

# Fixed Income Update Week 12

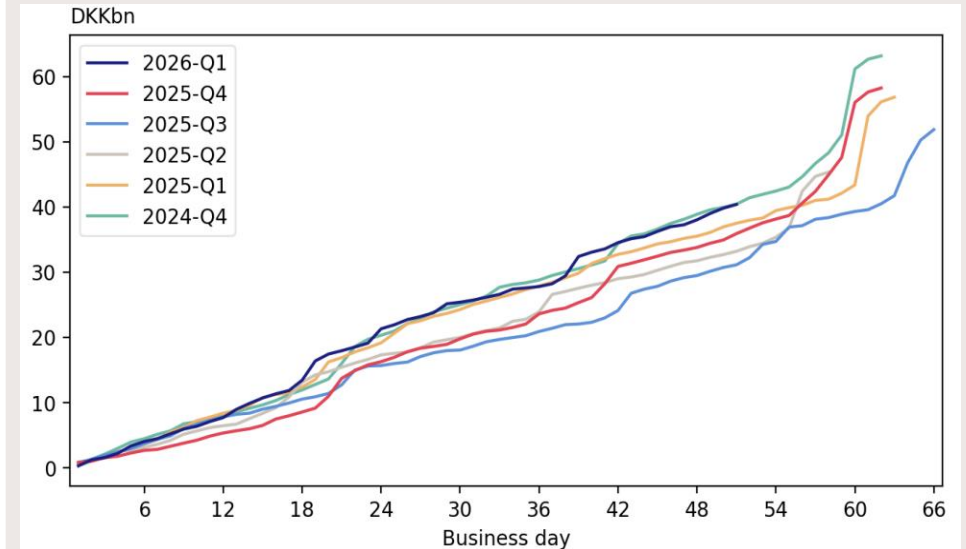
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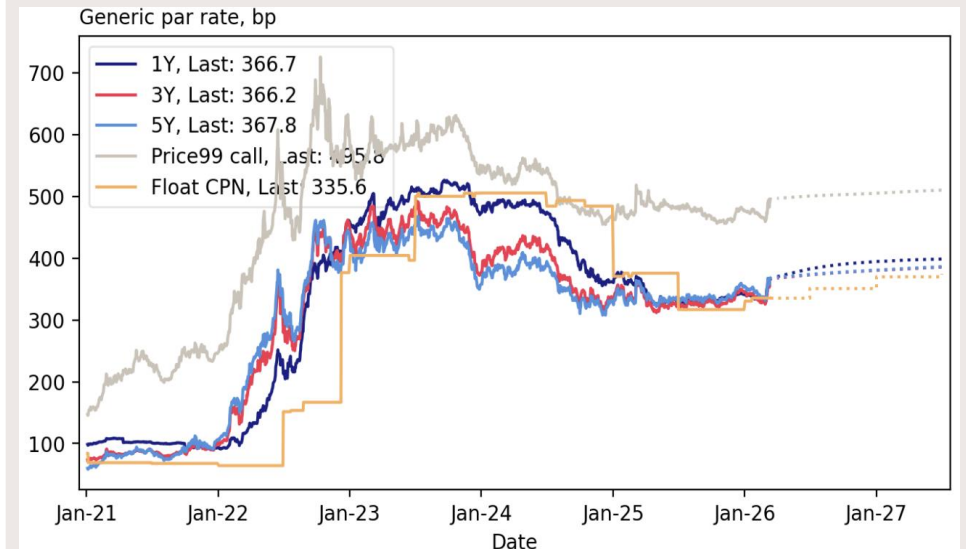
# Fewer bullets: Crying wolf

- It has been our expectation that bullet issuance – particularly of longer maturities – would tick down, driven by a lower volume of fixed-to-variable refinancing.
- So far, this has not been the case, and bullet issuance for Q1 is therefore higher than what we observed in the final quarters of 2025.
  - We assume that part of this is due to early refinancing by RD, which issued DKK 3.5bn-worth of longer-dated bullets in January.
- However, we continue to expect issuance to decline in the coming months.
  - In recent weeks, rising short-term rates have made FRN-funded loans relatively cheaper for borrowers compared with other loan types, including adjustable-rate mortgage loans.
  - In addition to lower volumes of fixed-to-variable refinancing, it may also lead to more borrowers choosing an FRN-funded loan over an adjustable-rate mortgage loan.

**Bullets: Accumulated issuance (OMX)**



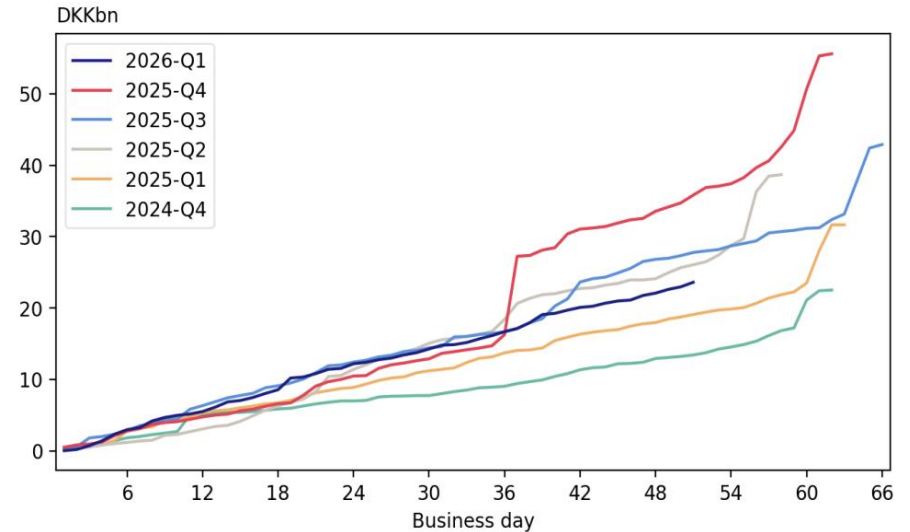
**Yields and coupons adjusted for margins etc**



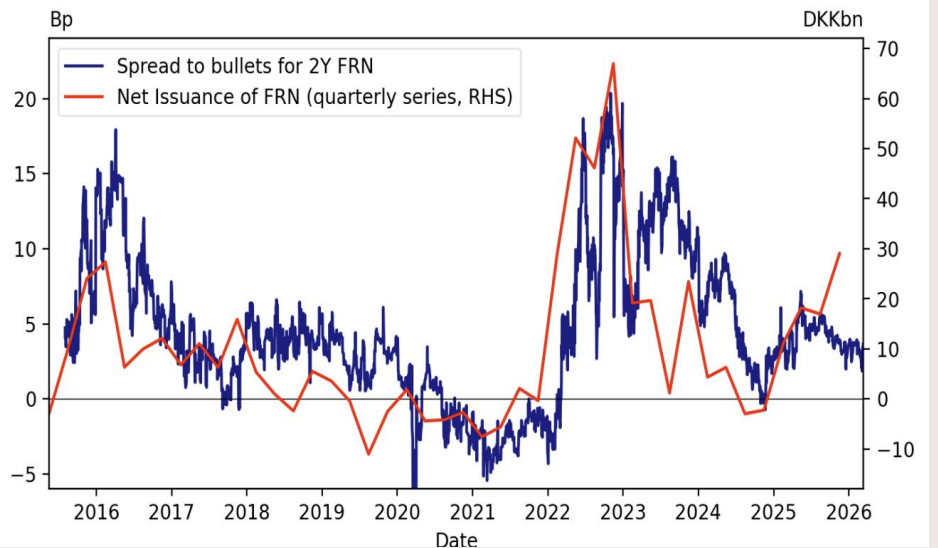
# Slightly lower FRN issuance recently

- FRN issuance is currently running slightly on the low side compared with recent quarters.
  - This may also have contributed to the currently low FRN spreads vs the bullet curve – see the bottom chart, where the latest observation for net issuance is Q4 2025.
- That said, most of the FRN issuance comes at the end of the quarter, as fixed-price agreements are generally not entered into on FRN-funded loans.
  - We expect the end-of-quarter issuance to amount to DKK 6-8 billion of FRNs.
  - This would bring FRN issuance closer to the levels seen in the last three quarters of 2025 (Note: When Q4 is adjusted for the DKK 10bn-worth of Cita 12M FRN issued by JRK).
- We believe that the ongoing FRN issuance is likely to pick up again in Q2, reflecting the relatively more attractive pricing of FRN-funded loans.

FRNs: Accumulated issuance (OMX)



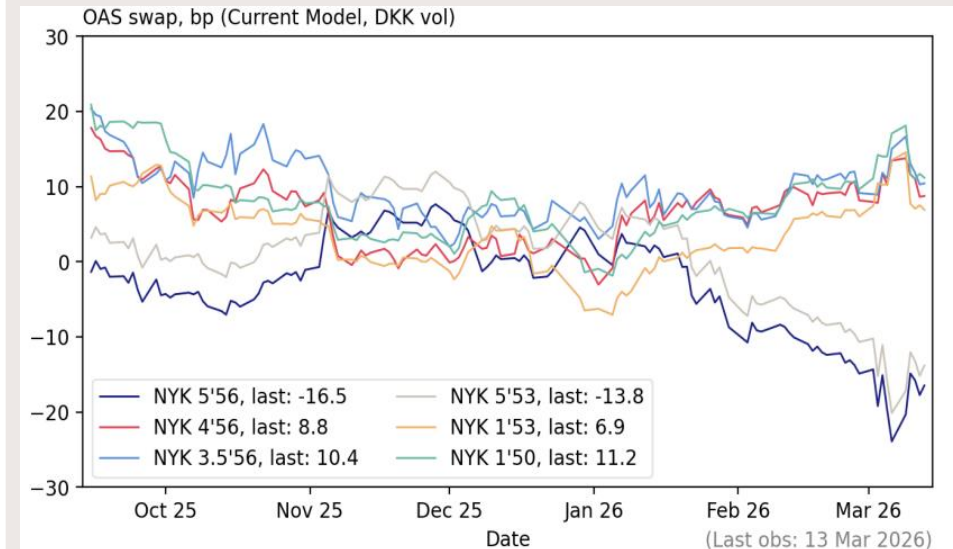
FRN spreads vs bullets and net issuance



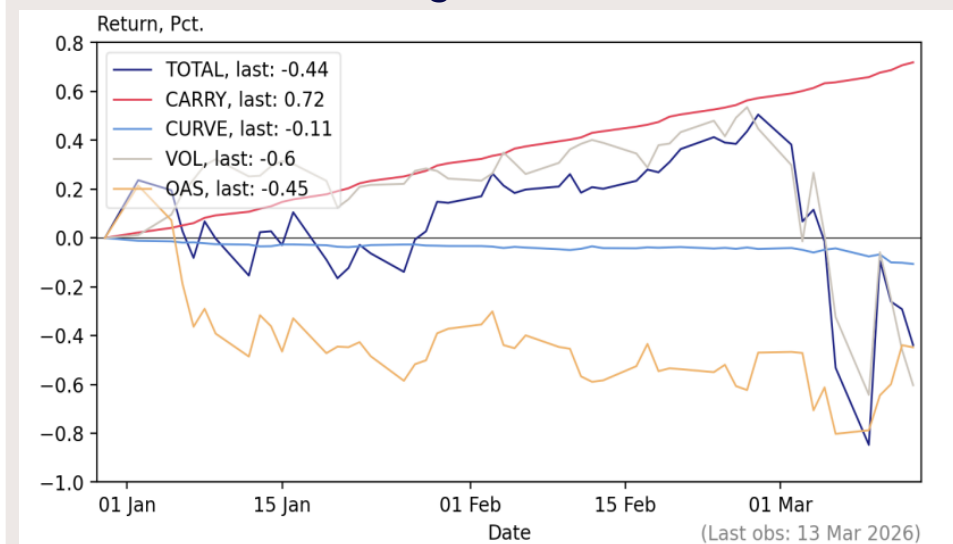
# Are callables shaking off the dust?

- 3.5'56 and 4'56 fell back last week to OAS levels broadly in line with those seen through much of February, before the war in the Middle East hit markets in early March.
- This is despite the fact that iTraxx Main has widened by more than 10bp since the end of February, while EUR 1Y10Y and EUR 10Y10Y volatility have widened by just over 20 and just over 5 points, respectively. EU Financials (AA) has also widened vs swap.
- Against this backdrop, the current OAS level of callables appears somewhat on the expensive side.
- It is possible that a "normalisation potential" are buoying up callables, implying that higher OAS is not currently required.
- The rise in volatility seen in March has resulted in a loss of about 1% on a delta-vector-hedged callable bond. This may be viewed as a potential "normalisation gain" if, over the next weeks, the situation calms down in the Middle East, and volatility falls back.
- However, there is also the possibility that the current OAS level reflects that the recent increase in volatility is not fully priced in.
- Volatility declined fairly significantly on Tuesday, but subsequently increased again, with OAS "normalising" in parallel. The latest movement raises concerns that the current volatility level is not fully priced in – and that callables may need to widen in the coming days, unless volatility falls back.

## OAS of selected 30Y callables



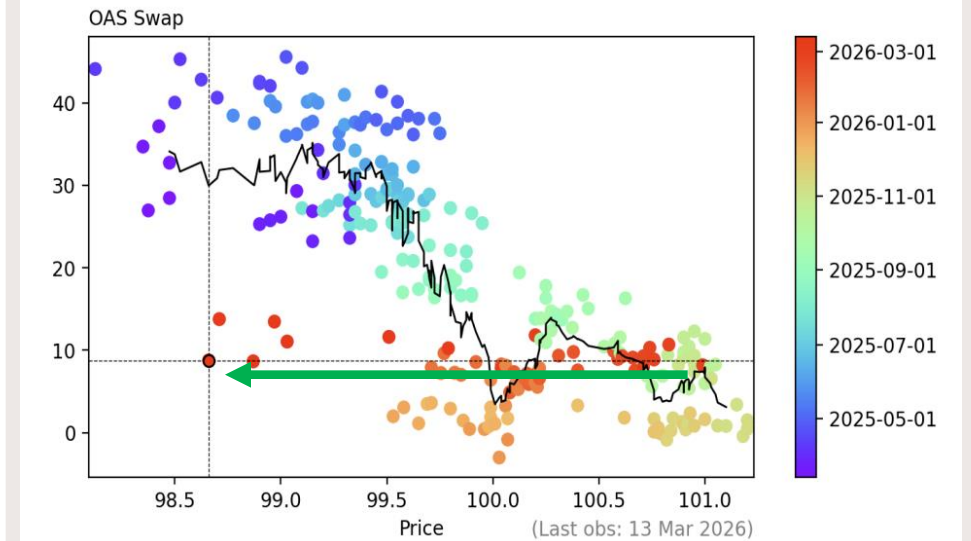
## Return on delta-vector-hedged 4'56: Vol is the villain!



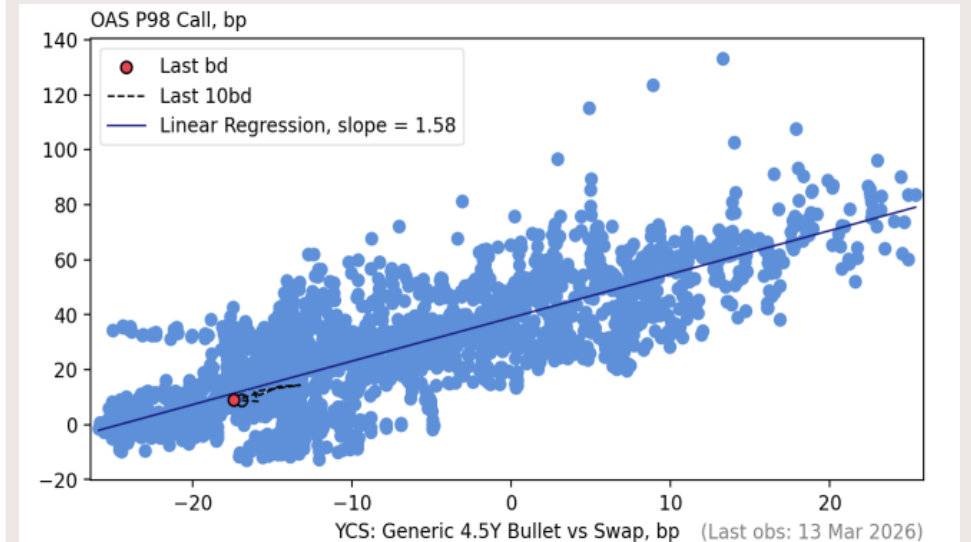
# Callables (continued)

- The price of 4.56 has decreased by over DKK 2 over the last two weeks.
  - We rarely see a price correction of this magnitude without a corresponding widening of OAS.
  - The last time 10–30 slope, volatility and credit spreads were at the current levels, OAS of callables was around 30bp higher.
  - The difference is that rates are significantly higher (the 10Y swap rate has risen by about 30bp just in March) – and the OAS would likely have widened if the recent turmoil had not triggered such a sharp rise in rates.
- The pricing of callables must, however, be viewed in correlation with the fact that bullets (in terms of spreads) have also demonstrated relatively strong resilience to the recent market fluctuations.
  - Hence, the pricing of callables has not moved out of balance relative to 4Y-5Y bullets ...
  - ... and 4Y-5Y bullets have not moved out of balance relative to EUR covered bonds, see also below.
  - It is thus possible that the very low credit risk in Danish mortgage lending contributes to buoy up mortgage bonds in the current situation.

## 4.56 has widened more than 2 points without any change in OAS



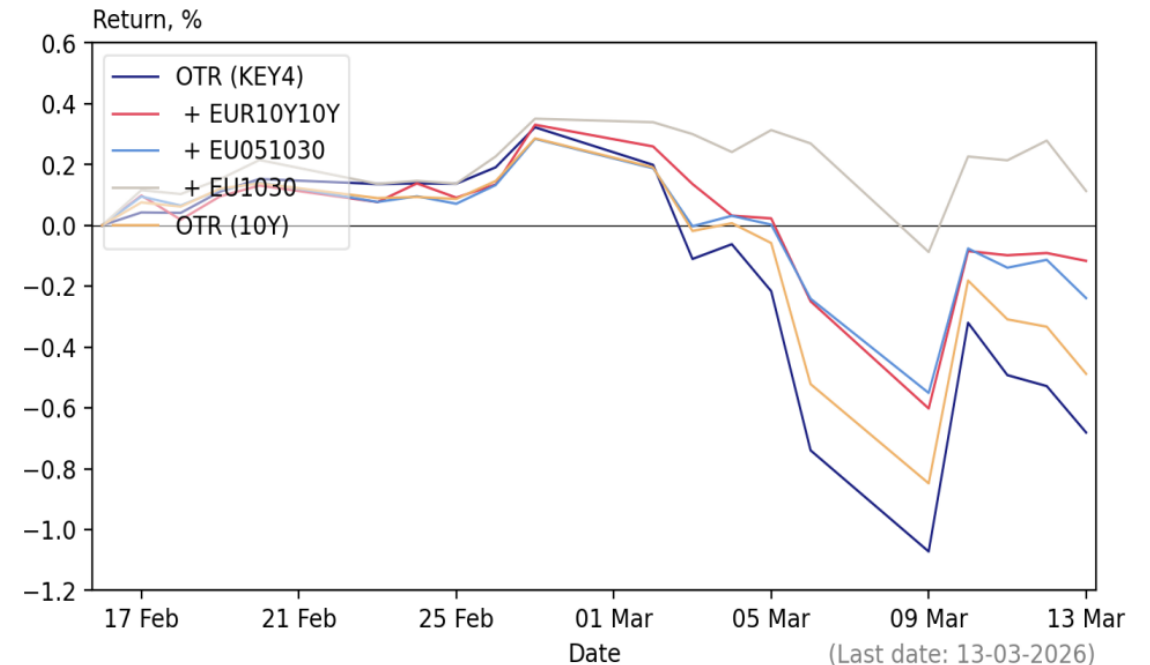
## Callables have not moved out of sync with bullets



# Swap-swap-swaption: Hedge or an alternative?

- At the beginning of last week, we [wrote about](#) how the three overlays we analysed in a research note shortly before the outbreak of the war (read [here](#) and listen [here](#)) would have mitigated the impact of the recent market moves on an OTR callable bond.
- The conclusion as of Friday remains that a 10-30 curve-flattener (EU1030) has continued to be the most effective of the three overlays in mitigating losses on a delta-vector-hedged callable during March.
- An EU051030 swap barbell and a EUR10Y10Y swaptions straddle have, however, also been able to offset a considerable share of the loss.
- This also indicates that for investors who see a "normalisation potential" in the volatility exposure of callables (see above), such potential could equally be pursued through these overlays – without taking on the OAS risk embedded in callables.
- In that case, investors would naturally need to take the opposite position of what would otherwise be required to hedge the callables (the details are described in this [research note](#)).

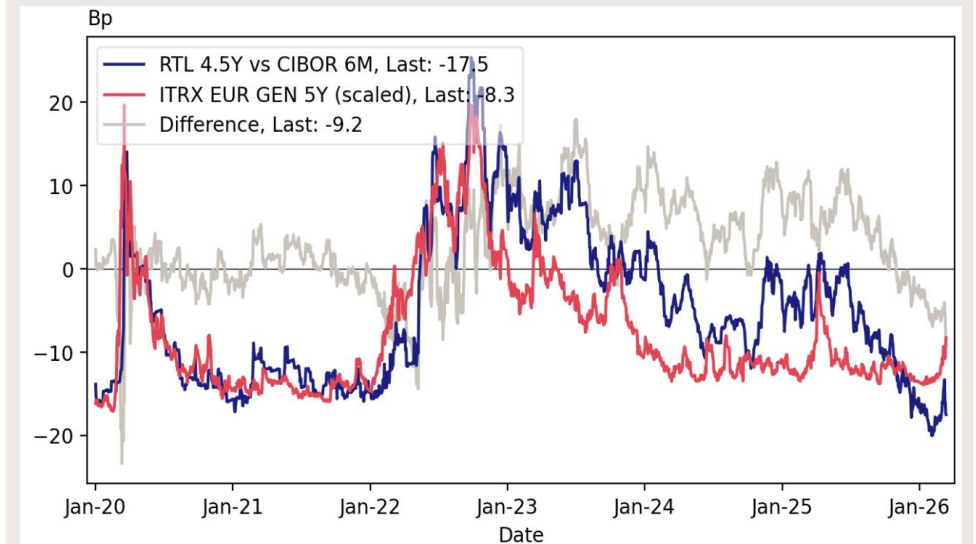
**OTR Callable with KEY4 + Overlays**



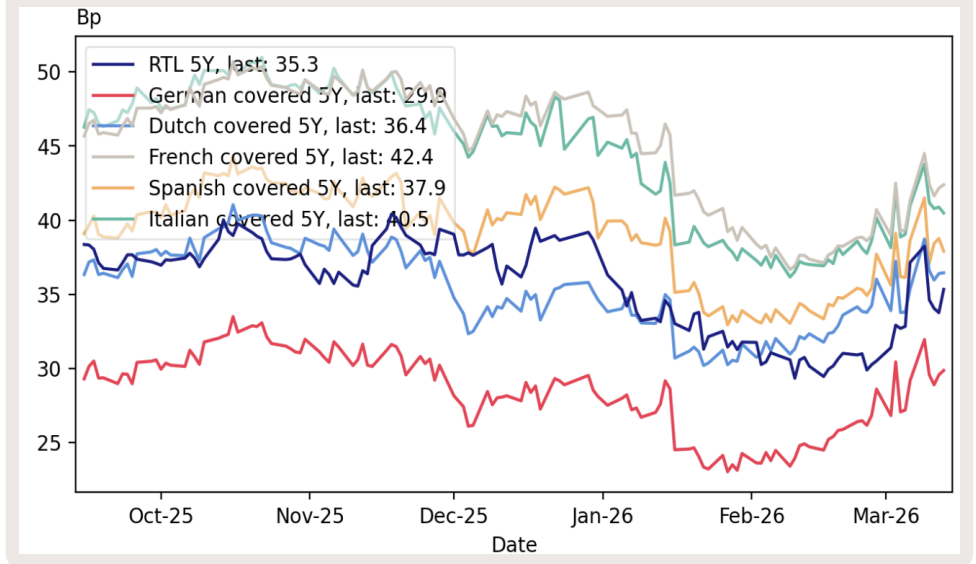
# Long-dated bullets have followed European covered bonds tighter

- While European credit spreads continued to widen last week, long-dated bullets moved tighter.
- The movement in 5Y bullets is consistent with what we have observed in European covered bonds.
- We therefore see that spread developments in longer-dated bullets continue to be driven primarily by dynamics in the European covered bond market.
- Relative to European covered bonds, the current pricing looks fair.

### 4.5Y bullets YCS vs iTraxx Main



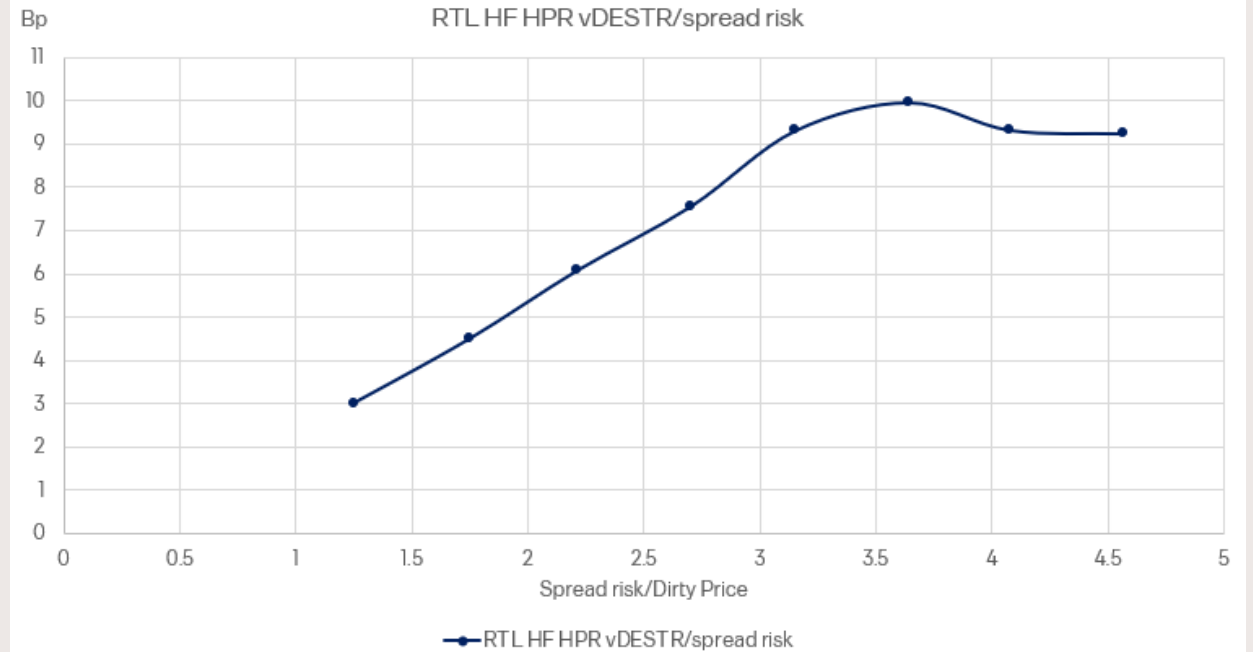
### Bullets and EUR covered bonds: Spread vs DGB/DBR



# Short-dated bullets continue to look expensive relative to long ones

- Short-dated bullets also performed last week, bringing them back to roughly the same spread levels seen before the conflict in the Middle East broke out.
- They still look expensive relative to longer-dated bullets, which currently offer up to around 6bp more in 12M HPR (hedged and funded) per unit of spread risk.
- We therefore still prefer longer-dated bullets over short ones.

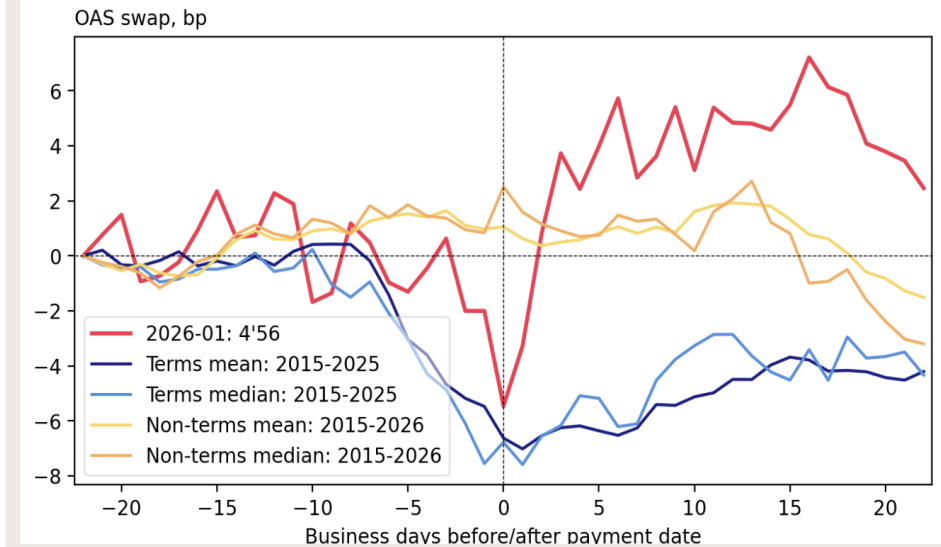
Hedged and funded HPR/spread risk (vs DESTR swap)



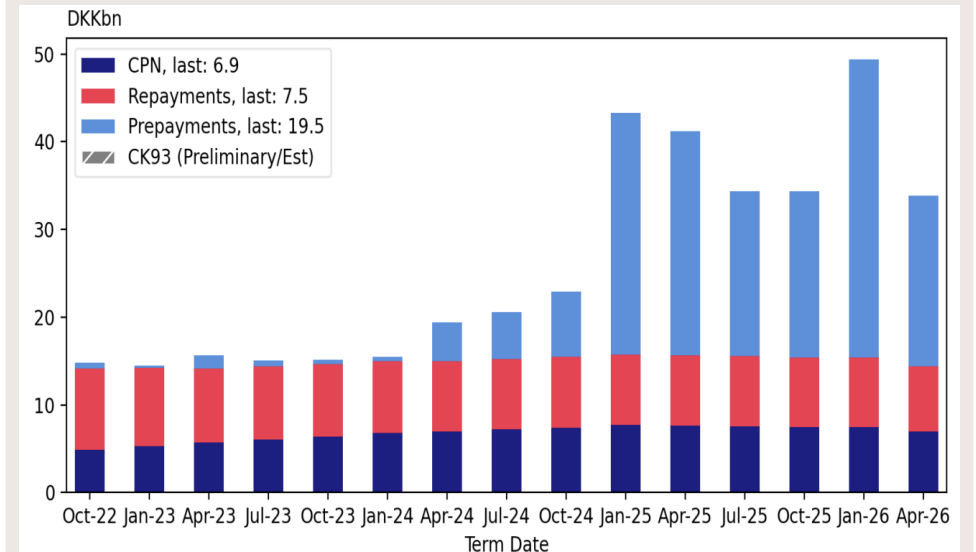
# Time for reinvestment performance – or is it?

- We expect more modest reinvestment performance in callables around the April payment date (5bp) and a normal degree of reinvestment performance in bullets (1-2bp).
- During the January payment date, we also observed weaker – and shorter-lived – reinvestment performance in callables than has historically been the case (see chart). At the same time, reinvestment performance in bullets was stronger than usual (3–4bp versus the typical 1–2bp).
  - We believe that this was due to the expensive pricing of callables at that time, which encouraged investors to reinvest in bullets instead.
- The spread widening over recent months now means that callables are no longer nearly as expensive.
- Furthermore, the reinvestment need is smaller this time and bullets – despite the recent spread widening – still trade at higher levels than they did at the January payment date.
- We therefore do not expect investors to rotate into bullets to the same extent as last time, and the smaller negative net issuance in callables should also imply more limited reinvestment performance.
- However, the current war in the Middle East may result in reinvestment performance being cancelled altogether this time.

Reinvestment performance in callables



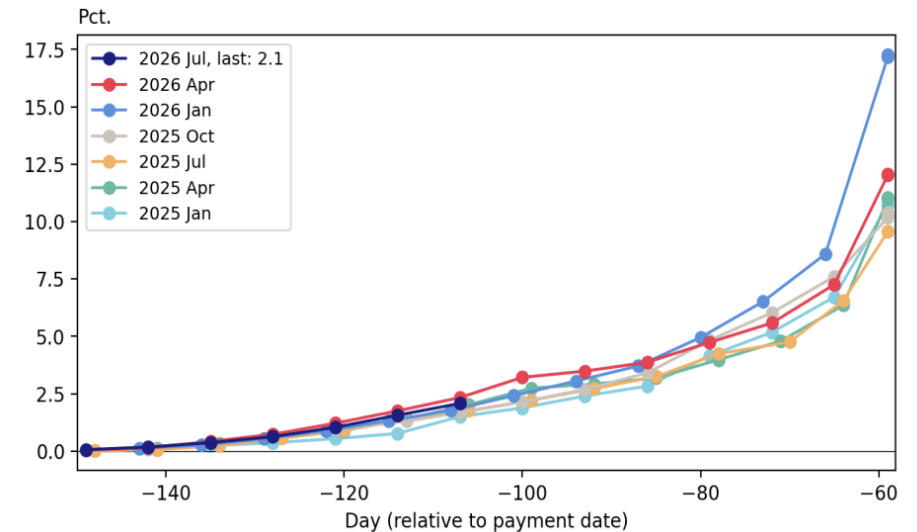
Prepayments and principal and coupon payments in callables



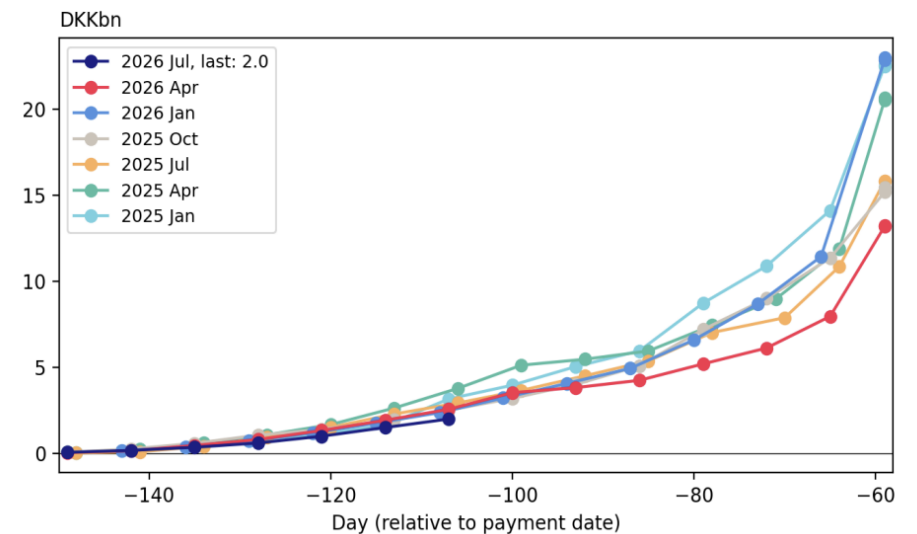
# The prepayment engine with fixed-to-variable refinancing is chugging along ...

- Today's CK93 data show that the percentage of preliminary prepayments in 5% callables at the July payment date continues along the same path we have observed since the January payment date (see top chart).
- This is an almost uncanny consistency in the percentage-based prepayments, interrupted only at the January 2026 payment date due to the 3.5'56 segment briefly trading around a price of 97.5 ahead of the prepayment deadline.
- Moreover, neither trade wars nor real wars have meaningfully shifted the refinancing rate of 5% bonds.
- However, with 4% bonds now trading below par, there is reason to expect that overall prepayments in the callables segment will decline, also because 10% prepayments in 5% bonds are no longer what they once were (see bottom chart) ...

Preliminary prepayments in 30Y 5% callables (in %)



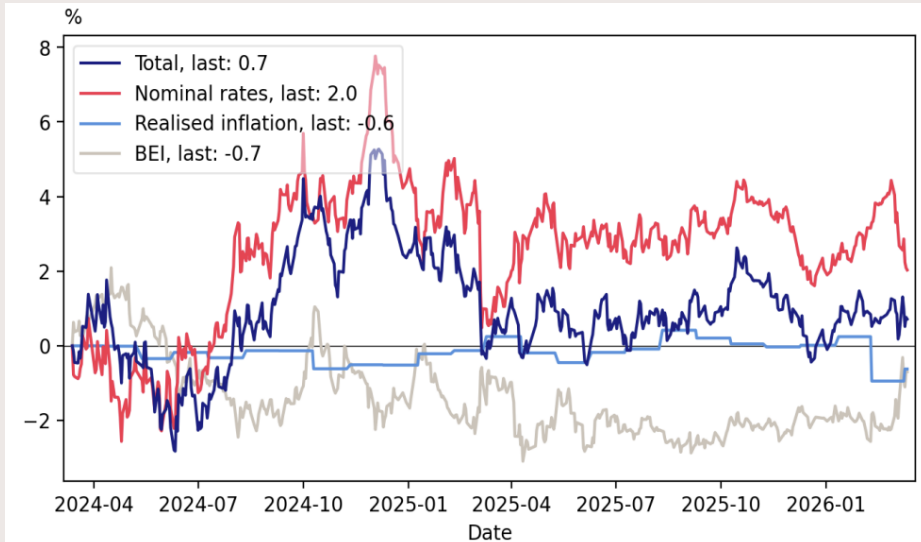
Preliminary prepayments in 30Y 5% callables (in DKK)



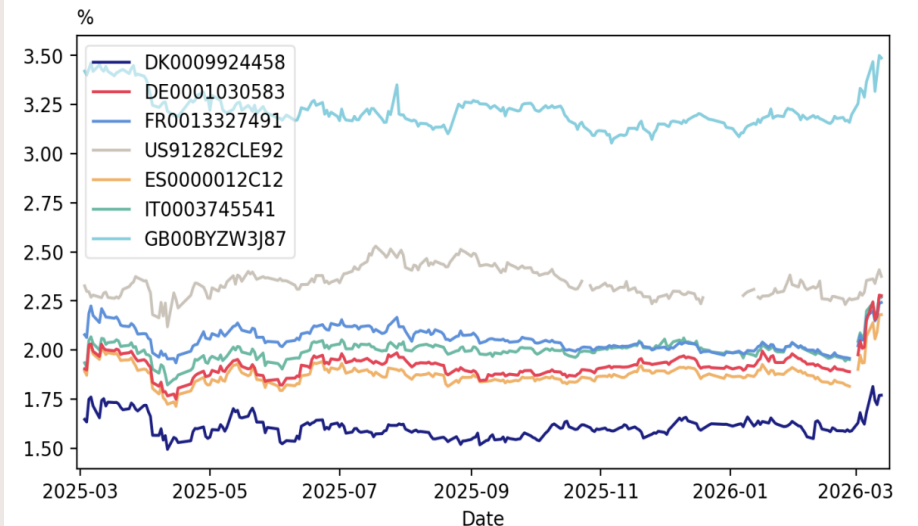
# DGBi on auction!

- Auction of 2% DGB'28 and 0.1% DGBi'34 will be held Wednesday, with bids due by 10:15 CET
- Particularly the DGBi'34 could prove interesting in light of the rise in inflation expectations since the outbreak of the war in the Middle East.
  - The bond has already performed well relative to nominal Danish government bonds (see top chart), as higher inflation expectations have fed into an increased breakeven inflation (BEI).
  - However, the seasonally adjusted BEI on the DGBi'34 has "only" risen by around 15–20bp, whereas the increase in comparable European linkers (and inflation swaps) has been closer to 30–40bp (see bottom chart).
  - It is also worth noting that the rise in seasonally adjusted BEI on the DGBi'30 — at around 45bp — has been much more in line with the move seen in European inflation swaps.

### Decomposed return on DGBi'34



### Seasonally adjusted BEI, 10Y inflation linkers



# Recommendations

- We have no updates to our recommendations this week.

Opening date	Name	Return 5bd	Total return
2025-08-25	CITA vs CIBOR 3M FRN	0.01	0.03
2025-11-27	CIBOR 6M vs CIBOR 3M FRN	0.00	0.06
2026-01-12	RTL5 vs. RTL3	-0.02	-0.09
2026-01-15	RTL vs FRN	0.04	-0.03
2026-01-15	NYK 4'56 vs RD 5'56 + JRK 1.5'53 IO	-0.01	-0.81
2026-01-26	4'56 vs RTL5	-0.28	-0.22
2026-02-23	DESTR vs. RTL1	-0.00	-0.02
2026-02-23	RTL5 vs. RTL1	0.01	-0.02

# Nykredit

## markets

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BUY: In our view, the bond pricing is fairly cheap relative to comparable alternatives in either the bond or the derivatives market. We expect that the bond will offer a higher return than any alternatives on a horizon of typically three months.

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Recommendation	
Buy	50%
Sell	50%

As at 13.12.2024

Note: Distribution of our recommendations, which therefore add up to 100%.

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