

# BondCliQ

## Institutional Market Monitor

March 31<sup>st</sup>, 2020

### You must SEE the market to BEAT the market

In the institutional corporate bond market, being able to leverage data to quickly identify trends, dislocations and shifts in behavior can give you a major edge. **BondTiQ is the most powerful data visualization application that gives you that edge in corporate bonds.**

Using BondTiQ we can illustrate the real story around corporate bond ETFs post-COVID-19.

### False Negatives, Real Positives

[Last week we examined the increased trading volumes in US credit markets](#) since the start of the COVID-19 market panic in the US (2/24/20). We now turn our focus to an area of the market that has received a lot of attention in the last few days, corporate bond ETFs (LQD, BND, NEAR, JNK, HYG).

For years there have been [warnings about the potential dangers caused by corporate bond ETFs](#). The overall argument is that corporate bond ETFs are writing liquidity checks that the underlying corporate bond market will not be able to cash, especially during a period of extreme, prolonged volatility. Well, thanks to COVID-19, those volatility conditions are here, so what does the data say about the structural integrity of corporate bond ETFs?



Recent conversation have centered [on the discount of bond ETF market pricing vs its net asset value](#), namely BND and LQD. While the price of an ETF is determined by open market trades, the NAV is a sum of the valuations of the individual, underlying bond's mark/valuation. This Bloomberg chart (left) illustrates the traditional, stable ETF price/NAV relationship for LQD.

Post-Covid 19 we see an expected deterioration in the value of the ETF given the market movements. But in LQD (and other credit ETFs) we also see additional market dislocation with LQD trading (market prices) at a large discount to NAV (~5%) on the 12<sup>th</sup> and 19<sup>th</sup> and similar premium at today's close relative to the historical average of +/- 0.2% this year. Persistence dislocations of this magnitude can reduce investors' confidence in an ETFs ability to mimic its defined index.

Like the Flash Crash, there's always finger pointing when the financial markets don't function as expected. Credit ETFs detractors accuse the redemption process, a NAV exchange of ETF shares for bonds held by the ETF, as the cause of ETF dislocation. The argument asserts that the process creates abnormal selling pressure on the ETF constituents, depressing their price relative to the overall market. If this was the case, we should see the following evidence in the transaction (TRACE) data:

- Negative customer flows in ETF constituents relative to the overall credit market
- Underperformance of the ETF constituents relative to the overall credit market

Using the data visualization application, BondTiQ, we can compare customer flows per sector for LQD constituents relative to the overall market when the ETF "dislocation" began on March 12<sup>th</sup>.

### LQD Constituents – Performance (Healthcare & Financial Sectors) March 12<sup>th</sup>

#### Healthcare

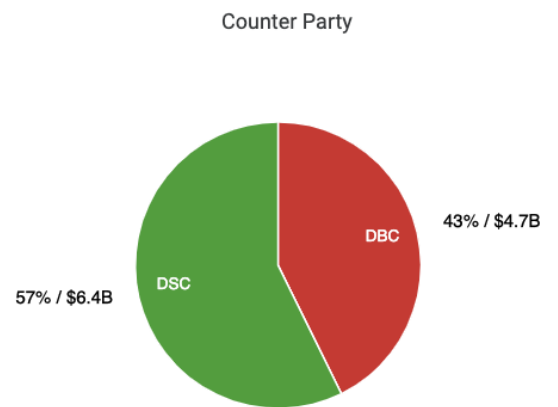
vol: 2,183,369,430 | trds: 1,734 | CF: +12% : 181.4MM

CVS	ABBV	CI	BMJ	UNH	HCA	AMGN	JNJ	GILD	NOVNVX
BIIB	AZN	PFE	TMO	MRK	ANTM	MDT	GSK	MYL	ABT

#### Financials

vol: 4,082,538,780 | trds: 4,099 | CF: +11% : 338.4MM

BAC	JPM	GS	C	WFC	MS	BRK	PNC	GE	AMT
WSTP	USB	V	HSBC	BBT	BK	TFC	PYPL	AXP	CS



The image above shows issuers held by LQD organized according to the underlying volume generated by the individual ETF constituents. For Healthcare and Financials, there are positive client flows with a net purchase imbalance of \$181MM and \$338MM respectively. In addition, overall client flows for all LQD constituents (pie chart) indicates a material imbalance with net purchase volume exceeding sales by \$1.7B for the day.

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#### Healthcare

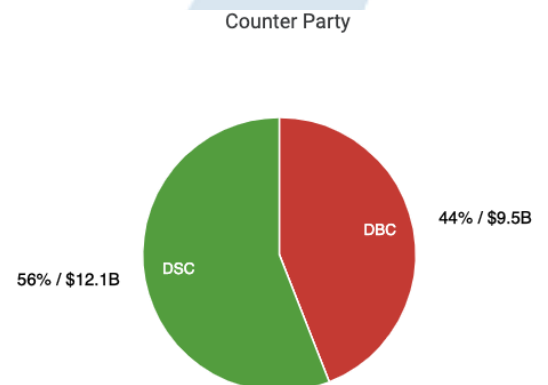
vol: 2,465,318,290 | trds: 1,793 | CF: +14% : 340.4MM

ABBV	CVS	CI	BMJ	CNC	UNH	HCA	AMGN	JNJ	NOVNVX
ANTM	MDT	SANFP	GSK	MCK	GILD	TMO	MYL	AZN	BDX

#### Financials

vol: 6,918,867,260 | trds: 7,517 | CF: +9% : 598.6MM

BAC	JPM	WFC	GS	C	MS	RY	WSTP	PNC	GE
USB	BRK	BK	CS	HSBC	AXP	AMT	STT	COF	CM



Compared to the overall market on March 12<sup>th</sup>, there is little difference between the transaction data generated by LQD constituents.

## A Closer Look – Credit Market Trading Concentration

Leveraging average daily transaction and quote data per week, at a CUSIP level, we can evaluate and compare the breath of trading and available liquidity of the broader market relative to LQD constituents:

Week starting	CUSIP Count		Quote Count	
	Market	LQD	Market	LQD
<b>2/10/2020</b>	14,319	1,890	8,040	1,751
<b>2/17/2020</b>	13,555	1,902	7,727	1,883
<b>2/24/2020</b>	14,165	1,906	7,540	1,863
<b>3/2/2020</b>	14,479	1,911	7,383	1,807
<b>3/9/2020</b>	13,531	1,902	5,307	1,571
<b>3/16/2020</b>	12,085	1,909	4,681	1,517

The table above illustrates a major difference between the transaction and BondCliQ institutional quote data for LQD constituents. While the broader market has experienced a contraction in the number of CUSIPs traded and a major decline in observable quotes on BondCliQ, **there has been no drop-off in the breadth of LQD constituents traded and a less pronounced reduction in available BondCliQ dealer quotes** over the same time period. These **results indicate that so far, COVID-19 has had minimal impact on the trading environment for LQD constituents.**

While more thorough analysis should include other prominent investment grade ETFs like, SPIB and VCIT, initial findings contradict some of the major negative assumptions about corporate bond ETFs during a period of pronounced volatility. It is possible that the active trading in the ETF itself, acts as an additional source of price transparency that aids in the ongoing trading and pricing of the underlying constituents. As for the pronounced corporate bond ETF discount to NAV that has recently been observed, this quote from a recent article might be the best explanation:

*“The first thing is that I took some comfort seeing that the trading was going on below net asset value (NAV)—BND was trading at a discount, I thought. For example, **BND closed at \$80.33 on March 12, 2020, while Morningstar shows a NAV of \$85.61. That difference is huge.**”*

*Unfortunately, Ben Johnson, Morningstar director of global ETF research, burst that bubble for me. He told me **the NAV is based on stale prices for the bonds in the portfolio; thus, it is a bit like clocking the Olympic 100m dash with a stopwatch that only counts in 10-second increments.**”*

[Why High-Quality Bond ETFs Failed Us](#) – ETF.com March 2020

If you are interested in a free trial of BondTiQ, reach out to us at [info@bondcliq.com](mailto:info@bondcliq.com).