Candriam Long Short Credit

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 US 30-year yield hit 5% for the first time since 2007 and European bond markets briefly reached the highest 10-year yields in a decade.

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. These comments were perceived as dovish and prompted a small period of sharp rates decrease, which continued on the back of the increased safe-haven demand driven by the unfortunate geopolitical tensions in the middle east. Overall though, The FED remains in wait-and-see mode and left rates unchanged, with their committee minutes indicating that policy should remain restrictive for some time.

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. Policymakers appeared concerned about the economic outlook, as the European economy shrank at the highest pace in three years. Corporates and households appear to be feeling the pressure of monetary tightening and inflation prints are gradually trending downwards as aggregate demand is dampened.

The earnings season saw large dispersion, and a material portion of the companies (both IG and HY) 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.

Credit spreads (ICE BofA Year Euro Corporate Index) widened by 8 bps to a level of 159 bps . Euro High yield spreads ended at 489p (or +42 bps).

Portfolio Highlights & Strategy Review

The fund posted a positive performance this month, + 23 bps come from Relative Value Bucket and + 24 bps from directional bucket. At the end of the month, we have a low credit duration (around 0.9) and a slight long interest rate duration of 0.1.

Directional Segment: we keep our short maturity IG and HY exposure on strong issuers. We bought some Engie, BBVA, EDP short dated bonds. Our Directional bucket is still partially hedged with Xover, Main and Total return swap on HY index.

Relative value segment:

Basis Trades: we put new negative basis on JP Morgan, Commerzbank, UBS, Intesa San Paolo and Barclays . We sold basis on Siemens and took profit on Tier 2 Basis on Santander and Intesa San Paolo AT1s. We look for opportunities to reload some positions.

Relative value: new cash pair trades: Total perp vs Bp perp, Orange perp vs Telefonica perp, Verizon Gbp vs Deutsche Telekom Eur, Cellnex vs American Tower. We took profit on CDS pair trades: Unicredit vs Mediobanca, Enel vs Unicredit, BNP vs Commerzbank. We participated cautiously in primary markets (EUR & USD).

Fund Outlook

Credit markets appear still to be challenged by the dual threat of rising rates & Inflation across the global and geopolitical risks still uncertain. The inflationary pressures are likely to have an impact on certain corporate balance sheets. In the absence of fiscal and monetary support, we expect the context characterized by heightened volatility and uncertainty to continue, while dispersion is likely to remain high. In such a context, the fund remains well positioned to capture performance with its mixed IG/HY profile and its two complementary engines of performances. Its focus on volatility and bond picking should allow it to successfully navigate the current context.