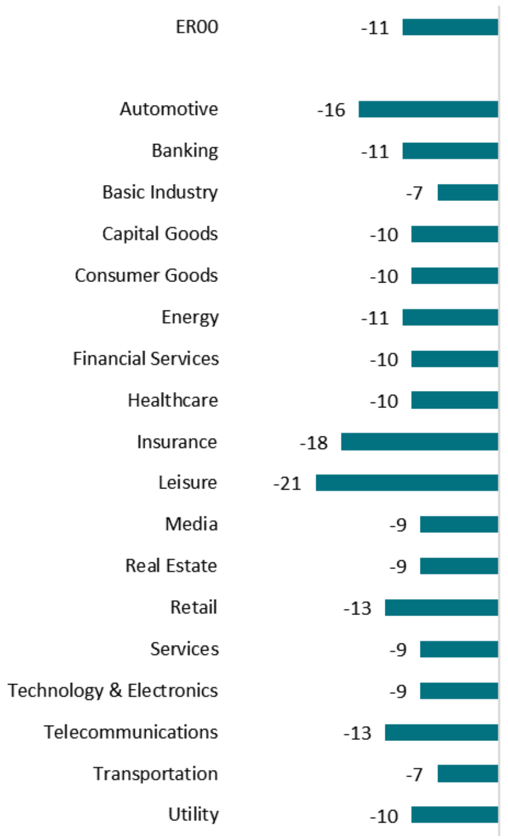
Euro Credit strategy
More of the same

What's happening?



Source: Asset Swap Spreads changes MTD, Bloomberg, BofA Merrill Lynch AXA IM, 31/12/2021
*Shown for illustrative purposes only and should not be considered as an advice or a recommendation for an investment strategy

- December has been a month particularly full of central banks announcements. Despite some fears about the new Omicron variant and its impact on global outlook, the persistent inflation has left no room to defer policy normalization, leading to a hawkish tone from central banks. The Fed was the first to act, the FOMC confirmed the acceleration of its tapering program by doubling the speed of its taper to $30bn a month from $15bn, implying that the program should be concluded by mid-March. Powell concluded that a quickening in the pace of the taper should leave the Fed better placed to adjust its policy if needed. There was also a material shift in the Fed statement regarding inflation. Indeed, Chair Powell stated that there was a "real risk that inflation may be more persistent", that inflation expectations could rise, and that higher inflation could become "entrenched". Similarly, the Bank of England raised its rates by 15bp to 0.25%, even though the growth backdrop had deteriorated since the previous meeting. However, the MPC reiterated that a hike was needed with elevated inflation rising more than expected.

- The ECB was also on the hawkish side despite some uncertainty on the Covid effect. President Lagarde stressed that inflationary pressures may last for longer, hence she confirmed that the PEPP will finish by March and the TLTRO bonus by June. Also, the enhancement of the APP was modest at € 40bn in Q2, € 30bn in Q3 and € 20bn in Q4. Still, she kept some form of flexibility with the extension of full PEPP reinvestments to the end of 2024 and a continued open-ended commitment to ongoing APP purchases while inflation remains below target.

- Regarding market reaction, the spike in spreads seen in the last week of November has partly reversed this month, with the Euro Merrill Lynch all maturity index finishing the year at 53bps. This has been mostly driven by the narrative that Omicron effects should be mild notably thanks to the vaccine effects, and hence the impact on global growth and on monetary policy should be modest. Subordinated financials and Corporate Hybrids have outperformed the rest with a tightening of 20bps. Within the senior category, Automotive, Real Estate, Leisure and Telecoms were the main outperformers.

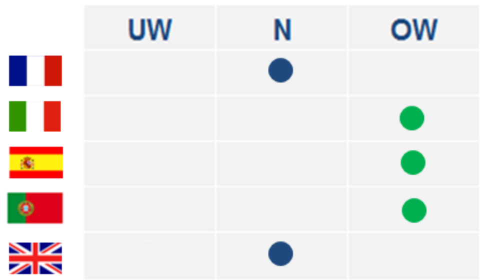
- In the primary market, we had only € 5bn issuance from NTT*, Orange*, Aroundtown*, Uniqa* and Westpac*, vs. an average of € 9bn over the last 5 years. Books were largely oversubscribed given attractive concessions, although premium has largely faded. Flows were mixed overall, largely tilted toward short-duration funds.

Portfolio positioning and performance

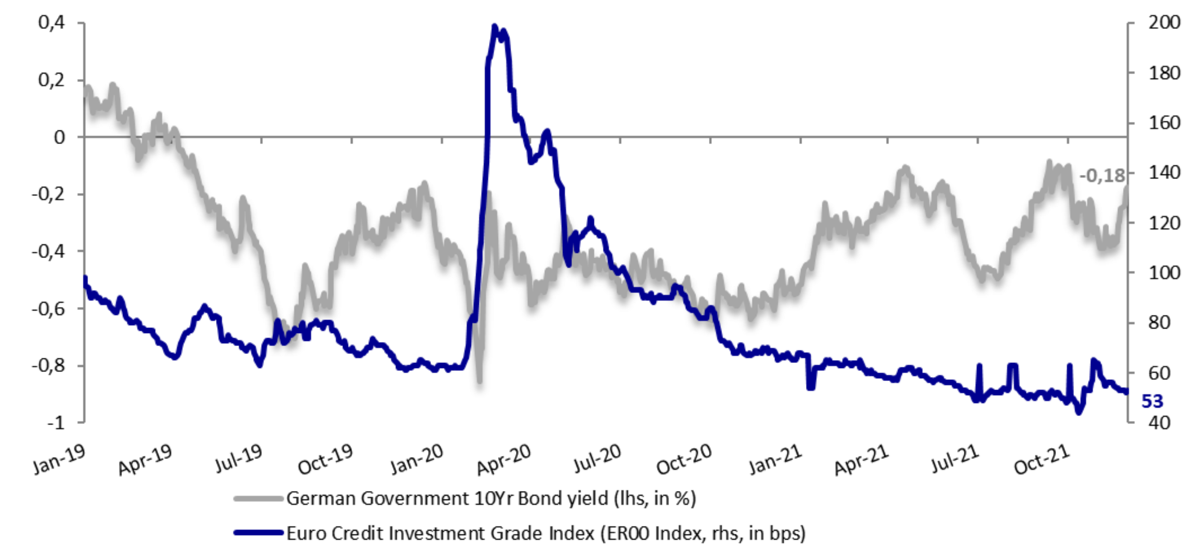
Our Sector Positioning

- **Overweight on financial subordinated** with a preference for intermediate call dates given flat curves. **Overweight on corporate hybrids** in both cyclical and defensive sectors. We are also exposed to the **Additional Tier 1 bonds** with intermediate call dates with a focus on national champions.
- **Neutral** on Financial senior, both Senior Preferred and Non Prefered, given tight valuations. We keep a preference for the Periphery.
- We maintain our **Overweight on the Real Estate sector** that still offers a good valuation especially in Tier 2 and some retail issuers. We have reduced our **positioning on some cyclicals** like Automotive and Energy due to tighter spreads. We are **Neutral to Underweight on Defensive sectors** with a preference for Utilities and Transportation on the back of resilient features, adequate fundamentals and Corporate Sector Purchase Programme eligibility that should be supportive.

Our Country Positioning



Euro Credit Market Valuation



Source: Bloomberg, 31/12/2021

Outlook

- Despite the surge in the number of cases, the market seems relaxed about the impact of Omicron notably in developed markets where the level of vaccination is quite high. Since the beginning of the year, we have experienced a strong recovery with a significant pent up demand and improving business and consumer confidence. The recovery is still ongoing although we may have some bumps down the road that could potentially affect economic data and market sentiment.

- Growth outlook remains strong while corporates earnings are in a good shape with higher top line and expanding margins. Financial institutions continue to report better asset quality and solid balance sheet. Disruption to the global supply chain has improved slightly in recent weeks, but it should remain an issue for some sectors like capital goods, carmakers and consumers. Freight costs and raw materials prices have also decelerated. This should have a positive effect on demand/supply dynamics, on margins and ultimately on global growth. The situation in China should also be watched.

- However, technicals should be less supportive from now on. Inflation data keeps surprising on the upside, and central banks make a clear message that monetary conditions will tighten. For now bond markets are comfortable with the idea that normalisation will be gradual and that inflationary pressures will ease in 2022. The ECB is still buying bonds but the amounts are much lower.

- In this context of gradual monetary policy normalisation, risky assets and notably the investment-grade asset class could trade in a relatively stable way overall. The path will probably depend on the rates moves and on the inflation data. This may lead to some episodes of volatility in the coming months.

	UW	N	OW
Financial Senior		●	
Financial Subordinated			●
Corporate Hybrids			●
Defensive Senior		●	
Cyclical Senior		●	

Duration Time Spread (DTS%)

We have reviewed down our targeted DTS between 100%-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.