

# Candriam Bonds Euro Short Term

## Market Overview

Financial markets are naturally compelled to challenge central banks, but over the month sticky inflation data had rates traders second-guess their expectations and further scale back their pricing of interest rate cuts. They now expect 90 bps of rate cuts from the ECB over 2024 (as opposed to 164 at the end of last year) and 100 bps from the FED (compared to 157 bps).

Central bank governors have repeated ad nauseam that they are data dependent, and macroeconomic data for the US appears to remain in a goldilocks zone. The labor market remains resilient, economic activity strong at 3.3% annualized for Q4, while inflation is on a slow retreat. Meanwhile, the Eurozone expanded 0.1% over Q4, though there is an increasing divergence between Germany and the rest of the region, as the former remains weighed down by continued weakness in its outsized manufacturing sector. Inflation in the block remains sticky with core inflation moderating less than expected to 3.1%. The ECB is especially weary of wage inflation, as consumers tend to suffer from recency bias (as evidenced by their inflation expectations of 3.2% over the next 12 months versus the ECB's estimate of 2.7%). Policymakers are afraid the elevated inflation expectations of consumers may enter wage negotiations and are likely to wait for more complete data on this front, making a policy pivot before end of April unlikely. The ECB members appear to converge around June for the first rate cut, while FED officials are cautiously guiding towards Q3 and are weary of potential accusations alleging election interference. Plenty of economic data will arrive before then, but the FED has more leeway in a context of strong economic growth, while the ECB has historically never cut rates before the FED.

The property crisis rippled across the world as Chinese investors, needing to raise cash amid a deepening crisis at home, offloaded assets in Europe and the US at significant discounts. Deal activity picked up and revealed just how far real estate prices have fallen, which raised concern about losses rippling across the global financial system. The turmoil, for now, remains concentrated around smaller banks and regional banks, with New York Community Bancorp, Japan's Aozora Bank Ltd. and Germany's Deutsche Pfandbriefbank AG in the spotlight as they took steps to brace for bad loans. The deepening real estate crisis prompted fixed income investors to become more reluctant to add exposure to lenders that are exposed to commercial real estate and has driven an increase in the issuance of covered bonds.

Strong primary activity this month of European Non-Fin corporations whose EUR-issuance volume is more than 20% higher than the mark recorded at the same period last year (EUR36bn vs EUR29bn as of end February) and is slightly less than January (-12%). The picture is a little bit less rosy for Banks.

whose deal volumes dramatically decreased after a hectic start to the year (EUR40bn / -53% MoM / -24% YoY). A lower supply could find explanations in the recent CRE stress episode seen in February, but a lower supply coupled with still intact appetite for Bank credit investors (especially Bail-In, Tier 2 and AT1 notes) has turned out to be an unexpected positive catalyst for spreads. Credit spreads (ICE BofA 1-3 Year Euro Corporate Index) benefited from the haven demand as longer duration bonds were under pressure and narrowed by 14 bps to a level of 94 bps. The US 5y rate ended the month at 4.24% (+41 bps), the German 5y rate rose to 2.43% (+38 bps) and the Italian 5y rate increased to 3.36% (+24 bps). The Euribor 3 months decreased marginally to 3.94% (+4 bps) while the Euribor 12 months rose to 3.75% (+18 bps).

## Portfolio Highlights & Strategy Review

The Fund posted a negative performance of -0.52% (I-shares), 5 bp below its benchmark. We kept our positive bias on credit with an exposure of roughly 72% (including Financials and Non-financials). We maintained an overweight on Senior Subordinated Banks (roughly 20% of the Fund) and T2 (roughly 1%). Within Non-financials, our main overweight came from Industrial (6%), Healthcare (5%), Technology (4%), Telecoms (3%), and Food & Beverage (2%). With regards to sensitivity to interest rates the fund was 25 bp above its benchmark at the end of month (2.12 vs 1.87). We maintained the exposure of the fund to the 3-5 year portion at +/- 13%.

## Fund Outlook

We closely monitor the evolution of economic activity, inflationary pressures and the varying and lagging impacts from the unprecedented rate hike cycles all around the world. Economic data and financial stability are likely to drive the reaction functions of central banks. While risks to global supply chains, from climate disruption to geopolitics (Ukraine/Russia,

Israel/Palestine, risks to maritime transport in the red sea and other rising tensions) remain. All of these will likely be key drivers for financial markets over 2024 and the uncertainty surrounding them will likely support volatility as sharp, two-way market reactions are being driven by incremental news flow. We therefore pay close attention to downside risk and favor high-quality, liquid assets while remaining selective in our investments. We rely on our rigorous in-house, bottom-up analysis and hold a preference for companies with strong ratings and low leverage.

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