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Short interest in largest corporate bond ETF hits record level

BlackRock's $33bn investment-grade fund sees almost 50% jump on bet of fall in price of securities

by: **Eric Platt** and **Joe Rennison** in New York

Bets that corporate bond prices will slide surged in the build-up to this month'sFederal Reserve meeting, with short interest in the largest corporate bond exchange traded fund hitting a record level.

The bearish signal is a measure of investor sales of shares that they do not hold, in a wager that the bond price will fall and they can repurchase it later at a lower price.

The increase in short interest could indicate that investors were seeking to hedge their exposure to corporate credit as they buy the underlying cash bonds, several fund managers said. It could also be a harbinger that investors expect markets to fall after abumper rally this year.

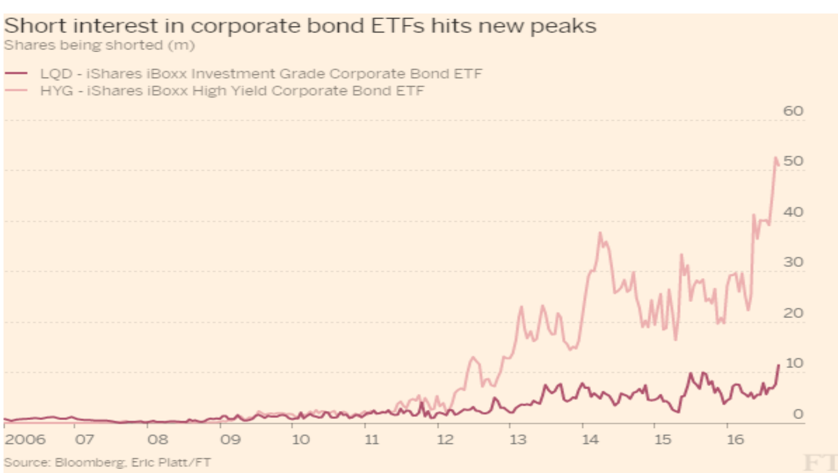
US junk-rated corporate paper has advanced 14.5 per cent this year, outpacing the 7.8 per cent total return of the benchmark S&P 500 stock index. By contrast, high-quality company bonds have returned 9.5 per cent.

"The levels are unjustifiable," Jack Flaherty, a portfolio manager with asset manager GAM, said of the prices of some high-yield debt. "We're not playing in nine out of 10 deals."

Short interest jumped almost 50 per cent to 11.4m shares in the two weeks to September 15 for BlackRock's $33bn investment-grade corporate bond ETF, the biggest corporate bond ETF with the ticker "LQD", according to data released this week.

For BlackRock's $17bn iShares iBoxx High Yield Corporate Bond ETF, the largest junk bond ETF with the ticker "HYG", short interest also remained near its record high, although it slipped 3 per cent over the period. Investors, including many hedge funds, have turned to ETFs to trade in and out of positions faster than they could if they transacted in the underlying bonds.

Matt Tucker, head of fixed income strategy for iShares in the Americas, added that it was "unclear" if the rise in short interest was "to create an outright short in the market or to hedge an existing position".



Data are not yet available that cover investor short positioning after the Fed meeting, but fund flows show investors have recently gravitated towards several of the largest US corporate bond ETFs and that the number of shares outstanding has climbed. Flows into LQD, HYG and JNK, State Street's high-yield bond ETF, have surpassed $1.7bn in the days since the US central bank left rates unchanged, according to FactSet.

Some investors said the movement underlined renewed interest in the corporate debt market after the prospect of tighter monetary policy had been deferred. Central bankstimulus efforts, including bond-buying programmes in Europe and Japan, have driven foreign investors into the market for US corporate paper, which offers appetising income at a time when nearly $13tn of debt trades with a yield below zero.

“High yield continues to shrug off negative news even as many participants believe the market is overbought,” said John Dixon, a junk bond trader at Clearview Trading.

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