Glencore news: Implications for iTraxx investors

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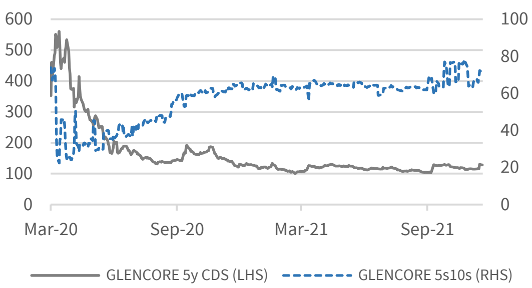
Recent reports indicate that Glencore (Ticker: GLENLN, CDS ticker: GLENCORE, Baa/BBB+) may have considerable exposures to methane emissions that previously have not been in the public eye, see Mining.com, 29 Nov 2021, "Glencore's Australian coal mine revealed as methane super-emitter."

At the same time, there are overnight news the activist hedge-fund Bluebell Capital Partners has asked for a split of the firm into a coal and non-coal component, see Bloomberg, 30 Nov 2021, "Glencore Faces Activist's Call to Separate Coal Unit."

First, we believe that an unremedied methane situation at the company would make it a difficult position for asset owners/managers trying to manage their funds into the EU's SFDR Article 8 or 9 classification. This has significant implications for such investors who are currently invested in iTraxx Main of various series as they through that have exposure to the name. In particular, for those structures who are long risk in the index, this poses a problem, as they are carrying a bond equivalent financing relationship.

Figure 1. Glencore spreads. Source: Bloomberg.



For such long iTraxx Main investors, a potential solution would be to hedge out the Glencore exposure (buy buying single name CDS protection on GLENCORE, matched maturity and notional exposure), alternatively to – where possible – shift into the iTraxx ESG index (Bloomberg ticker: ITXEM36 or equivalent for series matching). For a more technical perspective on these types of trades, refer to "Carbon negative leveraged investment strategies", AFII, 12 Aug 2021, or "ESG in CDS indices: A practitioner perspective", AFII, 14 Aug 2020.

For investors looking to potential spread developments on the back of Bluebell's approach to company management, we see this as an interesting long convexity situation. If a split is executed, investors may end up having their debt referencing to the 'good' part of the company, in which case its "ESG value" should be high and spreads would rally (CDS would go tighter). If current bond investors instead are stuck in the coal entity, and a new non-coal entity start raising debt, spread are likely to go significantly wider. In this context, it is worth to note that Bluebell is focusing on creating value for shareholders. There is a risk that some of that value will be extracted from bond holders.

We would argue that going long convexity through DV01 neutral 5s10s flatteners could be an interesting position to get positive exposure to either spreads tightening or widening significantly. AFII discussed a similar catalyst positioning "Mexiconvexity: Credit ideas on the IMF Pemex Funding", 8 Sep 2021 and we would refer back to "CDS Curve Trading Handbook", Barclays Capital, 2008, for a further deep-dive into these types of trades. The AFII team is also open to discuss the topic.

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