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Euro Credit strategy

Resilient Euro Credit IG markets despite volatile rate environment

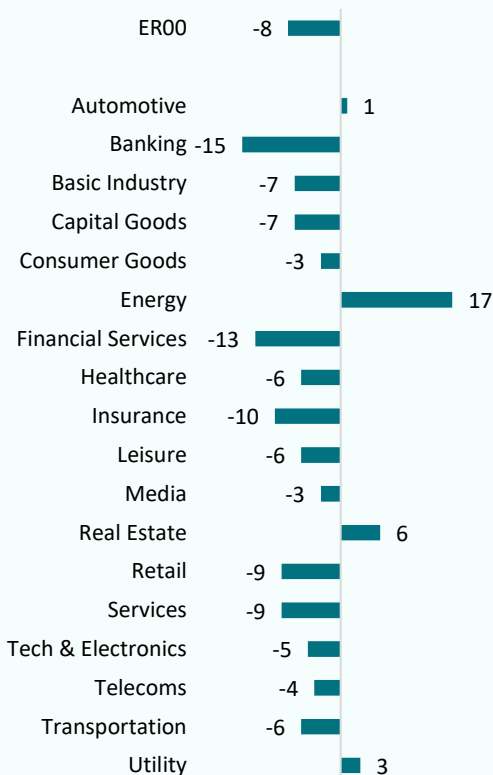
What's happening?

- The month of January has been a busy month marked by several significant events including fiscal concerns in the UK, unexpectedly strong US jobs, the inauguration of President Trump, escalating fears of a trade war and encouraging European PMI and inflation data.
- The rates sell-off that began in the wake of the hawkish December Federal Reserve (Fed) meeting has continued apace at the start of 2025, with rates exceeding the highest levels seen over the last couple of years with the UK 10 Year gilt hitting 4.84%. The US 10 Year yield and 10 Year bund exceeded 4.75%, and 2.6% levels respectively. Positively, in mid-January, lower UK and US CPI data came as a relief for the market putting a brake on the rates sell-off.
- Despite this volatility, credit markets were surprisingly resilient with spreads 8 basis points (bps) and 11bps tighter for investment-grade (IG) and high-yield respectively. Within IG, all sectors have performed well, and the usual high-beta sectors outperformed again. Subordinated financials and Corporate Hybrids tightened by 17bps, while Medias and Real Estate performed the least with “only” 3bps tightening. Indeed, the real estate sector has been impacted by fears about the impact of higher rates on their funding cost structure. More surprisingly, the Automotive sector was one of the best performers within corporates, tightening by 18bps led by Ford, Renault, Volkswagen, and Continental on the back of renewed optimism around the implementation of tariffs. Within the high-yield segment, automotive, retail and real estate sectors also performed well.
- On earnings, US banks posted exceptional figures especially in the Investment Bank which should read well for the earnings season in Europe. 4Q24 reporting season is starting slowly for European banks and corporates.
- The divergence between central banks is becoming more pronounced. Indeed, the ECB delivered a 25bp rate cut and maintained its meeting by meeting, data dependent approach to monetary policy, in line with expectations. Rates were still characterized as restrictive, suggesting that more rate cuts lie ahead. We expect another 25bp cut in March, April and June to reach 2%.
- In this context, €88bn was issued this month, or a 5% decline compared to the same period last year. European Financials dominated the primary market with 62% of issuance led by French, US and German banks notably Unicredit, BNP, Société Générale and Goldman Sachs. Within Non-Financials, Automotive and Utilities were the main issuers. Supply has been well received demonstrating again the credit fund inflow trends as well as the level of cash, providing a boost to credit technicals this month. New issue concessions are almost nil as order books are still multiple times covered (3.5x on average).

Portfolio positioning and performance

- We have a **DTS above benchmark** at around 130% on average, as we keep a constructive view on Euro Credit IG.
- We maintain a positive outlook on the fundamental performance of European banks within **Financials**. In particular, we remain overweight in **Financial Subordinated**, adopting a selective approach due to tighter spreads.
- **Corporate Hybrids** remain an attractive option, offering positive carry within the portfolio for investment-grade issuers.
- Within **Industrials**, we continue to overweight the **Real Estate sector**, although we have slightly reduced the exposure, favoring the Logistics and Residential sub-segments while focusing on top-tier investment-grade players.

Asset Swap Spreads changes - MTD



Source: AXA IM, Bloomberg, as of 31/01/2025.
ER00 = ICE BofA Euro Corporate Index

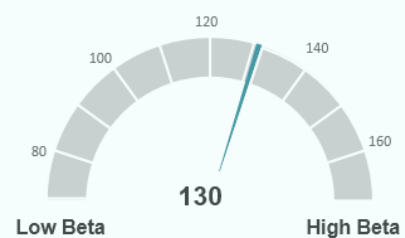
Our Country Positioning

| | 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 130%



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 big theme of central bank divergence will no doubt be tested multiple times this year. But we see a high bar for the European Central Bank to stop easing and continue to think that the Euro IG market still offers value from a total return perspective. Yet we doubt this year will be free of challenges. These include high valuations, potential impacts of Trump's tariff policies, and the Fed's challenge in managing inflation as it moves back towards its target. All these factors could put pressure on spreads over the course of the year. We expect spreads to remain rangebound over the year, and this will require a more agile and dynamic approach to our positioning.

Euro Credit Market Valuation



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