

Closing effects

– a myth from the old days?

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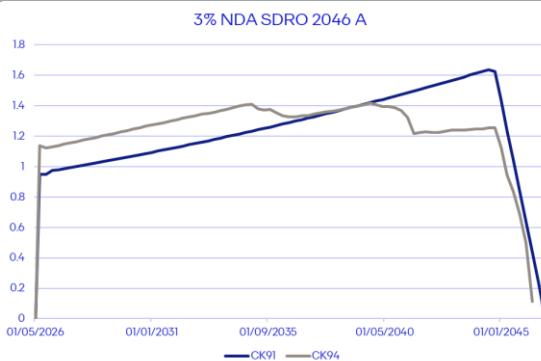
Marketing communication

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- Closing effects do not exist in Nykredit's prepayment model, but they may still be relevant in other models
- This time, the closing effect is limited, as issuance has taken place in most bonds throughout the entire opening period
- Bonds facing the largest potential closing effect could gain around DKK 0.50 at closing.

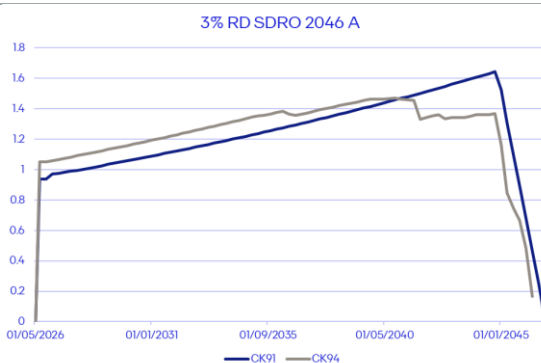
Bonds where the actual cash flow is shorter than assumed under CK91 will see higher OAS at closing, and historically, these bonds have tended to appreciate in price as they approach closing. This time, the largest potential closing effects are found in the 20Y segment. Investors should be mindful, however, that low liquidity may make it difficult to realise any potential "closing gains". Given the limited overall scope, closing effects are hardly worth pursuing, but if one is buying 20Y callable bonds anyway, it may be advantageous to select those where a little extra money could potentially be gained at closing.

Largest potential closing effect in NDA 3'46 non-IO



Source: Nykredit Markets

More liquidity in RD 3'46, which is also facing a closing effect



Source: Nykredit Markets

Shift from CK91 to CK94 may give rise to a closing effect

Historically, change of maturity class has been associated with closing effects stemming from the transition from OAS calculated on the basis of CK91 cash flows – which assume evenly distributed issuance throughout the entire opening period – to OAS calculated using actual cash flows (CK94).

Nykredit's prepayment model, however, applies CKNYK, which is based on a combination of CK94 and future issuance estimated using Nykredit Markets's pricing model for fixed-rate bonds. As a result, there are practically no closing effects in Nykredit's prepayment model (see also OAS CKNYK and OAS CK94 in the table).

Nevertheless, closing effects may still be relevant in other prepayment models.

Closing effects may drive price performance ahead of closing

We have previously shown that bonds facing the largest closing effects tend to deliver price performance as they approach closing as a result of the transition from CK91 to CK94 – that is, their cash flows shorten.

By contrast, there is typically little to observe after closing. In other words, if the closing effect is not fully priced in ahead of closing, the bond will simply appear cheaper in OAS terms as a result of the closing and remain cheap after that.

The table overleaf shows the 20 bonds – with a minimum outstanding amount of DKK 1 billion – that are currently facing the largest closing effect. However, most bonds have, by and large, seen issuance throughout the entire opening period and are therefore not facing a closing effect. The difference between CK91 and CK94 is consequently smaller this time around, and the potential closing gains are correspondingly limited.

The bond with the greatest potential closing gain is NDA 3'46 non-IO, which stands to gain DKK 0.60. Apart from RD's 1'56, the top of the list is generally dominated by 20Y bonds. This is due to lower issuance at the end of the opening period, combined with their already shorter cash flows, which increases sensitivity to further reductions in cash flow length.

RD's 1'56 ranks among the top candidates despite having opened later than the other issuers' 1% 2056 bonds. This is because, at the opening, RD transferred existing public housing loans from 4'56 into their 1'56. Thus, the majority of issuance occurred early in the opening period, thereby shortening the cash flows.

Mind the liquidity

Although we have excluded series with an outstanding amounts below DKK 1 billion, the bonds facing the largest closing effects (in terms of price) generally have outstanding volumes of only DKK 1-2 billion. This may make it difficult to realise any potential closing effects in practice, and with potential closing gains of less than DKK 0.50 in almost all bonds, it is hardly worth pursuing the closing effects. If you are looking to buy for example, 20Y callables, one may favour bonds such as NDA 3'46 or RD 3'46 and potentially earn the extra money.

Top 20 bonds with the greatest potential price impact from closing (outstanding amount > DKK 1 billion)

Obligation	OAS CKNYK	OAS CK94	OAS CK91	Potentiel "lukkeeffekt" (bp)	OAS risk	Potentiel kurseffekt	Cirkulerende mængde
3% NDA 2046 A	17.9	7.8	17.6	10.1	6.1	0.6	1070
3% RD 2046 A	15.2	7.8	14.9	7.4	6.0	0.4	1564
1% RD 2056 A	46.5	41.5	46.5	5.1	7.4	0.4	2192
4% NDA 2046 A	9.1	1.6	9.1	7.5	4.7	0.4	1358
4% RD 2056 DA	3.6	-1.3	3.6	4.9	7.0	0.3	16915
3.5% NDA 2056 DA	3.4	-0.1	3.3	3.5	8.6	0.3	2184
3.5% RD 2056 DA	2.2	-1.3	2.1	3.5	8.4	0.3	1338
3.5% DLR 2056 A	8.0	4.2	7.9	3.8	7.4	0.3	1201
3.5% BRF 2046 A	17.8	12.8	17.7	5.1	5.4	0.3	2376
3.5% NYK 2056 DA	2.0	-1.0	1.9	3.0	8.5	0.3	3783
4% RD 2046 A	6.2	1.1	6.3	5.1	4.6	0.2	2055
4% BRF 2056 DA	4.4	1.2	4.4	3.3	7.0	0.2	7993
4% RD 2056 DA30	-8.2	-10.9	-8.2	2.7	8.4	0.2	4461
5% BRF 2056 DA	16.2	10.8	16.3	5.4	4.1	0.2	1841
3.5% NYK 2046 A	14.8	11.1	14.7	3.7	5.7	0.2	8322
4% NYK 2056 DA	4.3	1.4	4.3	2.9	7.2	0.2	47784
4% NYK 2046 A	7.5	3.2	7.5	4.3	4.7	0.2	7121
5% NYK 2056 DA	8.8	4.1	9.0	4.7	4.2	0.2	4609
3.5% NDA 2056 A	7.6	5.3	7.6	2.4	7.7	0.2	6060
5% RD 2056 DA	12.6	7.7	12.6	4.8	3.7	0.2	1926

A = non-IO, DA = IO10, DA30 = IOIO

Source: Nykredit Markets

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Recom- menda- tion	
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As at 13.12.2024

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

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