CANDRIAM
A NEW YORK LIFE INVESTMENTS COMPANY

Candriam Bonds Euro High Yield

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 labor 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.

Fund performance & Portfolio activity

In October, the strategy outperformed the benchmark. Most of the outperformance came from our conviction on the long side (Teva, Iliad, Repsol and Accor) while we managed to avoid the underperformers (Heimstaden, Altice France and Atos).
In the current environment, we remain focused on leading players with a strong pricing power and a proven ability to pass through inflation costs. We 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 defensive and energy intensive sectors (Telecommunications, Packaging, Healthcare and Utilities).
We maintained a lower credit duration and a lower interest rate duration of -0.5 vs the benchmark.

Fund outlook

We maintain our cautious stance on European High Yield markets given where we are in the credit cycle and the very high level of uncertainties on the macro front but we remain constructive on defensive sectors and high quality credits where the combination of wider spreads 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.