Candriam Bonds Credit Opportunities

Market Overview

Treasury yield curves continued to bear steepen in the US and in Europe, driven primarily by the better-than-expected economic prints from the US and its exceptionally resilient labour market. The unrelenting rise in long-term rates has been noted by the FED, with officials commenting that tightening financial conditions and the sharp increase in long-term real yields were doing some of the hard work for the Fed. Similarly, across the Atlantic, as the lagged impact of tighter financial conditions increasingly ripple through the economy and markets, the ECB also kept rates unchanged and gave a dovish impression as Lagarde repeatedly and explicitly mentioned the clearly weakening economic growth.

On the micro front, the earnings season saw large dispersion, and a material portion of the companies missed on top-line expectations. Although the majority could beat on the operating margin, guidance has generally become materially cautious and companies conceded increasing concern about their ability to defend margins.

Technicals were the bright spot with Ford being upgrading back to investment grade which will provide a massive tailwind to High Yield markets in the coming weeks.

In this context, High Yield spread widened 50 bps to reach 450 bps in the US and 500 bps in Europe.

Portfolio Highlights & Strategy Review

Performance share I - month (management data): +0.37% vs +0.43% for IG QW5A and -0.29% for HY IBOXXMJA.

As a reminder, the fund is 100% Corporate and does not invest in banking or insurance securities.

Short-duration pocket: +0.19%. Core pocket.

Reinforcement of investments to take advantage of the carry and early redemption option in the event of refinancing, a source of capital gain as market prices are below par, at 100.

Opportunistic pocket: +0.18%. Net exposure is +14% versus +16.1% at the end of August. The long credit segment posted a performance of +0.10%, the hedging credit pocket +0.08 . %. The fund no longer has a state hedge by buying back the German 5-year rate put options, whose premium was virtually zero (rate seller at 2%).

Portfolio strategies:

- Since June, sale of all LDIG securities positions and removal of the QW5A TRS hedge for 10% in favour of short-term HY securities offering a higher yield than the arbitrage position in an inverted yield curve situation.
- Reduction of investments in issuers with a single B rating and removal of part of the market beta hedge by selling 20% of the assets of the IBOXXMJA TRS, compared with 25% in June, in order to reduce the portfolio's risk in this rating segment, which is more sensitive to financing costs and the risk of recession. In return, purchases of BB HY securities with maturities of less than 2028, priced at around 80% to 90% of par, offer protection in the event of a rating downgrade.
- No interest-rate hedging is currently in place, following the rise in government rates over the past two months.

Fund Outlook

The key is in the hands of the central banks, which must answer the question: how high should rates rise to stabilize inflation without sending economies into recession? For the first time in almost two years, central banks are delaying their rhetoric. Are we approaching the end of the rate hike cycle?