Euro Credit strategy

Euro Investment Grade spreads continue to tighten

What's happening?

- The positive market trends continue in March supported by solid technicals, the soft-landing rhetoric supporting corporate fundamentals, the dovish tone from the Fed followed by an equally dovish speech from the BOE, increasing the chances of a rate cut from June. This has led most investors to throw in the towel and make risky assets perform despite expensive valuations. In this context, the Euro Credit Merrill Lynch index continued its tightening trend to 78bps from 85bps over one month, with all sectors contributing to this performance. In line with the last couple of months, Financials both subordinated and senior, and Corporate Hybrids outperformed the rest. Basics, Transportation and Utilities, notably affected by EDF, were the main underperformers.

- Central banks remain on the driver seat in the overall context of monetary policy easing, the key theme remains the lack of volatility. In Europe, as expected the ECB remained on hold as rates reached a sufficiently restrictive level, contributing "substantially" to inflation returning to target. Further progress on disinflation was confirmed in the statement, but “domestic price pressures were characterized as remaining high, due to strong growth in wages”. The data-dependent approach was maintained, but during the conference, Lagarde sent a signal that it could be reasonable to expect a first rate cut in June. We reaffirm our long-held call of a 25bp rate cut in June, expecting three in total this year.

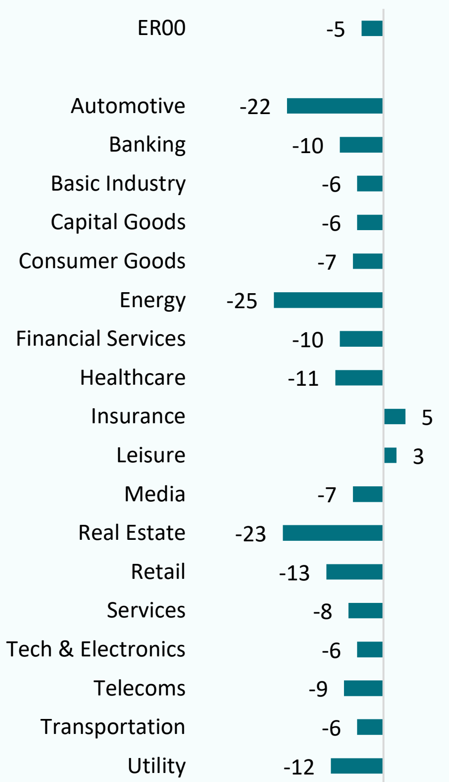
- In the US, there was no major surprises from the FOMC March meeting. The Fed left policy rates unchanged at 5.25-5.50% as inflation outlook did not really change. The Fed maintained an outlook for 3 cuts this year, but reduced expectations for cuts in 2025. Powell reiterated that the Fed needed more confidence to begin the process of dialing back policy restrictiveness but expected to do so “at some point this year”.

- Primary market continued to impress positively with a total issuance of €67bn, split at 58% for Corporates and 42% for Financials. Within non-financials, automotive and consumer goods (largely driven by the brewer AB Inbev) were the largest issuers. The Corporate Hybrids segment was also well represented with 7% of new issuance from Tennet, Orange, BT and Arkema notably. Demand for primary continues to be solid although decelerating a bit by end of the month. Books were oversubscribed by 4x on average with wide variations between high beta names (over 5x for Sabadell, Commerzbank, Virgin Money, Banco BPM) and low beta issues (below 2x for Kering, Svenska, Metlife).

Portfolio positioning and performance

- We have a **DTS above benchmark** at around 110% to 120% on average. We have a neutral position in spread duration versus benchmark.
- **Financials Senior** are a good place to be thanks to solid fundamentals, despite a dynamic primary market.
- We continue to be **overweight on Financial Subordinated** with a selective approach given tighter spreads. We also have a preference for intermediate call dates given flat curves.
- We have a preference for **Corporate Hybrids** offering attractive carry and better risk-reward opportunities compared to BB rated issuers.
- In Industrials, we maintained **our overweight in Real Estate sector** which offers good valuations still, despite the recent rally over the past few months.

Asset Swap Spreads changes - MTD



Source: AXA IM, Bloomberg, as of 31/03/2024.
ER00 = ICE BofA Euro Corporate Index

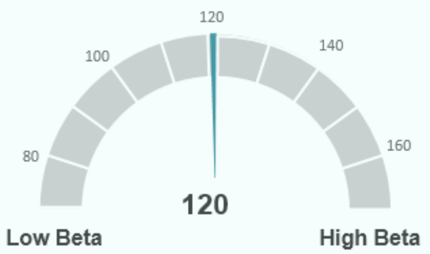
Our Country Positioning

	UW	N	OW
Core	●		
Semi-Core	●		
Peripherals			●
United States	●		
United Kingdom		●	

Our Sector Positioning

	UW	N	OW
Financial Senior			●
Financial Subordinated			●
Corporate Hybrids			●
Defensive Senior	●		
Cyclical Senior	●		

Our targeted DTS is around 110%-120%



No assurance can be given that the Euro Credit will be successful. Investors can lose some or all of their capital invested. The Euro Credit strategy is subject to risks including Credit risk, Liquidity risk, Derivatives and leverage, High yield debt securities, Contingent convertible bonds.

Outlook

- The Euro Investment Grade spreads have continued to tighten since the end of October, reflecting a strong US economy, improving activity in Europe, and decreasing inflation. The market is anticipating an ECB rate cut in June and a Fed cut in September. Given the current economic conditions, the tightening in spreads appears justified, although valuation constraints may limit further tightening below 100 basis points.

- We anticipate another strong year in 2024, as central bank rate reductions are expected to benefit corporate bonds. Historical data suggests that when central banks pause, it often leads to reduced rate volatility and positive returns for Investment Grade assets.

- Recently, a few specific credit stories have captured the attention of the high yield market. Despite this, there has been no evidence of these issues affecting the broader market. However, one consequence of these special situations has been several high-profile ratings downgrades, including SFR. That being said, we continue to believe default risk remains limited and manageable with the asset class.

Euro Credit Market Valuation

Source: AXA IM, Bloomberg, as of 31/03/2024. ER00 = ICE BofA Euro Corporate Index.

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