

Candriam Sustainable Bond Global High Yield

Market Overview

Over the month of February, sticky inflation data had rates traders second-guess their expectations and further scale back their pricing of rate cuts both in Europe and in the US. In this context, risky assets continued to perform well supported by the AI driven equity rally and credit spreads tighten further.

Fundamentals are still better oriented in Europe where most corporates remain focused on debt reduction while some cracks are appearing in the US in sectors like TMTs and some companies shifted to more equity friendly behaviours. Technicals are more supportive in Europe where we continue to see more rising stars than fallen angels and where the net supply is still negative. In the US, the primary market is much more active with new issuers coming to the market to refinance expensive loans and M&A transactions.

In this context, credit spreads tightened further and are now priced to perfection in US at multi decade tights. In Europe, we continue to see few opportunities supported by strong technicals.

Portfolio Highlights & Strategy Review

In February the strategy posted below benchmark returns.

As markets continue to grind tighter despite wider rates, volumes remain thin within High Yield markets with very few new issues and no real activity from real money community with spreads back to multi years tights across BBs and Bs.

The funds bias towards higher quality (a result of our ESG Filter) was detrimental in an environment where rates rose and better rated issuers (more sensitive to rise in rates) have lagged lower rated ones. Cash balance remains elevated. Overall, we have a structural overweight on BB rated and above names, and we also have a strong exposure to Corporate hybrids (in the Utilities) as an attractive carry trade on robust Investment Grade credits with the segment still trading with discount to generic High Yield issuers. Finally, we hold a full underweight to the Energy sector that exhibits weak ESG profile and carbon footprint.

In the current environment, we continue to favour issuers with prudent capital management and credit friendly behaviours. In terms of sector allocation, we remain overweight on more defensive sectors (Media, Healthcare and European Utilities) as dispersion between cyclical and non-cyclical sectors remains limited.

* net of fees in EUR terms

Fund Outlook

High Yield spread rallied strongly in the last quarter of 2023 and rates have already discounted a potential policy pivot which have set up a challenging start for 2024. 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.

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.

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