

Candriam Bonds Global High Yield

Market Overview

Both bond and equity markets rallied strongly across the developed markets over the final month of 2023, driven by the expectation of easier monetary policy as inflation fears evaporated.

The move was primarily triggered by the surprising dovishness of the Fed, that held rates constant, but did not push back against market expectations that the Fed is done raising rates and may start cutting in 2024. In Europe, the economic outlook is far less resilient than the US, with industrial production falling in Germany, Italy, Spain and France and confidence indicators pointed towards further pain and industrials and manufacturing firms reducing investments and operating costs. On the other hand, a downward surprise in November core HICP had even the notably hawkish council members concede that the progress on inflation was encouraging and makes further rate hikes unlikely. The ECB held rates constant, and revised inflation expectations for 2024 and 2025 downward as it expects inflation to decline gradually despite the upward pressure of wage increases.

Fundamentals remain well oriented in Europe as illustrated by the upgrade back to investment grade of Lufthansa while the picture is more negative in the US where we see more downgrades than upgrades.

The technicals were in the driving seat especially in Europe with limited supply on the primary market and Lufthansa leaving the market at the end of year.

In this context, High Yield markets rallied strongly by another 50 bps both in Europe and in the US and spreads ended the year at 400 and 325 bps respectively.

Portfolio Highlights & Strategy Review

In December, the strategy underperformed its benchmark by 0.35%* as compression trade was in play and higher quality issuers started to feel out of juice in term of spreads tightening potential.

Overall, we used the rally to take profit on tightest credits. We ended the year with 5% cash balance and duration slightly below the benchmark. We continue to favor Euro HY, trading 75bps wider than US HY. We keep a large OW to Corporate hybrids (Utilities, Energy) as an attractive carry trade into 2024 on robust IG credits with the segment still trading with discount to generic HY issuers.

In the current environment, we continue to favor issuers with prudent capital management and credit friendly behaviors. In terms of sector allocation, we maintain our underweight exposure to rate sensitive sectors (Real Estate, Chemicals and Construction) and we remain overweight on more defensive sectors (Telecommunications, Packaging, Healthcare and European Utilities).

Fund Outlook

Currently, we believe that spreads in the asset class do not adequately price the risks in the markets. Fundamentals are expected to deteriorate especially for more levered companies that will face significantly higher interest costs as they will start to tackle their maturity wall. With much tighter conditions leading to deteriorating earnings and strengthening momentum in downgrades/defaults, we expect credit selection to be of utmost importance in this cycle.

We remain constructive on defensive sectors and high-quality credits where the combination of higher yields and very low cash prices (70-80s) creates an attractive investment opportunity with an asymmetric profile over the medium term. In the short term, we intend to manage the beta actively and to remain very selective as we expect idiosyncratic risk to increase substantially through the year.

* net of fees in EUR terms

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