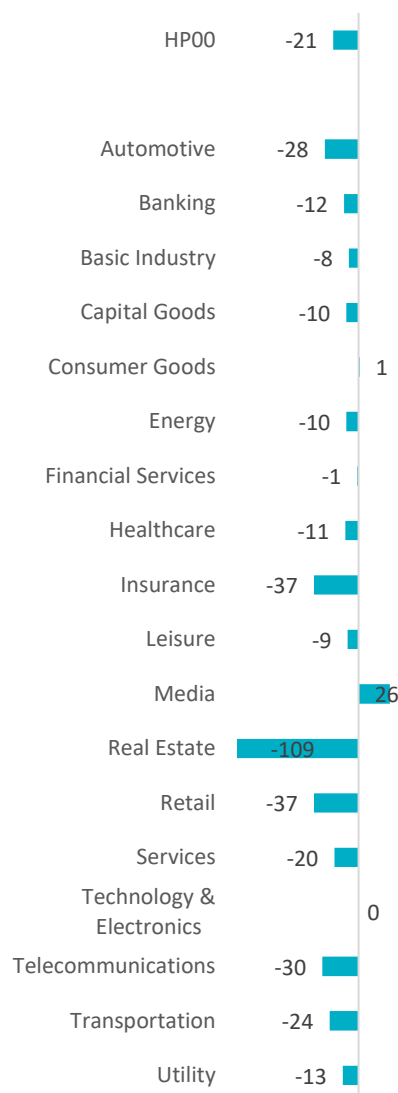


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European High Yield

European high yield continues to offer treats amidst tricky October markets

What's happening



- After an unseasonably positive September, markets were brought back to earth a little in October. Both bonds and equities lost ground – indeed, it was the worst month for the Bloomberg global bond aggregate since September 2022, when inflation was still raging and the Fed had just hiked by 75bps. And for the S&P500, despite another all-time high on October 18th, some weak earnings reports at the very end of the period meant it ended down -0.9%.
- In reality, most of the above moves seem to represent a fairly rational reversal of some of the over-exuberance that built up during September. After the Fed's bumper 50bps cut last month, a couple of data points out of the US – namely, a very strong payrolls print and a slightly higher-than-expected inflation figure – served to remind investors that the continuation of such a steep path downwards is not a given (particularly with a knife-edge election around the corner). That said, perhaps unsurprisingly European government bonds were less weak than Treasuries and Gilts. Over here, the growing concern seems to be the sluggish macro-outlook. This prompted the first back-to-back rate cut of this cycle by the ECB.
- European high yield again bucked the trend with a positive performance of +0.6%. Carry and some decent tightening of spreads produced strong excess returns that were more than enough to offset the losses in underlying government bonds. CCCs slightly outperformed (+0.9%), with BBs and Bs both adding +0.6%. Although US high yield spreads also narrowed, the impact from the larger moves in Treasuries meant that market fell -0.6%.
- As we've become accustomed to repeating, primary markets were very active. Indeed, Deutsche Bank believe it was the busiest month in over three years. New names to the market included Fressnapf (Retail), Belron (Autos) and Evri (Services), whilst Metlen (Capital Goods), TAP (Transportation) and Stada (Healthcare) were just some of the companies refinancing existing bonds.

(Sources: all Bloomberg)

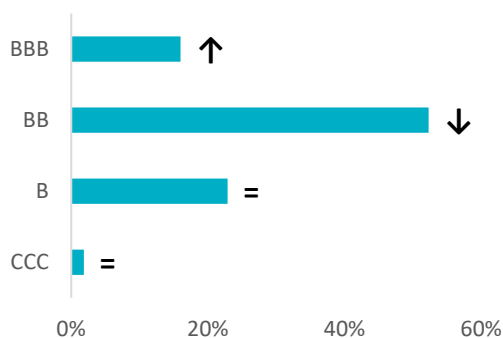
Source: Asset Swap Spreads changes MTD, Bloomberg, BofA AXA IM, 31 October 2024. Shown for illustrative purposes only and should not be considered as an advice or a recommendation for an investment strategy.

Short duration strategy characteristics

Yield	4.41%
Spread	183
Duration	1.49
Average rating	BB
ESG score	6.5

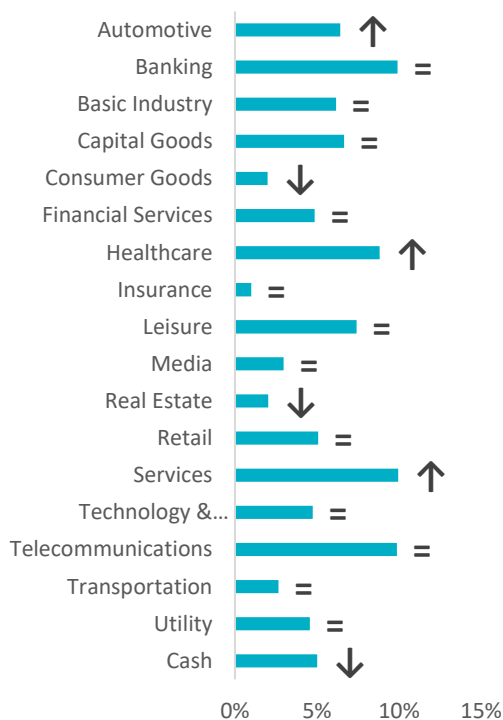
Source: AXA IM as of 31 October 2024

Our Rating Positioning



Source: AXA IM as of 31 October 2024

Our Sector Positioning



Source: AXA IM as of 31 October 2024

Short duration strategy positioning and performance

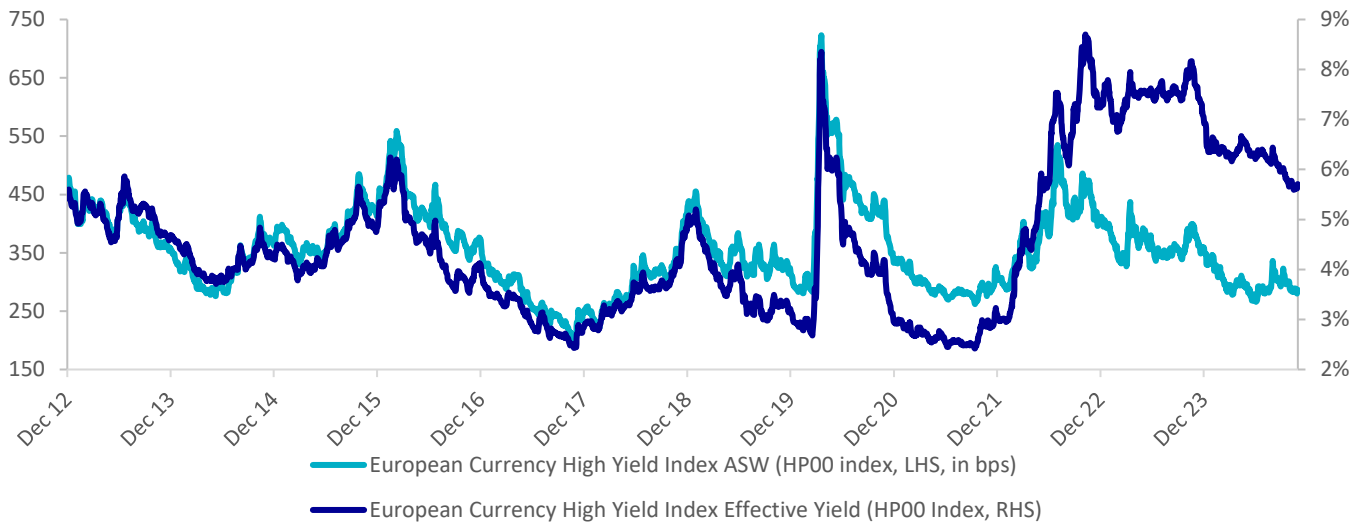
- The +0.6% return for the month added to a strong +7.7% return YTD for our universe (HP00). These returns have also been reflected in our strategy, with a 0.4% (EUR Gross) return in October and a +5.1% (EUR Gross) return YTD. However, we achieved these returns with significantly less volatility than our universe, 0.4% vs 0.9% for October and 1.1% vs 2.1% YTD.
- October's activity was dominated by the reinvestment of proceeds from holdings which were called or matured. IHO Verwaltungs (Autos), Metlen and United Group (Media) all replaced with longer paper notes we held – given our well-established comfort with these credits, we rolled into the next bond on each of their respective curves. Away from that, we added to our position in Domestic and General (Insurance), as it becomes increasingly likely that the company will look to address this 2026 maturing bond in the near future.

One name we've been watching



- French grocery retailer **Auchan** was downgraded to high yield in March this year.
- S&P then **further downgraded** the company from BB+ to BB in August.
- They have concerns about the company's long term credit profile, given its weak operating performance in a very competitive French market.
- There are also worries that the assets it bought from the defaulted Casino will be challenging to turnaround and integrate. Indeed, some investors have begun to see parallels between that company and Auchan.
- We think that is a little **unfair**. As well as a deteriorating business, Casino suffered from an extremely complicated financing structure and aggressive owner. Neither of these conditions appear to be true at Auchan.
- Still, while we have been happy to add a small position in the cash-covered 2025 bonds, we are not yet willing to commit to any bonds further out on the curve. We await greater clarity around the intentions for its sizeable real-estate assets, as well as signs that the operating decline has been arrested.

European High Yield Market Valuation



Source: ICE as of 31 October 2024

Outlook

As mentioned above, in what was a tough month for most risky assets European high yield sailed serenely on. We've pointed out many times in the last couple of years how much protection really is given to total returns by chunky yields. We can even try to quantify the size of this cushion via a "breakeven rate" – that is, the level of yield per unit of duration. For our asset class, this is still higher than at any time during the ten years between 2012 and 2022 (source: Bloomberg). Defensive carry is truly alive and well.

During October, it was also interesting to note the diverging fortunes of Europe and the US. More specifically, whilst the headline readings from the US economy suggests it continues to defy gravity and to fire on all cylinders, the outlook in Europe is quite clearly much less dynamic. Yet this was not reflected in the performance of markets.

Partly, of course, it's because of interest rate volatility – the path seems much more assured in Europe since we are simply in greater need of a looser monetary policy. Plus, this side of what looks to be an incredibly tight US election, there remains great uncertainty around the likely fiscal outlook there. But it does also show that bad news for the economy as a whole is not necessarily a negative for credit. Remember, the decade after the Eurozone crisis was one of sclerotic growth in Europe... and yet, between the start of 2012 and the end of 2019, European high yield produced an average annualised return of +9.3% (source: Bloomberg).

We are not suggesting history will repeat. But something else of note from last month: a couple of storied, previously stressed credits (Boparan [Consumer Goods] and SIG [Services]) successfully came to market and refinanced their bonds. We were happy to continue giving these particular issuers a wide berth but it speaks to the fact that, as rates continue to fall, more and more business' balance sheets look sustainable. Some of our favourite picks in the B/CCC space this year have been geared towards just such a conviction around their fundamentals. And with both the market and the AXA IM house view now expecting the ECB's deposit rate to be 2% by the middle of 2025 – we are keeping a close eye on exactly how many boats this particular (falling) tide can lift.

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