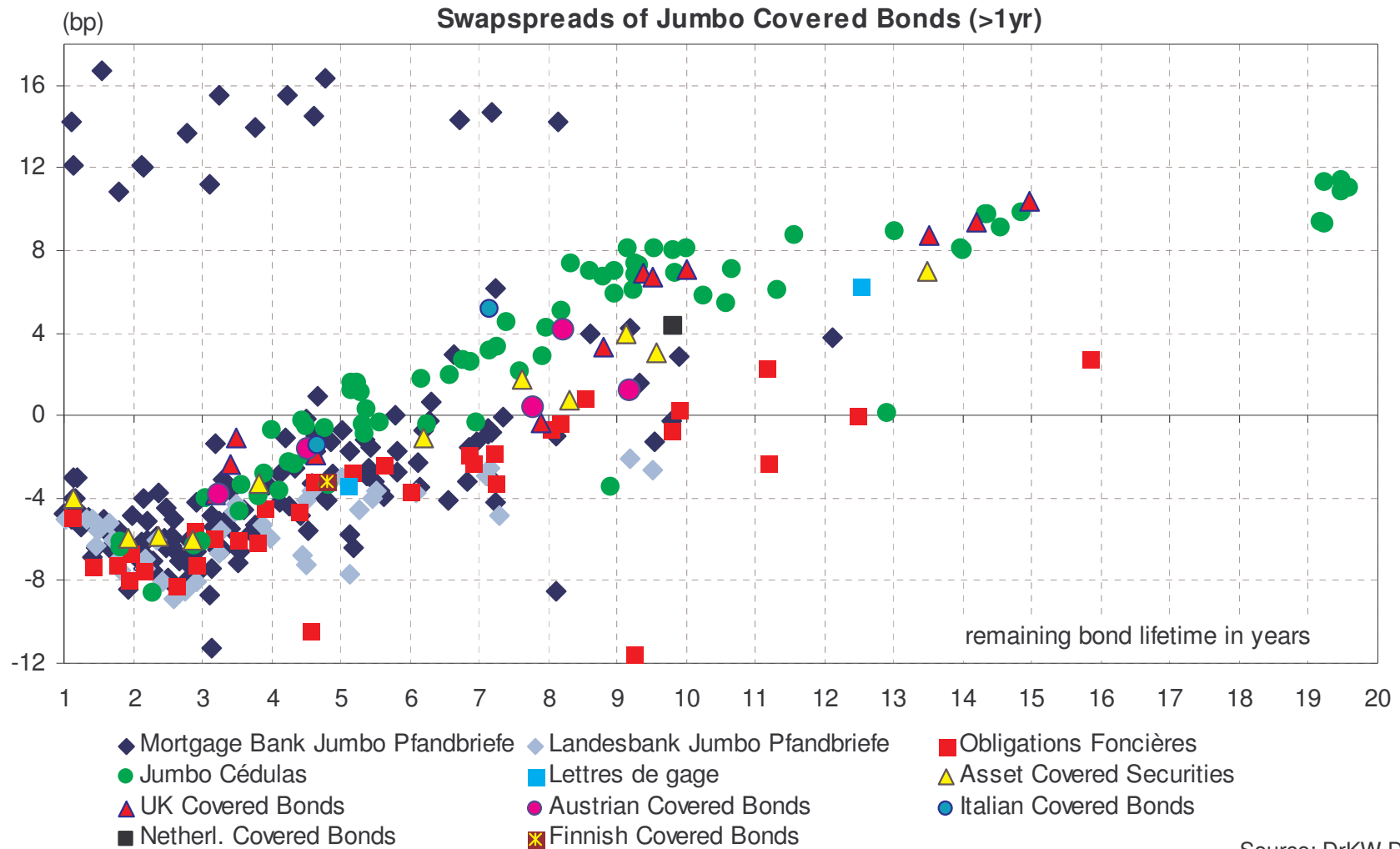
## ECB tightening raises risks for spread products



Source: DrKW Debt research

# The Jumbo spread universe

## Product differentiation still limited (with the exception of AHBR)... poised to rise again?

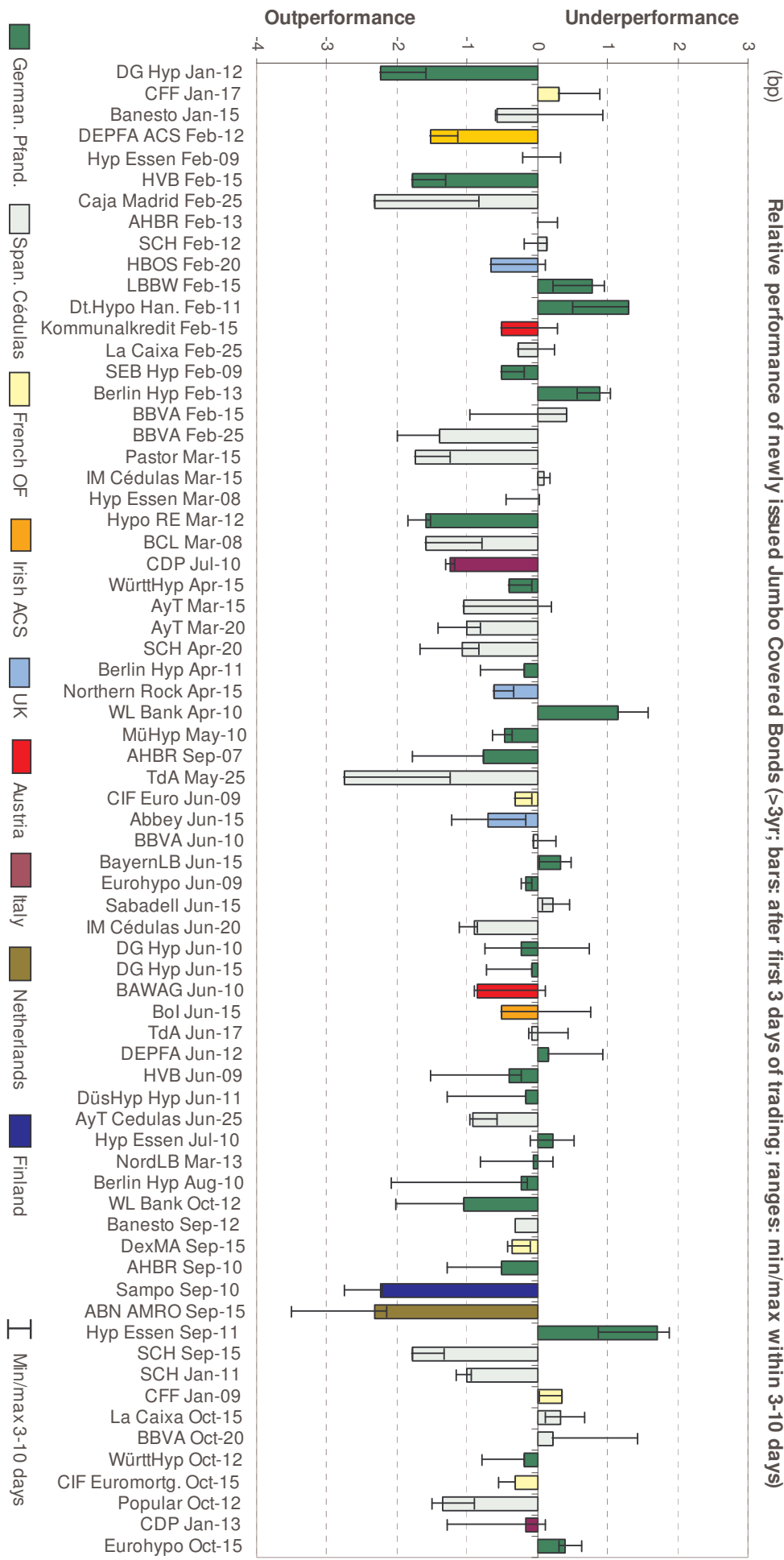


Source: DrKW Debt research

Performance

# New issue performance

## Fairly priced new issues continue to find solid demand



Source: DRKW Debt research

Performance

## Outlook

### Factors to keep in mind

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- ▶ Yields to remain relatively low, but risks have increased with the ECB having started raising rates
- ▶ Bund-Swapsreads increasingly facing widening risk
- ▶ Hence, while pick-up remains sought after, the Jumbo spread outlook has become somewhat more vulnerable
- ▶ Continuing consolidation among German issuers fosters broadening of investment horizons
- ▶ AHBR outcome awaited
- ▶ Name differentiation could return to the market with Basel II
- ▶ Moody's adjusted rating methodology likely to result in upgrades eg for Spanish bonds
- ▶ New issue front to remain active, but priced fairly
- ▶ etc.

=> *Compare with outlook presentation tomorrow...*

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Issuer	Definition
Overweight	The recommendation is based upon DrKW's assessment of the fundamental credit quality of an issuer together with the expected market performance of the issuer's bonds relative to the iBoxx/iTraxx indices. This approach applies at the borrower level, where the benchmark index for allocation is, unless otherwise specified, the relevant sector iBoxx index for cash instruments or iTraxx index for CDS. The weightings are not indications of particular degrees of expected spread movement relative to the index. An overweight recommendation implies expected outperformance to the relevant index over a three months time horizon. For issuers that are not included in the relevant iBoxx/iTraxx indices, we express expected performance compared to the appropriate sector indices.
Marketweight	The recommendation is based upon DrKW's assessment of the fundamental credit quality of an issuer together with the expected market performance of the issuer's bonds relative to the iBoxx/iTraxx index. This approach applies at the borrower level, where the benchmark index for allocation is, unless otherwise specified, the relevant sector iBoxx index for cash instruments and iTraxx index for CDS. The weightings are not indications of particular degrees of expected spread movement relative to the index. A marketweight recommendation implies expected in-line performance to the relevant index over a three months time horizon. For issuers that are not included in the relevant iBoxx/iTraxx indices, we express expected performance compared to the appropriate sector indices.
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	All covered companies	Companies where a DrKW company has provided investment banking services
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Overweight (€)	24	4
Marketweight (€)	112	22
Underweight (€)	54	7
<b>Total Euro</b>	<b>190</b>	<b>33</b>
<b>Investment grade Sterling Recommendations</b>		
Overweight (£)	8	2
Marketweight (£)	9	2
Underweight (£)	6	1
<b>Total Sterling</b>	<b>23</b>	<b>5</b>
<b>High Yield Recommendations</b>		
Buy/Add	4	0
Hold	6	1
Sell/Reduce	3	0
<b>Total High Yield</b>	<b>13</b>	<b>1</b>

Source: DrKW Debt research

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