Euro Credit strategy

ECB rates cut on the horizon

What's happening?

- May was a month of two halves with rates rallying up to the 15th of May supported by reassuring data from the US. However, this move reversed in the second part of the month as we had another wave of volatility fueled by news about better growth momentum and the persistence of sticky core inflation - notably in services - leading to renewed concerns of delayed rate cycle cuts. The market is now pricing two and half cuts in the Eurozone and around one cut in the US this year. Indeed, economic data in the Eurozone has shown a pick-up in growth, strength in hiring and a modest improvement in industrial production. Hawkish German inflation was another case in point, bringing new risks of stickier inflation especially on services. The comment made by a US central banker about keeping the door open for a rate hike clearly did not help sentiment. The June cut is almost a done deal but there are increasing question marks regarding the pace of future cuts, especially if the Fed does not start its easing cycle. So, the June European Central Bank (ECB) speech will be key this time.

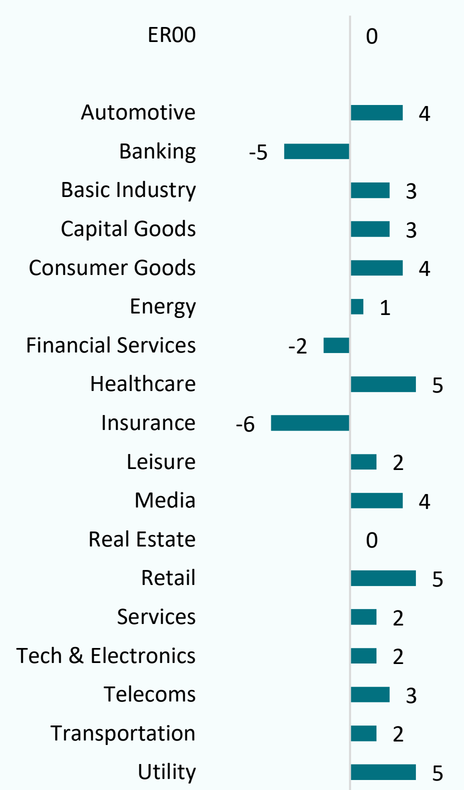
- In May, the euro credit market has performed relatively well although we have seen some signs of fatigue. Despite the volatility in the rates market, the ICE BofA Euro Credit index remained flat at 77bps. By sector, Financials subordinated debt and Corporate Hybrids were again the main outperformers tightening by 12bps and 6bps respectively. Retail, Healthcare and Consumers Goods underperformed the rest with a 3bps widening. On a name-by-name basis, high beta issuers like PBBGR, AARB, CPI, Aroundtown and Balder performed the best, while defensive credits as well as names that tapped the primary market, like Merck, Novo Nordisk, underperformed. In the senior bucket, financials (-3bps) performed well vs. corporates (+3bps) reflecting heavier supply in Non-Financials and still solid Q1 earnings season in the banking sector. The euro high-yield (HY) market has outperformed with a notable 19bps tightening during the month led by Real Estate (Adler, Heimstaden), Basics (Vallourec) and Media (Adebno and UPC).

- Primary issuance has been strong this month despite shorter weeks. Total issuance was at €84bn, split 35% for Financials and 55% for non-financials. Within corporates, we had few multi-tranches in the healthcare sector like Novo Nordisk, Medtronics and Johnson & Johnson. US issuers accounted for about 20% of the primary market issuers. Books were oversubscribed by 3.1x while new issue concession has been decreasing. Appetite for high beta remains intact (Bank of Ireland, WP Carey, Raiffeisen Bank and Alstom Hybrid oversubscribed 10x), while demand for most senior/low beta issuers is more mixed with books hardly more than 2.0x oversubscribed such as LVMH, Mercedes, Vinci and BMW. Despite this healthy primary, secondary spreads remain relatively resilient attesting still satisfactory fundamentals and more importantly robust credit market technicals. Indeed, flows continue to be solid into investment-grade (IG), and we saw some inflows into HY as well. In the HY, gross supply was at €14bn during the month. One of the big themes for IG supply in 2024 is that volumes were pulled forward in the first half of the year, which should result in relatively slower issuance in June onwards.

Portfolio positioning and performance

- We have a **DTS above benchmark** at around 130% on average. We have an overweight position in spread duration versus benchmark.
- In **Financials**, we hold a positive outlook on the fundamental performance of European banks and we remain optimistic for the rest of 2024. Especially, we continue to be **overweight in Financial Subordinated** with a selective approach given tighter spreads.
- We have a preference for **Corporate Hybrids** compared to BB rated issuers, as they offer attractive carry and better risk-reward opportunities.
- In **Industrials**, we maintained our **overweight in Real Estate sector**, given the sector's attractive valuations and our focus on top-tier player in the Investment Grade universe.

Asset Swap Spreads changes - MTD



Source: AXA IM, Bloomberg, as of 31/05/2024.
ER00 = ICE BofA Euro Corporate Index

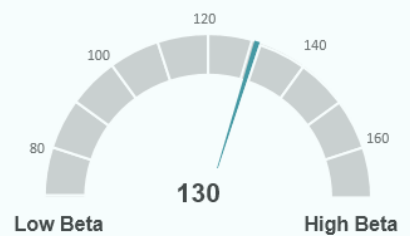
Our Country Positioning

	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 130%



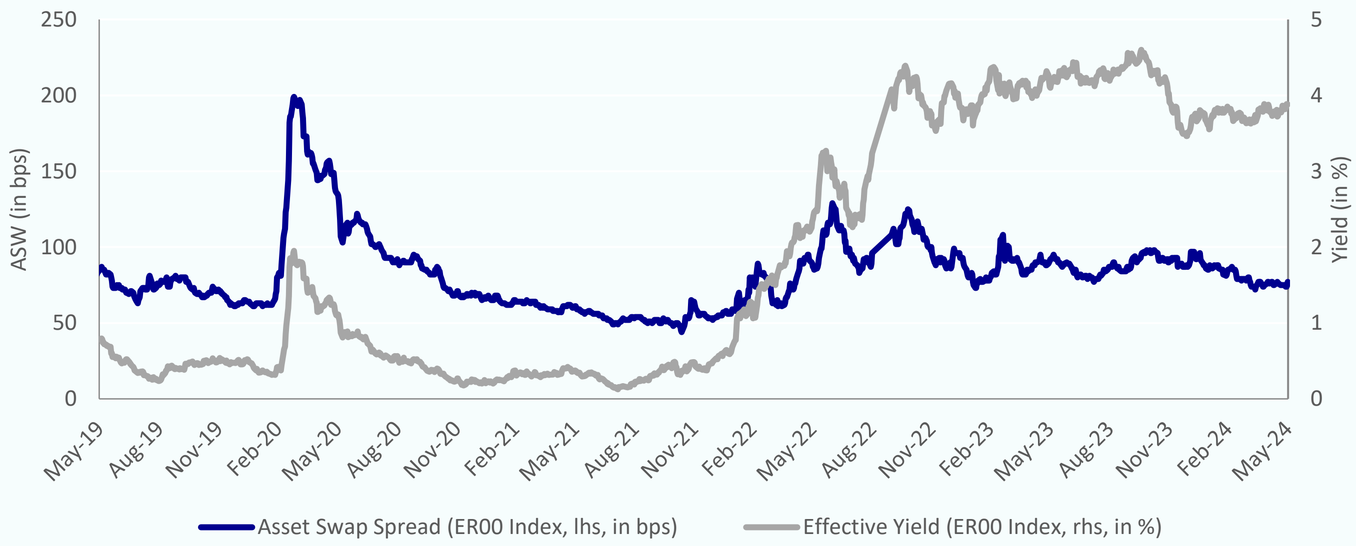
No assurance can be given that the Euro Credit will be successful. Investors can lose some or all of their capital invested. The Euro Credit strategy is subject to risks including Credit risk, Liquidity risk, Derivatives and leverage, High yield debt securities, Contingent convertible bonds.

Outlook

- The European Central Bank (ECB) has strongly hinted at its intention to initiate interest rate cuts in June. This indication comes at a time when the Eurozone inflation readings have come a long way since their all-time highs, providing the central bank with what it sees as a justification for taking action. Looking ahead, a potential complication may arise from the contrast between the longer-term policies of the Federal Reserve (Fed) and those of the Eurozone.

- In Credit, we believe the segment benefits from strong fundamentals and the ECB's clear willingness to normalize policy. The earnings season for the first quarter (Q1) of the year has been above expectations, both in the US and in Europe. And the technical have been very supportive with large inflows into the asset class. We continue to see valuations as attractive both in Investment Grade and in High Yield. Despite the tighter spread environment, we do not see any strong catalyst for spread widening and we focus on selectivity in issuer selection.

Euro Credit Market Valuation



Source: AXA IM, Bloomberg, as of 31/05/2024. ER00 = ICE BofA Euro Corporate Index.

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