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Regions and Synovus typify a manic corporate bond market

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Markets can swing from staidness to despondency to exuberance to madness. Charles MacKay chronicled human nature and investing 172 years ago with his book *Extraordinary Popular Delusions and the Madness of Crowds*. Perhaps the corporate and structured finance markets reflect that more than equities as we near the sixth anniversary of the start of the financial crisis. Most seem to mark the formal start of the crisis in mid-2007 when two Bear Stearns hedge funds (Bear Stearns High-Grade Structured Credit Fund and Bear Stearns High-Grade Structured Credit Enhanced Leverage Fund) failed; others date it to the failure of New Century Financial Corp., a subprime originator, in March 2007.

Regions Financial Corp. never was in danger of failing, though exposure to Georgia and Florida real estate heightened the risk in its loan portfolio. When Regions' shares dived below $3 per share in early 2009, from a peak of $38 per share in October 2007, there was a decided panic in the market for Regions' and most banks' shares. Investors also were guesstimating the amount of dilution they would incur for forthcoming common raises. Panics usually pass, however. Regions closed on May 2 at $8.46 per share, which represented 116% of tangible book value per share, a dirt-cheap valuation prior to the financial panic and ensuing recession.

Regions caught my attention recently when it issued $750 million of five-year senior debt due May 2018 on April 25. The coupon was 2.00%; the yield-to-maturity was 2.07%, given that the issue priced at 99.67% of par. The spread to the five-year U.S. Treasury was 138 basis points, which is not bad for a BBB-rated company by S&P. The coupon, rather than the spread, is what caught my attention, however. It is about equal to the current inflation rate, though some are starting to trumpet disinflation and, if you are an unlucky debtor, deflation. Maybe the real spread is better than I imagine. The rating agencies are probably overly cautious too; I think the credit risk for the parent company obligations of Regions, whose credit quality is improving and parent company liquidity is high, is negligible absent a cataclysmic macro event. Further, wholly owned Regions Bank paid its first upstream dividend to the parent since 2008 in 2012 via a $950 million dividend.

Regions, perhaps as well as any other large financial company that is not a TBTF, embodies the massive rally in bond prices and the tightening of credit spreads over the past few years. Regions has two other outstanding senior debt issues: $700 million of 7.75% notes due November 2014 that were issued in November 2009; and $500 million of 5.75% notes due June 2015 that were issued in April 2010. The spread on the 7.75% notes relative to the five-year U.S. Treasury was 5.65 basis points at the time of issue in 2009; the spread was 350 basis points when the 5.75% notes were issued in 2010, according to SNL Financial.

As of May 2, the 7.75% issue traded at 110, had a yield-to-maturity of 0.95% and a spread to comparable maturity U.S. Treasury of 79 basis points, according to Bloomberg. The 5.75% notes were trading at 109 to yield 1.40% and a spread of 118 basis points. It seems like a lifetime ago when markets were fearful during the 2011 third quarter as a result of a near Lehman moment in Europe when intrabank funding markets froze and S&P downgraded the U.S. During that period, the 7.75% notes traded around 100, which put the spread at approximately 700 basis points over U.S. Treasury with four years of remaining maturity. The 5.75% notes traded around 95 and yielded above 7%.

Synovus Financial Corp. is another case in point. In June 2005, Synovus issued $450 million of 5.125% notes due June 2017 at 99.5 to yield 5.18%. According to SNL Financial, the spread was just 105 basis points over comparable U.S. Treasuries. It was an era when all things were possible, especially in housing finance in Georgia and Florida. At the time, bond investors could also look to Total Systems Services Inc. for parent cash flow support because Synovus owned 80% of the profitable processing company. Exuberant pricing eventually gave way to despondency as the bonds would trade as low as 50 in 2009.

During February 2012, B+ rated Synovus returned to the bond market to issue $300 million of 7.875% notes due February 2019 at 99.4 to yield 8.00%. The spread was 661 basis points over comparable U.S. Treasuries. At the time, some analysts carped the rate would clip EPS a bit because the funds would be used to retire $300 million of 4.875% notes that matured a year later and had been issued in 2003. But these new notes were bridge financing for a challenged company, which investors priced accordingly. This issue insured the parent company's liquidity position would be OK, in my view, so that the only remaining capital issue to be dealt with was $968 million of TARP. As of May 2, the 7.875% notes trade near 116, according to Bloomberg, to yield 4.73%, or about 380 basis points over a comparable maturity U.S. Treasury. The 5.125% notes due in 2017 that traded as low as 50 in the 2009 first quarter and again in the fourth quarter of 2009 trade around 104 to yield 3.93% today, or 340 basis points over.

The ability of Regions to issue five-year notes at 2.00% may not be a sign of the top in the corporate bond market. I may be wrong in thinking pricing was tight on a relative basis. I would have said the coupon was ridiculously low on an absolute basis, but that was before Apple's $17 billion bond offering earlier this week. It is hard to see how anyone makes money from these deals, though the issuers benefit.

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Ultimately, no one knows when the Fed's induced exuberance in the bond market will end. What I think is obvious is that there are not many attractive risk-reward situations in the bond market absent a few special situations. That was not the case as recently as early 2012 and certainly in the 2011 third quarter when fear reigned. In late 2003, Bill Gross was quoted as saying Treasuries' salad days were over. And they were, for over three years until exuberance (or fear of leverage) returned again. On May 1, Gross tweeted "World awash in money. Fed buys 85 billion per month. BOJ 75 billion. ECB hints at neg interest rates. Don't buy — sell risk assets." But it is not clear to me if he is talking about bonds, equities or both.

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