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Quant Alert

Is there still value in T1 bonds?

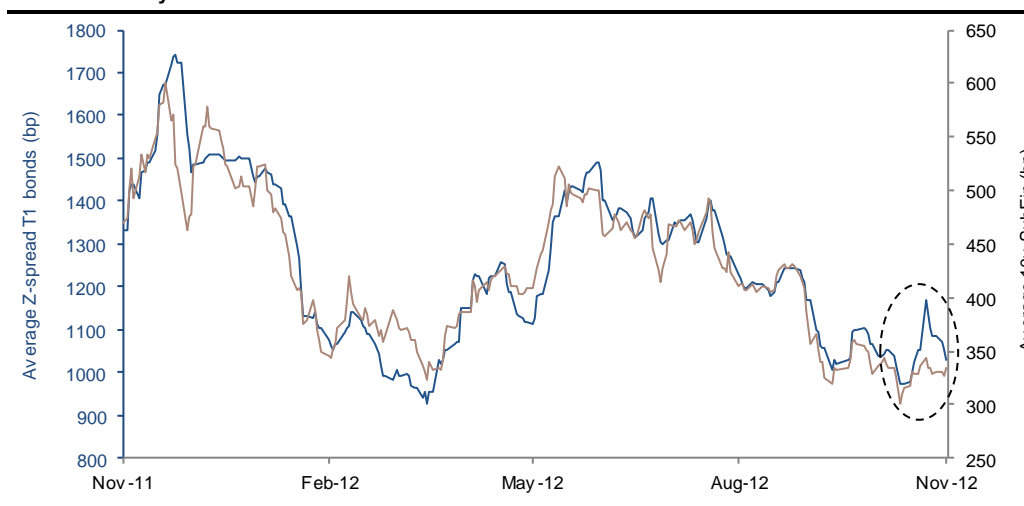
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T1 bonds back to pre-Intesa levels

T1 bonds underperformed sharply sub financials after Intesa's removal of call options on LT2 bonds at the end of October. T1 bond z-spreads widened by 20% on average from the 22th to the 27th of October while the 10y subfinancial index widened by 8%. The market has already recovered, being close to pre-Intesa levels: T1 bond z-spreads have tightened by 12% on average while the 10y subfinancial index has tightened by 3% from the 29th of October to the 7th of November.

T1 bond vs 10y subfinancial



Source: SG Cross Asset Research

There is still value in T1 bonds according to our T1 pricing model

We have developed a T1 pricing model to evaluate the value of the extension and deferral options in T1 bonds. This evaluation process is based on a stochastic model which takes several inputs into account:

- CDS spreads - to evaluate the default risk of each issuer;
- Basis between cash and CDS - to account for the specific risk in bonds;
- Index spread options - to assess the volatility of credit spreads;
- Long-term corporate bond curves - to evaluate the refinancing costs of long-term bonds.

Based on these inputs we can compute the fair value of T1 bonds and estimate the impact of the extension and the deferral risk in market prices. Please refer to our reference articles: [Do corporate hybrids offer value](#) of October 2005 and [Looking for value in bank T1 market](#) of April 2006 for more details on the model.

According to our model, T1 bonds are too cheap, they are 6.2% undervalued on average on our universe of 36 T1 bonds. BACR 4 3/4 03/29/49 (market price: 68 / model price: 93), RBS 4.243 12/29/49 (market: 65 / model: 82) and CMZB 5.012 03/29/49 (market price: 65 / model price: 79) are the cheapest ones. Moreover our model measures the impact of the extension and the coupon deferral risks. T1 bonds prices should be on average 13% higher without these options. Model outputs are available in the **T1 monitor** which is available on [SG research website](#) in credit screener on the right-hand and updated on a regular basis.

T1 bonds - model vs. market prices

Bond	Issuer	Next call date	Extension probability	Market price	Model price	Market / model price	Deferral impact on market price	Deferral+extension impact on market price
BACR 4 3/4 03/29/49	Barclays	15/03/20	0%	68	93	73%	-3	-3
RBS 4.243 12/29/49	RBS	12/01/16	77%	65	82	78%	-3	-26
CMZB 5.012 03/29/49	Commerzbank	12/04/16	72%	65	79	82%	-3	-25
BACR 4 7/8 12/29/49	Barclays	15/12/14	91%	71	86	82%	-2	-30
DB 5.33 09/29/49	Deutsche Bank	19/09/13	99%	78	92	84%	-1	-26
INTNED 4.176 06/29/49	ING Bank	08/06/15	90%	82	94	87%	-1	-20
CMZB 6.352 07/29/49	Dresdner	30/06/17	59%	74	84	88%	-3	-15
ASSGEN 5.479 12/29/49	Generali	08/02/17	66%	80	90	88%	-2	-14
AXASA 6.211 10/29/49	AXA	05/10/17	59%	90	102	88%	-2	-9
BNP 5.019 04/29/49	BNP	13/04/17	73%	86	97	89%	-2	-12
ASSGEN 5.317 06/29/49	Generali	16/06/16	74%	81	89	91%	-2	-16
SEB 7.0922 12/29/49	SEB	21/12/17	34%	107	118	91%	-1	-4
SRENVX 5.252 05/29/49	Swiss Re	25/05/16	73%	98	107	92%	-1	-10
FBAVP 4 5/8 10/29/49	BNP	27/10/14	94%	84	91	92%	-1	-19
ISPIM 8.047 06/29/49	Intesa San Paolo	20/06/18	27%	90	97	92%	-4	-7
BNP 7.781 06/29/49	BNP	02/07/18	36%	103	112	92%	-2	-5
BNP 4.73 04/29/49	BNP	12/04/16	84%	87	94	92%	-1	-15
UBS 7.152 12/29/49	UBS	21/12/17	34%	105	114	93%	-2	-5
SEB 9 1/4 10/29/49	SEB	31/03/15	46%	108	116	93%	-1	-6
ISPIM 8 3/8 10/29/49	Intesa San Paolo	14/10/19	6%	95	101	94%	-3	-3
HSBC 5.13 12/29/49	HSBC	29/03/16	81%	98	104	94%	-1	-9
HANRUE 5 06/29/49	Hannover Re	01/06/15	70%	98	103	95%	-1	-8
ACAFF 8.2 03/29/49	Credit Agricole	31/03/18	30%	102	106	96%	-3	-6
DANBNK 4.878 05/29/49	Danske	15/05/17	66%	96	99	97%	-1	-6
UBS 4.28 04/29/49	UBS	15/04/15	92%	94	96	98%	-0	-11
HSBC 5.3687 10/29/49	HSBC	24/03/14	89%	99	100	99%	-0	-7
UCGIM 4.028 10/29/49	Unicredito	27/10/15	78%	71	72	99%	-2	-20
UCGIM 8 1/8 12/29/49	Unicredito	10/12/19	0%	93	93	100%	-3	-3
BBVASM 8 1/2 10/29/49	BBVA	21/10/14	69%	94	94	100%	-2	-12
AVLN 4.7291 11/29/49	Aviva	28/11/14	90%	93	92	100%	-1	-11
UBS 8.836 04/29/49	UBS	11/04/13	17%	103	102	100%	-0	-6
UCGIM 9 3/8 07/29/49	Unicredito	21/07/20	0%	98	98	100%	-4	-4
BNP 8.667 09/29/49	BNP	11/09/13	76%	101	100	101%	-1	-6
MUNRE 5.767 06/29/49	Munich Re	12/06/17	83%	99	95	105%	-1	-16
BNP 5.868 01/29/49	BNP	16/01/13	99%	97	91	106%	-0	-9
AXASA 5.777 07/29/49	AXA	06/07/16	85%	92	75	123%	-2	-19
Average			62%	90	96	94%	-2	-12

Source: SG Cross Asset Research, as of 05/11/12

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APPENDIX

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