Euro Credit Market Update, June transcript

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Welcome to this market update video on euro credit where we will discuss what has been happening in the market and what we expect over the coming months.

What has been happening in the euro credit market?

The first half of 2024 has been bumpy with high volatility levels in the rates market as contradictory macroeconomic data, especially in the US, has pushed the rates
market in opposite directions.
As such, markets have repriced the number of rate cuts from central banks this year.

Despite this volatility, the euro credit markets once again showed little response to these catalysts, with investment grade spreads tightening by 12 basis points since the beginning of the year.

The move was even more pronounced in the high yield market, which has outperformed and tightened by over 40 basis points. As anticipated, the ECB (European Central Bank) cut its rates by 25 basis points this month, although it has not committed
to any further action and any further move will be data dependent, our economists believe that the direction of travel is still downward.

What is the outlook for euro credit?

So what do we expect from here? We foresee a scenario of slowing, but positive growth supported by solid, fundamentals and technicals, which should counterbalance slightly tight valuation.

Thus, we anticipate spreads to remain range-bound at the end of the year. Even if spreads appear fair, and in line with historical average, we believe that absolute performance for credit remains attractive for investors given the healthy all-in yields currently offered.

Interest rate cuts should also provide a supportive environment for the credit asset class. In the high yield segment, although valuations appear rich, aggregate fundamentals remain healthy, with manageable default rates.

Fundamentals have been much more resilient than what market was expecting, and the earnings season for the first quarter has illustrated this trend. In the second half of the year, we expect improving performance for cyclical sectors on the back of the end of destocking and better manufacturing PMI.

Defensive industries should continue to deliverin terms of cash flow generation and leverage ratio. Guidance for 2024 is overall confirmed, but remains slightly cautious for some sectors like autos. Balance sheets remain sound in general, with a focus on debt reduction amid rising financial costs, notably for some sectors like real estate. Finally, large M&A should be limited to some sectors like US healthcare.

Last but not least, we believe that absent of unexpected monetary policy or growth shocks, credit technicals should stay firm. Positive flows have been
a key driver for the credit asset class since last year, and we anticipate this trend to continue in the second half of 2024 thanks to attractive yields.

On supply, after a vigorous €400bn issued in the first part of the year, we expect issuance to slow in the second part of 2024, which should be a positive catalyst for spread moves.

What opportunities are you seeing in euro credit?

Political event risk has made a comeback in recent weeks, leading to wider spreads, notably for French issuers. The outcome of the election is clearly highly uncertain,
implying that volatility will probably persist in the upcoming weeks until we get more clarity.

In this more challenging and uncertain environment, there will be some investment opportunities emerging across both investment grade and high yield. As active credit managers, we aim to seize opportunities as spread widening should provide an attractive entry point for sectors, like financials, that have recently underperformed.

We also expect greater spread dispersion going forward, so taking an active management approach to find opportunities in both duration sector allocation, seniority and bond picking, we believe, will be key.

Thank you for watching this video. We will keep you updated for the latest developments for euro credit market.

Source: AXA IM as of June 2024

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