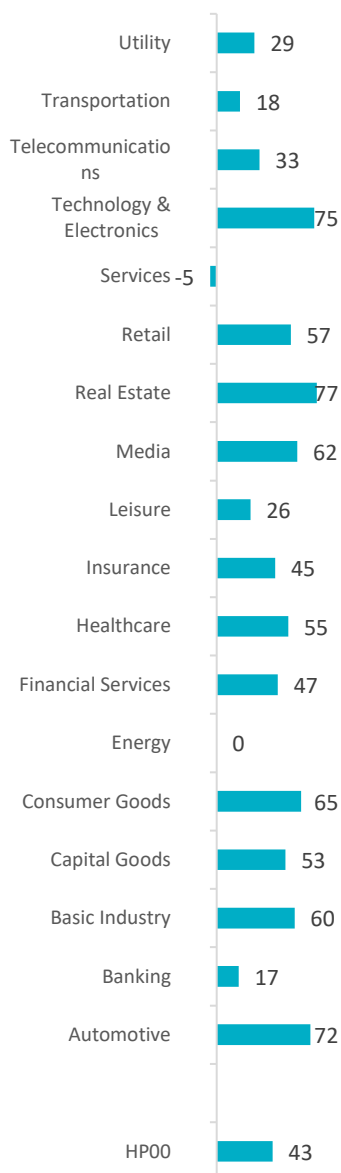


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European High Yield Sheltering in Short Duration

What's happening



Source: Asset Swap Spreads changes MTD, Bloomberg, BofA AXA IM, 31 March 2025. Shown for illustrative purposes only and should not be considered as an advice or a recommendation for an investment strategy.

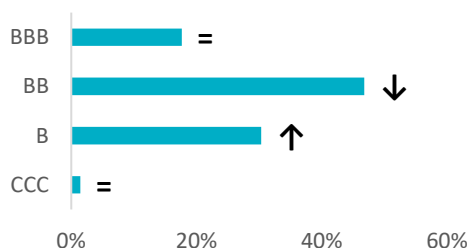
- After plenty of noise during February, in March markets began to take seriously the real-world consequences of all that has been threatened by the new Trump administration. After the previously delayed tariffs on Canada and Mexico were imposed on March 4th, by the end of the month investors were anxiously awaiting the arrival of “Liberation Day” on April 2nd – this is when much broader, reciprocal tariffs have been promised. But already, asset prices are reflecting a higher likelihood of stagflation in the US. This reflects the inflationary impact and the growth-sapping effects of such moves, both of which are already beginning to be reflected in the soft data: the University of Michigan’s measure of consumers’ inflation expectations moved up to 4.1% in March, the highest level since 1993; and the Conference Board’s consumer confidence gauge fell to just 92.9, the weakest print since January 2021.
- The result was the worst quarterly performance for the S&P500 since 2022. It fell -5.6% in March alone, taking it down -4.3% since January. The Magnificent 7 technology firms, which have driven so much of that index’s performance in the last few years, actually ended the quarter in a technical bear market.
- Although the prospect of tariffs meant that the Eurostoxx600 also fell during March (-3.7%), its +5.9% return for the quarter as a whole was actually the biggest outperformance against US equities in over a decade. This was spurred by the incoming German government’s announcement of an almost €1 trillion defence and infrastructure investment plan. And while the ECB cut rates again during the month, the 10-year Bund has risen +37bps since the start of the year – including +30bps on the day after the above news, the single biggest daily move since German reunification in 1990.
- Unsurprisingly, given the sell-offs in both rates and equities, European high yield produced its first negative monthly return since October 2023. It fell -1.0%, slightly ahead of US high yield (-1.1%). Since the start of the year, the respective market returns are +0.7% and +0.9%: though spread performance has been significantly better in Europe, Treasury yields have fallen whilst those on Bunds have risen. Relative duration exposures are also the driver behind European CCC returns (+3.0%) leading Bs (+0.8%) and BBs (+0.5%) during the quarter.
- After quiet primary markets in January and February, we finally saw a resurgence in March – much of it in the last week. The tally since the start of the year almost doubled, to €10.6bn, possibly as issuers looked to get in front of any further tariff-induced volatility [source: Deutsche Bank]. Most of this was refinancing, from companies including Itelyum (Services), Ontex (Basic Industries) and Shaeffler (Autos). There was also a bumper new deal from Opella (Healthcare), the large LBO of Sanofi’s consumer health business announced in 2024. All of the above deals were generally well-received, with sizeable order books and tight pricing. (All sources: Bloomberg)

Short duration strategy characteristics

Yield	4.38%
Spread	202
Duration	1.48
Average rating	BB-
ESG score	6.5

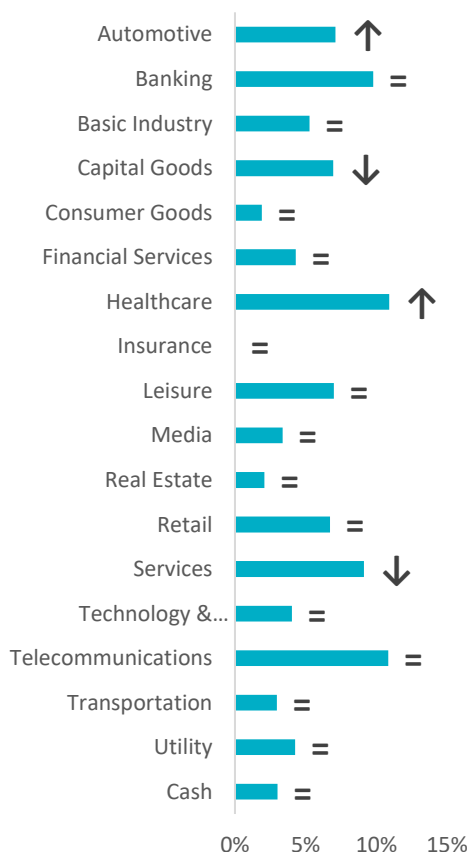
Source: AXA IM as of 31 March 2025

Our Rating Positioning



Source: AXA IM as of 31 March 2025

Our Sector Positioning



Source: AXA IM as of 31 March 2025

Short duration strategy positioning and performance

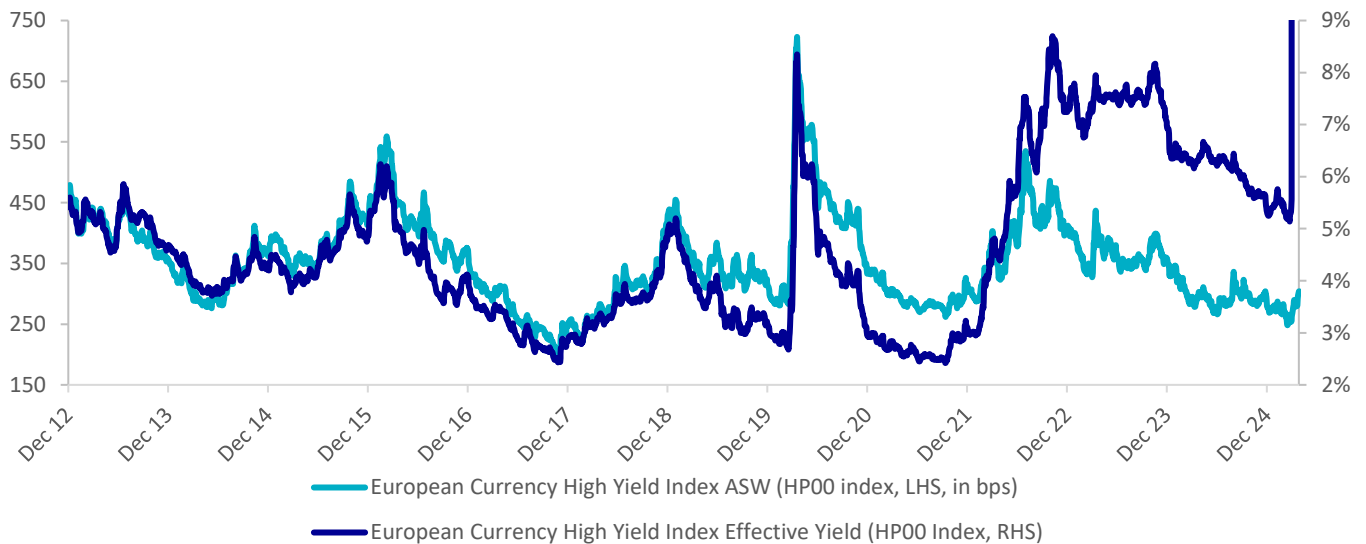
- After a very strong period for European High Yield, we experienced the first month of negative total returns in 18 months. Encouragingly for our strategy, which emphasises protection of principal loss, a total return of -0.25% (gross-of-fees, A share class) meant we captured only 25% of the downside.
- We participated in the new issues for Itelyum and Shaeffler mentioned above. We also added new positions in Voyage Care (Healthcare) and True Potential (Financial Services). Both of these are performing credits whose bonds offer attractive carry into a likely refinancing within the next year.

One theme we've been watching



- Along with almost every other market participant, we awaited the outcome of Trump's major tariff announcement on "Liberation Day," April 2nd
- The European rate of 20% was in-line with what had begun to be discussed in the previous days. High yield traded quite weakly into and after the event itself and spreads are now about 50bps wider than their tights of mid-February (and c. 20bps wider year-to-date)
- That said, this has not felt particularly disorderly. In general the nature of our asset class is such that the issuers tend to be much more domestically focussed than, for example, big, multi-national, investment grade companies
- Clearly, the biggest shocks in our market are likely to be felt by cyclical sectors: directly by Autos manufacturers and suppliers; and indirectly by industries like Chemicals. The latter generally have localised production but are exposed to commodities prices
- Whilst it's not surprising that spreads have moved to better reflect the risk-off tone, we continue to focus on the usual sources of comfort for European high yield - namely, solid fundamentals and supportive technicals
- We expect both of these to remain intact: company balance sheets are in generally good shape, giving them room to adjust to the new growth outlook; and new issue supply volumes will likely stay low
- Individual issuer exposures will no doubt be a focus on the next set of quarterly earnings calls with management teams - though what level of tariffs we're talking about at that point is anyone's guess

European High Yield Market Valuation



Source: ICE as of 31 March 2025

Outlook

The difficulty with thinking and writing about markets currently is that, if the rest of Trump’s second term proceeds at the same pace as the first 70 days have (and yes, it has only been 70 days...), we will quickly run out of interesting ways of talking about volatility. Similarly, and more importantly, markets can quickly become inured to all of the noise and disruption... until, suddenly they’re not. Indeed, after the tariffs on Mexico and Canada were removed almost as abruptly as they were first applied, investors began to pay a little less attention to further threats. Then, those tariffs were reapplied on March 4th and the month went downhill from there.

Writing the morning after so-called “Liberation Day”, we continue to believe that being positioned strategically remains the best defence against all of this. There’s simply too much flip-flopping to try and trade such whims tactically. For us, that translate into a large allocation to high quality, defensive businesses which, a small amount of possible spread widening aside, have the strong balance sheets necessary to sail through the various storms emanating from the White House. That said, we do continue to find a good number of selected credits which sit lower-down on the quality spectrum. Whilst these might be buffeted a little more by the prevailing winds, we believe the increase in volatility is well worth the extra returns they generate. Many of these bonds have high coupons, having been issued in the last couple of years or so – the sheer amount of income they generate should soon offset any short-term price movements.

But by far the surest strategy in the current environment is, in our opinion, a short duration one. It’s always worth remembering that, as well as rates volatility, such a strategy will be low on spread duration – thus also guarding against a weak environment for credit. This last month was an excellent case-in-point: the -1.0% return for the European high yield universe was driven roughly 20% by rates moves and 80% by spread widening. Yet our Europe Short Duration High Yield fund fell only -0.25% (gross-of-fees, A share class), benefitting from its lower exposure to both of these things. Whilst we can’t be sure what the next quarter will bring, we can be sure that our strategy remains a good place to shelter.

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