

Candriam Bonds Euro Diversified

Market Overview

European bond markets saw mixed performance in February as US inflation and labor market data again surprised on the upside. Against this backdrop, central bankers in the US and Europe signaled that they want to see more evidence that inflation is on track to reach their inflation target on a sustainable basis before starting their easing cycle. As a result, market expectations regarding the first rate cut have been pushed back towards June compared to March at the beginning of the year for both the Fed as well as the ECB.

In the eurozone growth expectations remain low, but we have seen some modest improvements in data recently. The February composite PMI increased to 49.2, driven by services. On a country level we saw a large drop in Germany while data improved in the rest of the Euro-area. On the inflation front, data decelerated further in the eurozone, driven by energy and food with headline standing at 2.6% YoY. Core inflation decelerated (3.1% YoY), but proved more resilient while services also remained sticky at 3.9%.

On the monetary front, ECB members appear to converge towards June for the first rate cut while they continue to closely monitor wage developments in the eurozone to have a better view on the medium term inflation outlook. The Fed from its side has more leeway given the resilience of the US economy.

Concerns related to US commercial real estate continue to raise some concerns 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.

In this environment, German 10 yr yields increased to 2.41%, while Italian and Spanish 10 yr yields ended the month at respectively 3.84% and 3.29%. In terms of yield curve, we saw some flattening of the curve. The supply frontloading in the euro aggregate universe continued both on the sovereign (more than Euro 300 bn YTD) and credit front (close to 170 bn. YTD) but was well absorbed by the market. Excess return was again positive for Euro IG credit, despite a weaker end of the month. Performance wise real estate, insurance and banks were again among the better performing sectors.

Portfolio Highlights & Strategy Review

In February, relative performance was positive. Our overweight on credit, SSA and EE contributed positively while duration and curve were negative drivers. We initiated a long duration bias as 10-year yields turned back above 2.3% while we kept our steepening bias on the 10-30 year part of the curve. Country-wise, we kept an underweight stance on France and Belgium preferring exposure to Austria among core peers. We increased our exposure on Luxemburg via a 10-year primary issue. Among non-core countries we favour EE countries. On Italy we favour corporate exposure relative to sovereign exposure. On credit we maintained our constructive stance and were active on the primary market with still a more important bias on financials vs non-financials. Among non-financials, we favour telecoms, technology, food and beverage while we are more prudent on the Oil sector. We remain overweight on SSA, as we continue to see potential for swap spread tightening. Lastly, we continue to increase and have a marked active exposure to Green, Social and Sustainability Bonds.

Fund Outlook

At the end of February, the modified duration of the portfolio compared to the benchmark stands at +0.53 years, increasing by +0.53 compared to last month (4.89 in absolute terms). Meanwhile, the relative spread duration is +0.35 years, increasing by +0.49 (4.68 in absolute terms).

Relative modified duration is the highest in Austria (+0.17 years). In contrast, it is the lowest in Italy (-0.13 years) and France (-0.11 years).

With regards to countries allocation, the fund's investment in Luxembourg (+0.66%) was increased.

From a sector point of view, we increased our position in Corporate IG Non Financials (+0.61%), while reducing in Sub-Sovereign (-1.12%) and Corporate IG Financials (-0.58%).

Regarding our positioning compared to the benchmark at the end of the month, we are underweight in Germany (-9.96%).

Considering sectors, we are overweight in Corporate IG Non Financials (+11.14%) and Corporate IG Financials (+10.85%), and underweight in Sovereign (-27.88%) and Collateralized (-6.49%).

net of fees in EUR terms

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