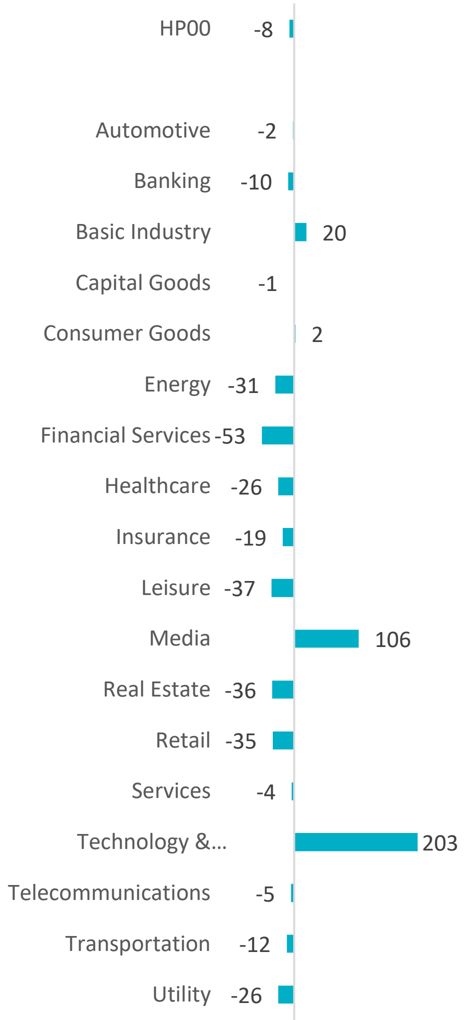
For professional clients only
May 2024
Monthly Perspectives
Fixed Income

European High Yield

Keep calm and carry on

What's happening



Source: Asset Swap Spreads changes MTD, Bloomberg, BofA AXA IM, 30/03/2024.[1]Shown for illustrative purposes only and should not be considered as an advice or a recommendation for an investment strategy

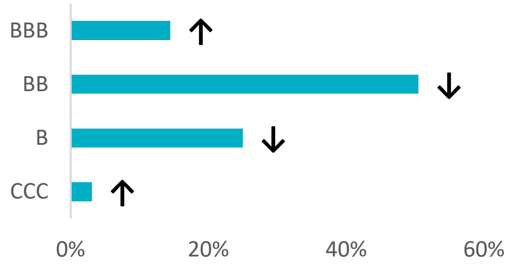
- After five almost relentlessly strong months, April finally saw risk assets take a proper pause. The S&P500 and Eurostoxx600, having both finished March at record highs, ended the month down for the first time since October. US Treasuries also had their worst monthly performance of the year so far.
- The driver, unsurprisingly, was inflation: specifically, continued indications out of the US that the economy may be too hot for the Fed to cut rates. Though these signs had been increasingly prevalent since the start of the year, April was the month when investors finally decided they were no longer able to shrug the data off as a "temporary blip." Most significantly, the US CPI report for March showed a third consecutive core figure of +0.4%. Markets duly priced the amount of Fed easing expected in 2024 down to 28bps, from 67bps at the start of April (and 158bps at the start of the year!). And whilst the data in Europe did not give similar cause for concern, investors are increasingly sceptical of the ECB's ability to diverge significantly from the Fed. Implied cuts here were reduced from 89bps to 66bps.
- European high yield was actually a relative bright spot. Whilst the contribution from government bonds was unsurprisingly negative, and spreads were unchanged, the power of carry was demonstrated once again – returns from income meant that our asset class finished the month flat (+0.0%). Spread widening amongst Bs and CCCs, where some of the riskiest names continued to be weak after the idiosyncratic situations of March, meant that these cohorts underperformed. They fell -0.2% and -0.9%, compared to +0.2% for BBs. In the US, where the Treasury moves were more extreme than those in Bunds, high yield fared worse – that index was down -1.0%.
- Primary markets continued to be very strong. They followed March's €13.5bn of new issues with another €12bn. Whilst this gross figure was still dominated by refinancings, somewhat expected given the maturity wall, net supply is also picking up. At almost €6bn of M&A/LBO-related issuance so far this year, we are already closing in on 2023's full-year total of €7bn (source: Deutsche Bank). Avolta (Retail), Techem (Services) and Volvo (Automotive) all successfully completed refinancings of their existing bonds, whilst Flutter (Leisure) was one of the new names to debut.

(Sources: all Bloomberg)

Short duration strategy characteristics	
Yield	6.36%
Spread	321
Duration	1.60
Average rating	BB
ESG score	6.3

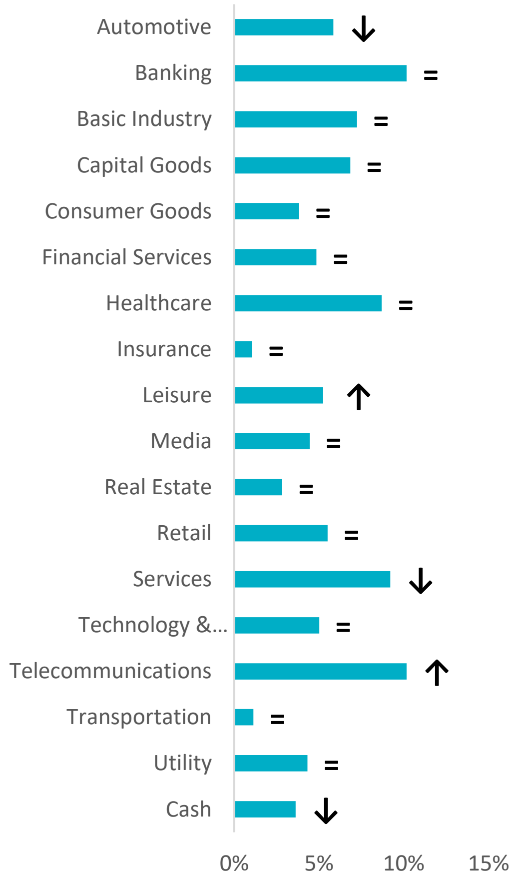
Source: AXA IM as of 30 April 2024

Our Rating Positioning



Source: AXA IM as of 30 April 2024

Our Sector Positioning



Source: AXA IM as of 30 April 2024

Short duration strategy positioning and performance

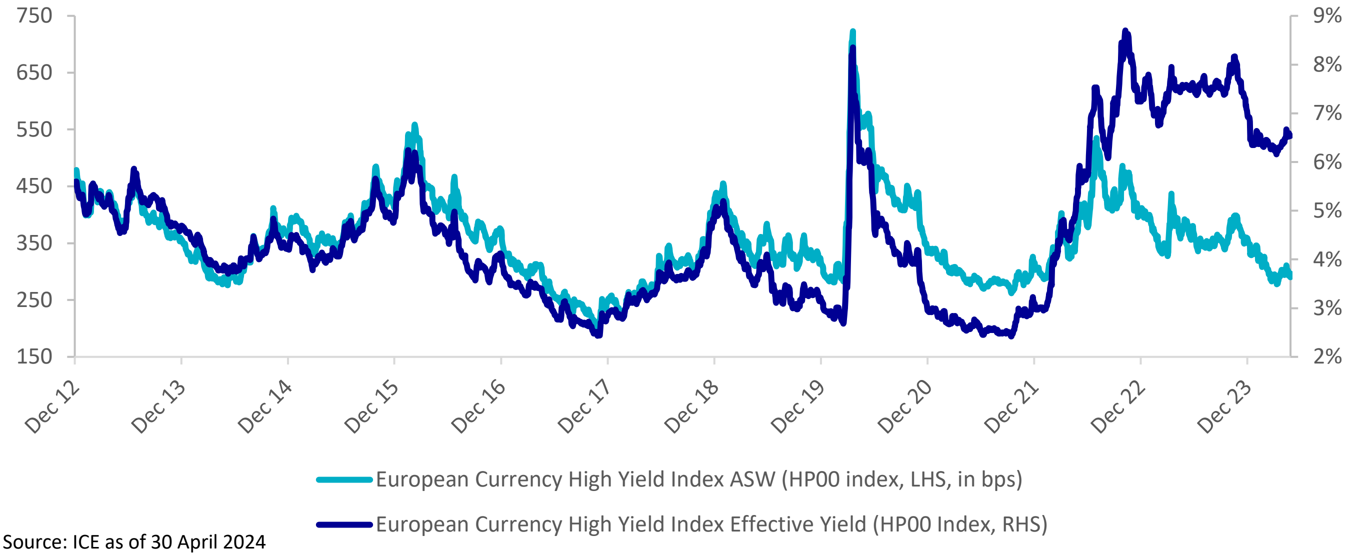
- Despite the **negative or at best flat** returns across global markets in April, our strategy, by focusing on **quality single names** and avoiding the **riskiest** parts of our universe**,** achieved a total return of **+0.25%** (A EUR Net) during the month.
- We held some of the bonds which were redeemed by Avolta and Techem, as well as Telecom Italia (Telecommunications), and so we rolled our exposure to these **well-liked credits**. We also saw maturities in our holdings of Renault (Automotive) and Elis (Services).
- We participated in the new deal from Flutter and, in the same sector (Leisure), added 888 Holdings to the fund for the first time. The credit has suffered from some volatility since it came to market in 2022. But its recent operations have been much more **stable** and we believe it now has **an attractive, short duration profile.**

One name we've been watching

GRIFOLS

- The bonds of **Grifols** sold off sharply in January, after a short-seller report alleged accounting and corporate governance concerns.
- We had a **strong conviction** that these issues were unlikely to be material, as well as a positive opinion of the company's operations. We therefore **took advantage** of the price moves to add to our positions in its short-dated paper – including in the riskier, unsecured notes.
- During April, the company confirmed that its large, ongoing asset-sale process was **very close to completion** and that this would lead to an **imminent refinancing** of its debt maturing in 2025.
- Bonds have therefore returned to pricing very close to **par**, in anticipation of this take-out.

European High Yield Market Valuation



Source: ICE as of 30 April 2024

Outlook

We wrote at the start of the year that a mild recession and falling rates ("soft-landing") was our base case for 2024. We also outlined two other possibilities: of no recession and a resurgence in inflation ("no landing"), or of a deeper recession ("hard landing"). It has been interesting, in the first third of the year, to watch how markets have moved from very much pricing for the first case, then becoming increasingly concerned about the second, before, at the start of May, getting comfortable (again) with the first.

To us, this serves merely to reinforce something else we highlighted back then - that after two years of turbulence in the government bond market, it pays to be cautious about the path of interest rates. Markets have proved to be, and are indeed likely to remain, particularly sensitive to economic data and to central bank communications. Though a soft landing is still, in Europe at least, our and the market's base case, further volatility would not surprise us. Indeed, as was shown in April, this doesn't even have to be homegrown – the Fed's actions (or inactions) continue to have an impact on rates markets over here. In any case, this all serves to remind us why we are very comfortable in our short-duration asset class, and with a short-duration bias to boot.

We also continue to feel more positively about the macro outlook in Europe. GDP in the Eurozone expanded by +0.3% in Q1 – not amazing, to be clear, but solid enough and only a little behind the figure for the US (+0.4%). Perhaps most importantly, the European growth was achieved without any real inflationary pressures. Without wanting to project too much from the macro to the micro, such economic performance is clearly positive for high yield credits. We wrote last month that we thought the three restructuring situations which arose remained idiosyncratic. Whilst, as alluded to above, April has seen some weakness in a few risky names – generally reflective of a more cautious investor base after SFR et al – we stand by this assertion. Whilst other challenged credits are not out of the woods yet, a steadily improving economy, and benign inflationary environment, should continue to provide a tailwind to our companies' earnings, balance sheet and cash flow profiles.

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