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Hybrid Redemptions – Tier-2 Primary Back in Play and other Alternatives

By James Verschoor

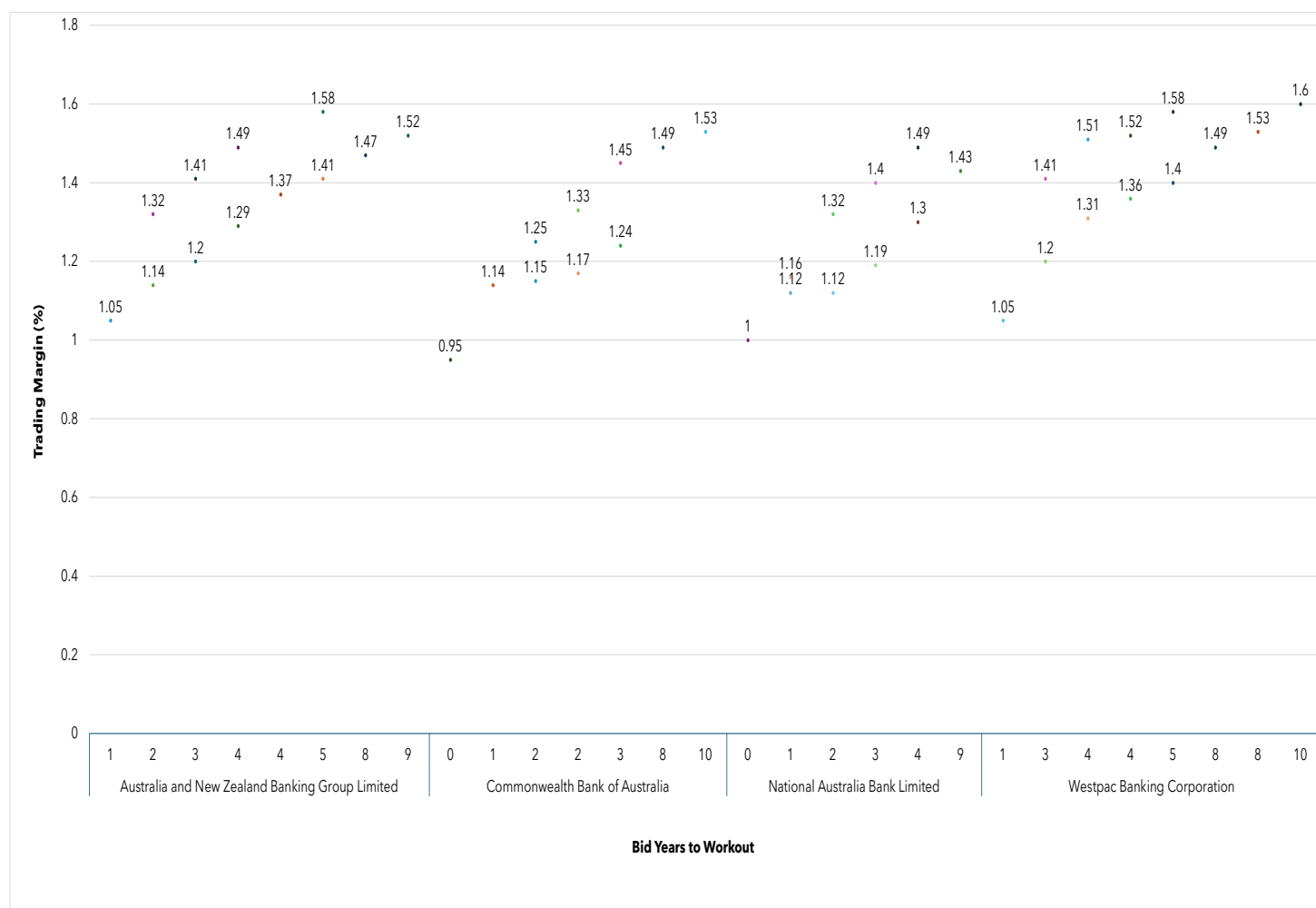
Both major bank AT1 and T2 have widened over the last week, although over the last month, T2 has tightened compared to AT1, which is 9bps wider (see Table 1). As seen below, trading margins for both T2 and AT1 have widened by 2.99% and 5.12%, respectively, over the last week. AT1 is trading relatively cheaper, with the ratio of trading margins of AT1 to T2 sitting at ~1.64x as compared to ~1.60x the week before.

| | Last (29/05) | 1-week | 1-month | 3-month | YTD |
|--|---------------------------|--------|---------|---------|--------|
| AT1 Major Bank Index Trading Margin (%) | 2.26 | 2.15 | 2.17 | 2.03 | 1.79 |
| | Change to last (%) | 5.12% | 4.15% | 11.33% | 26.26% |
| T2 Major Bank Index Trading Margin (%) | 1.38 | 1.34 | 1.53 | 1.13 | 1.14 |
| | Change to last (%) | 2.99% | -9.80% | 22.12% | 21.05% |

Table 1: Trading margins from BondAdviser Major Bank Capital Indices (29 May 2025)

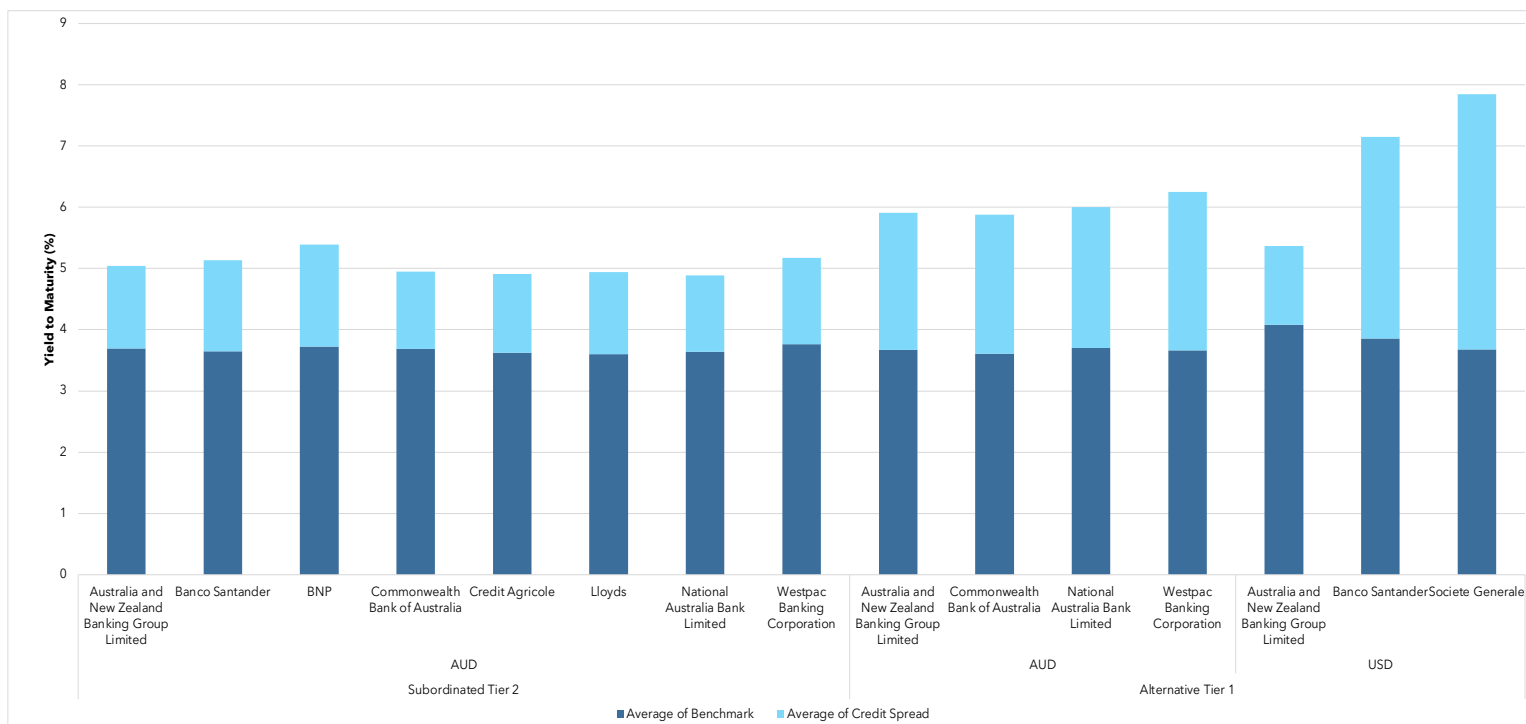
Volatility has subsided over the last two weeks as trade related news has been overall positive on net. Major Bank tier-2 has come back to the primary market with the recent 15NC10 tier-2 issues by Westpac, pricing at 5.815% and Macquarie Bank at 6.1456%. These new issues have provided significant value over secondary offers, with the recent Westpac currently trading ~7bps wider in terms of trading margins to the nearest maturing line. These deals have seen subscription rates of ~5x issue sizes, with significant demand for fixed-rate securities as the RBA begins to cut rates.

As mentioned previously in this newsletter, these primary opportunities are the best way to begin investing in tier-2, with these bonds picking up capital appreciation within days of secondary trading.



Graph 1: Major Bank Tier 2 Trading Margins (29 May 2025)

As for alternative tier-2, European issuers in Australia's tier-2 market are trading at around similar ~5% YTM's on average, across all maturities. Notably, Banco Santander and Societe Generale \$US AT1 hybrids are yielding 7%+ YTM. These securities may be considered for investors who are seeking high yields above and beyond those available in Australian dollar markets.



Graph 2: Australian Major Bank + European Bank T2 and AT1 (29 May 2025)

For current AT1 hybrid owners seeking to learn more about alternatives in OTC markets, or simply a greater understanding of fixed income investing, please contact one of IAM Relationship Managers for more information.

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