Investment Managers

Core

European Short Duration High Yield: Optimistic despite the odds

Review and outlook for AXA IM FIIS Europe Short Duration High Yield

- European short duration high yield proved to be resilient during the tumultuous days of Liberation Day and beyond
- The fund has been targeting a core allocation to high quality names combined with a focus on high-conviction, lower-quality picks
- Going forward, European high yield investors potentially may still achieve attractive total returns in the region of the current yield of 6%[1].

By Chris Ellis, CFA, European High Yield Portfolio Manager, Yves Berger, European High Yield Portfolio Manager & Richard Jones, Fixed Income Investment Specialist.

At the start of 2025 our base case outlook was for a continuation of the soft-landing that began in 2024 and an investment return-profile centred around income.
We thought there was a risk that US tariffs might provide the Federal Reserve (Fed) with less scope to cut rates but we certainly did not expect *Liberation Day* on 2 April - and everything that followed.

However, amid those tumultuous days, it was encouraging to see how resilient European short duration high yield proved to be. This continues a long-term pattern - especially since 2022 - during which we have targeted a core allocation to high quality names combined with a focus on high-conviction, lower-quality picks. We believe the fund should continue to offer investors the balanced approach needed to successfully navigate these more volatile markets.

What happened to European high yield in April?

In the week or so after 2 April, European high yield had fallen a little over 2% and asset swap spreads had moved out from 304 basis points (bp) to 386bp[2]. After US President Donald Trump began reversing course by announcing the 90 day pause in reciprocal tariffs, spreads steadily rallied into the month end reaching 337bp by 30 April. This saw our asset class finish the month with a +0.3% total return[3]. By mid-May, spreads had fully narrowed from their wider positioning.

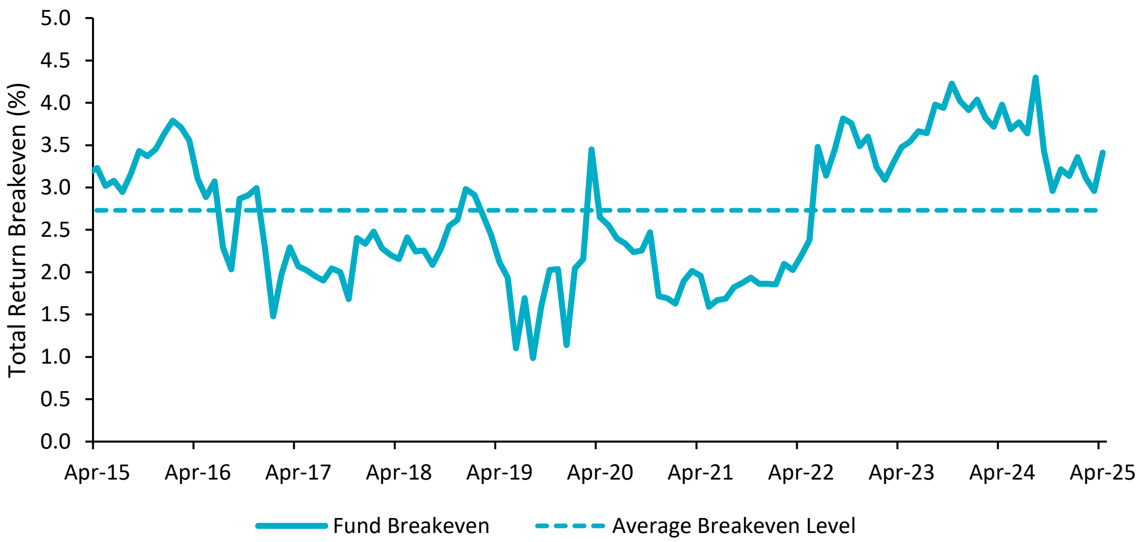
[1] Source: AXA IM, Bloomberg as of 22 May 2025
[2] Source: AXA IM, Bloomberg as of 14 May 2025
[3] Source: AXA IM, Bloomberg as of 30 April 2025

How did AXA IM FIIS Europe Short Duration High Yield perform?

As would be expected from a defensively positioned short-duration fund, it proved to be resilient amid the volatility. During April the fund's maximum drawdown was less than half that of the European high yield market as a whole. It also kept up well with the pace of the snap-back - indeed, the total monthly return for the fund was +0.48%, compared to +0.30% for the market (HP00 EUR Hedged)[4]. There are two key reasons for this:

- The fund has a conservative credit risk-profile. Two-thirds of the fund is invested in bonds rated either BB or investment grade. After over two years of steady spread compression in the weakest parts of the market, we were increasingly of the opinion that higher-rated credits represented the best balance of risk and reward for the core of our fund's holdings
- The fund's very short duration (just 1.29 years) means it has limited exposure to both interest rates and to spreads. During the inflation-driven bouts of volatility that we saw in 2022 and 2023, it was the lack of exposure to interest rates which provided the greatest protection. Today, our focus on higher quality names gives us comfort in the case of a weaker credit environment. Indeed, looking at it in terms of total return breakevens, the chart below suggests this has rarely been higher for the fund.

Chart 1. AXA IM FIIS Europe Short Duration High Yield Total Return Breakevens



Source: AXA IM as of 30 April 2025. Past performance is not indicative of future results.

What's in store for the rest of 2025?

Somewhat ironically, given what's happened in 2025, our start-of-year expectations just about still hold i.e. we expect total returns for European high yield to be income-driven. Obviously, this destination is unlikely to be linear – after all, there are plenty of months left for more Trump-induced chaos. We may also find that spreads settle themselves a little bit higher to reflect some of this uncertainty. Our positioning is therefore broadly unchanged: an emphasis on the higher-quality credit segments, with yield boosted by *extra selective* picks from the lower-rated parts of the market.

[4] Source: AXA IM, Bloomberg as of 30 April 2025, performance is net-of-fees, A-share class. Past performance is not indicative of future results. The AXA IM FIIS Europe Short Duration High Yield Fund is managed without reference to any benchmark and the BofA European Currency High Yield index (HP00) is used to represent our investment universe.

Should we be concerned about European high yield?

Clearly, the high yield market comes with more beta than government or investment grade bonds. And as was shown after Liberation Day, Europe is never able to entirely avoid storms emanating from the US. The same would almost certainly be true in any future episodes, and the risk of a full-on, global incident is surely higher now than it was a few months ago. Still, there are sources of comfort. In contrast to the Fed, there is next to nothing now standing in the way of further European Central Bank (ECB) rate cuts. Our economists recently lowered their year-end forecasts for the deposit rate to 1%.
This is supportive of credit conditions and, most importantly, company fundamentals. Of course, US trade policy (whatever it ends up being) looks certain to have a negative impact on credit metrics globally.

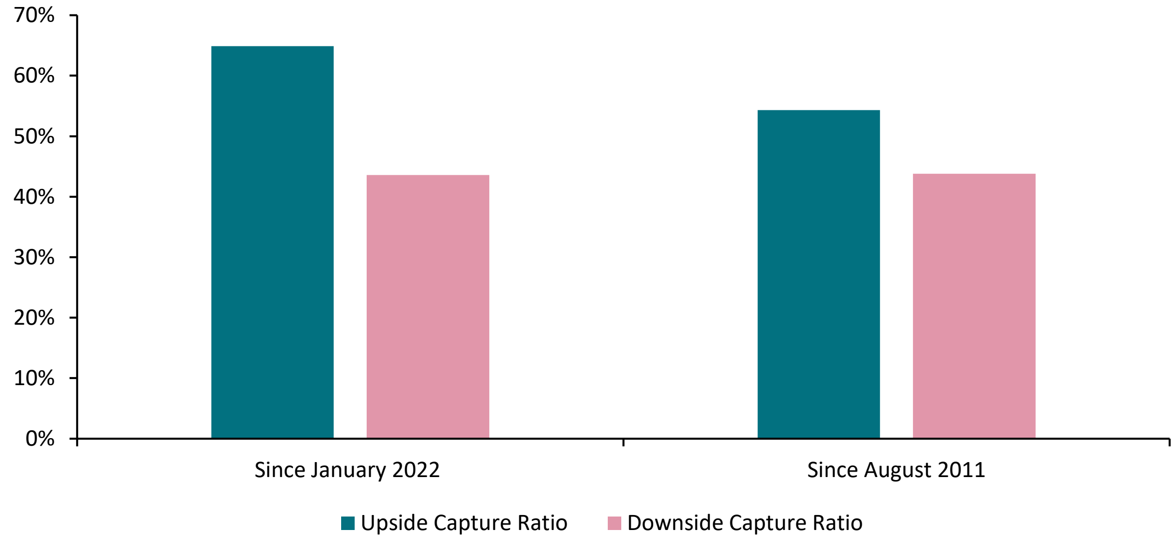
In the short-term, revenues and margins may fall. But European high yield corporates are stepping into this new environment in good shape: leverage ratios remain low (and trending lower) and interest coverage ratios remain high (and trending higher). In combination, it's difficult to point to a tangible reason to increase our expectations for default rates over the next 12 months.

Finally, there remains the strong technical support for the asset class. Not only did this remain in place throughout the recent volatility but muted net supply volumes are one key element of this equation - something which, paradoxically, the events of April are likely to even further entrench as M&A and leveraged buyout appetite dries up.

The tactical case for European short duration high yield

We have often written about the strategic case for a short duration approach to investing in European high yield. What is particularly interesting is how well the fund has adapted to the more volatile post-pandemic world. As illustrated below, while always positive, our up/down capture ratio is even better since the start of 2022 than it was before:

Chart 2. AXA IM FIIS Europe Short Duration High Yield Upside and Downside Capture Ratios



Source: AXA IM as of 30 April 2025. Past performance is not indicative of future returns

In a more tactical sense, we also believe the front-end of the curve is a good place to ride out the rest of 2025. Undoubtedly, the second half offers the potential for plenty of downside risks, however as shown during April, we would expect the fund to be capable of performing well in such conditions.

As Trump continues to unwind more of his tariffs, investors should be careful not to neglect the upside opportunity. For European high yield, investors may still achieve attractive total returns in the region of the current yield of 6%[5]. It certainly now represents a significant pickup over short-term savings rates.

AXA IM FIIS European Short Duration currently offers yields of roughly three quarters of that available from the broader market. As such, we believe the fund offers both an appealing hedge against wider spreads and the opportunity to capture attractive yields.

Calendar year performance

Past performance is not indicative of future results

	2024	2023	2022	2021	2020	2019	2018	2017	2016	2015
AXA IM FIIS Europe Short Duration High Yield - A EUR Net	5.38%	8.1%	-4.0%	2.4%	-0.2%	5.8%	-2.6%	1.5%	5.5%	3.5%

Source: AXA IM as of 30 April 2025.

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The value of investments may fall as well as rise and you may not get back the full amount invested.

Key risks: AXA IM FIIS Europe Short Duration High Yield Fund

Credit Risk: risk that issuers of debt securities held in the Fund may default on their obligations or have their credit rating downgraded, resulting in a decrease in the Net Asset Value.

Liquidity Risk: risk of low liquidity level in certain market conditions that might lead the Sub-Fund to face difficulties valuing, purchasing or selling all/part of its assets and resulting in potential impact on its net asset value.

Counterparty Risk: risk of bankruptcy, insolvency, or payment or delivery failure of any of the Sub-Fund's counterparties, leading to a payment or delivery default.

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The use of such strategies may also involve leverage, which may increase the effect of market movements on the Sub-Fund and may result in significant risk of losses.

[5] Source: AXA IM, Bloomberg as of 22 May 2025

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