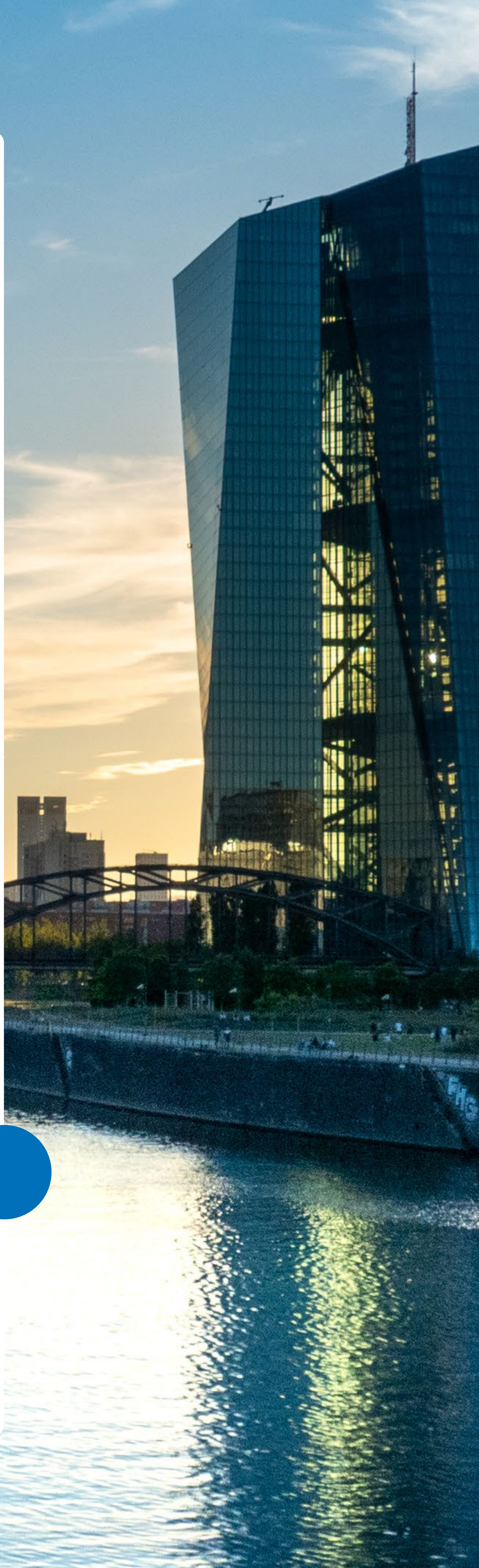
CANDRIAM
A NEW YORK LIFE INVESTMENTS COMPANY

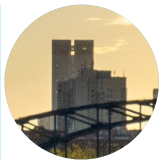
The Bonds are Back in Town

Is it time for a long-term commitment to Euro Aggregate bond investments?



MAY 2024

Marketing communication

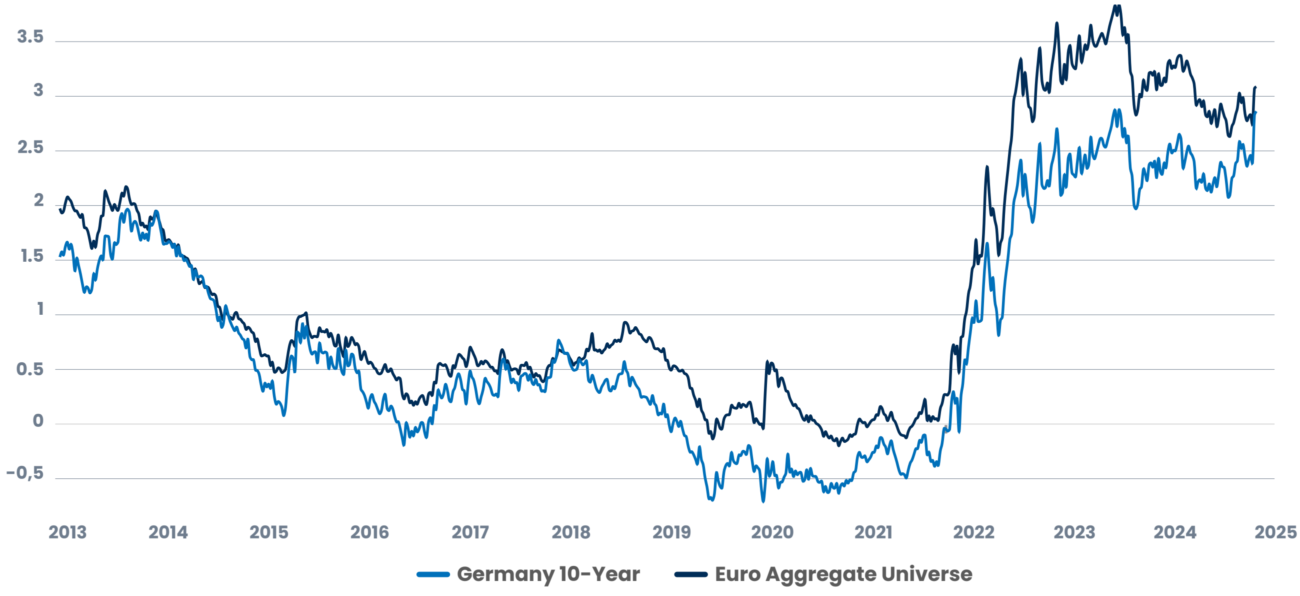


1. A Return to a Traditional Landscape?

Yields in core euro aggregate fixed income markets were on the rise again as markets entered 2025, particularly for sovereign assets. For example, the German 10-year government (Bund) hit a decade high, crossing the 2.9% mark in early March. Yields have also increased in other segments of the euro aggregate universe like high-quality corporate bonds.

Figure 1: Navigating a Higher Rate Environment

Core Euro Aggregate Universe



Source: Candriam, Bloomberg, 24 March 2025.

The potential to generate higher current income in the bond asset class has increased, likely for some years to come. The fiscal announcements in Germany on the back of the February elections and the ReArm Europe defence proposals ("whatever it takes"[1]) clearly contributed to the upward move in euro yields. On the economic front, the Euro zone is nevertheless not out of the woods, with growth currently only modestly in positive territory and no signs of acceleration yet. At the same time, tariffs continue to loom on the horizon suggesting that despite the ambitious fiscal and defence announcements, we expect 2025 GDP growth to be around 0.5%.[2]

Overall yields of the euro aggregate fixed income universe are trading at the higher end and for some sovereigns, even at the highs of the past decade. After the rise in yields at the beginning of March 2025,[3] bonds are able to absorb larger absolute increases

1 - German Chancellor Friedrich Merz on the topic of European defence, 5 March, 2025.
2 - Candriam economic Euro zone forecast, as of 15 April, 2025.
3 - The ten-year high for euro IG corps, based on the ICE BofA EUR Corporate IG Index, was 4.66% on 12 Oct 2023. This index was 3.13% on 30 April, 2025. By comparison, for governments, the 2.97% peak of the 10-year German Bund was reached on 3 Oct 2023.

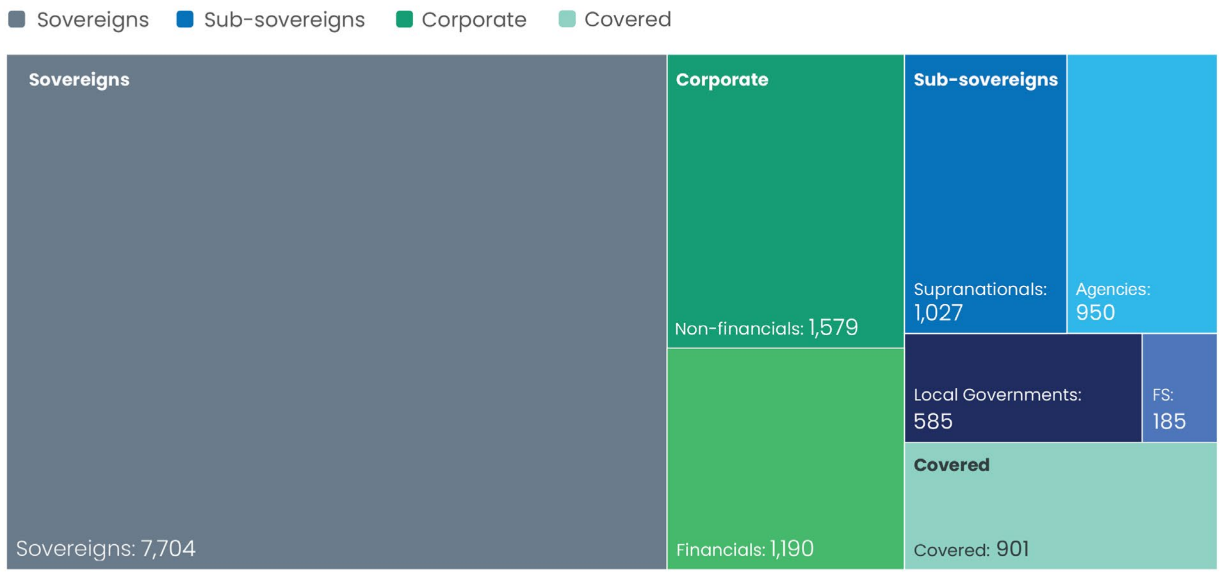
in yield rises on a one-year horizon and continue to provide positive total returns. That is, higher starting yields offer better protection against swings in interest rates. This so-called one-year 'breakeven' on a one-year basis currently stands at close to 0.35% for the 10 year German Bund.[4] The yield curve has also been generally steepening over the years that the ten-year yields have been rising. Yields have increased more for longer-term bonds, with their typically higher interest rate sensitivity.

These fundamentals present a case for a greater allocation to euro bonds. Investors who maintained only modest exposure during the low- and zero-interest rate era may consider increasing their exposure to more historical norms, and benefit from the lower volatility of fixed income sectors relative to equity.

2. The Euro Aggregate Universe.

This group of asset classes can play a key or anchoring role in the asset allocation of euro-based investors. There are roughly 7,500 issues in the Bloomberg euro aggregate investment universe, with a total market size of €14,200 billion (€14 trillion).[5] It consists of investment grade issuers ranging across government, government-related, corporate, and covered[6] bonds

Figure 2: Euro Aggregate Segment Sizes
Bloomberg Euro Aggregate 1-10 Total Return Index, Segment Sizes in € billions



Source: Candriam, Bloomberg, as of 24 March 2025. FS = Foreign Sovereigns

4 - As of 30 March, 2025. Not to be confused with inflation break-evens on inflation-linked bonds.
5 - Bloomberg, as of 24 March 2025.
6 - Also known as collateralized bonds.

3. Divergence Among Euro Fixed Income Segments Provides Diversification and Performance Opportunities.

We believe active investment among fixed income segments can enhance the overall risk/return profile. The performance of euro aggregate and other euro fixed income segments over the past eleven years illustrates the degree to which both returns and correlations can vary (Figures 3 and 4). Notably, this dispersion applies to high-quality sovereign bonds as well as so-called 'spread products', ie bonds that include additional credit risk.

Figure 3: Annual Performances of Selected Euro Fixed Income

2014 to 2024, including sectors within the Bloomberg index (cf Figure 2) and non-index FI segments

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Agencies	Sovereign 13.13%	Sovereign 1.65%	Euro High Yield 9.13%	Convertibles 21.73%	Sovereign 0.98%	Euro High Yield 11.33%	Convertibles 18.84%	Inflation Linked 6.35%	Inflation Linked -9.66%	Convertibles 12.35%	Euro High Yield 8.22%
Collateralized	Euro Aggregate 11.1%	Euro Aggregate 1%	Emerging Markets 8.35%	Emerging Markets 7.3%	Local Governments 0.88%	Emerging Markets 11.07%	Sovereign 4.99%	Euro High Yield 3.43%	Euro High Yield -10.64%	Euro High Yield 12.12%	Financials 5.71%
Convertibles	Supranationals 10.59%	Euro High Yield 1%	Corporate 4.73%	Euro High Yield 6.9%	Euro Aggregate 0.41%	Foreign Sovereign 8.06%	Supranationals 4.27%	Financials -0.6%	Collateralized -13.22%	Foreign Sovereign 8.9%	Corporate 4.74%
Corporate	Corporate 8.4%	Local Governments 0.9%	Financials 3.89%	Foreign Sovereign 4.69%	Collateralized 0.27%	Sovereign 6.77%	Emerging Markets 4.14%	Corporate -0.97%	Financials -13.36%	Financials 8.57%	Foreign Sovereign 4.27%
Emerging Markets	Foreign Sovereign 8.27%	Foreign Sovereign 0.89%	Inflation Linked 3.79%	Financials 3.23%	Agencies 0.24%	Inflation Linked 6.56%	Euro Aggregate 4.05%	Collateralized -2.14%	Corporate -13.65%	Corporate 8.19%	Emerging Markets 3.88%
Euro Aggregate	Agencies 7.88%	Inflation Linked 0.82%	Foreign Sovereign 3.65%	Corporate 2.41%	Supranationals 0.23%	Corporate 6.24%	Local Governments 3.85%	Agencies -2.31%	Agencies -16.12%	Emerging Markets 7.78%	Collateralized 3.36%
Euro High Yield	Financials 7.78%	Emerging Markets 0.75%	Euro Aggregate 3.32%	Inflation Linked 1.4%	Foreign Sovereign -0.51%	Financials 6.12%	Inflation Linked 3.13%	Foreign Sovereign -2.47%	Euro Aggregate -17.18%	Euro Aggregate 7.19%	Euro Aggregate 2.63%
Financials	Collateralized 7.54%	Supranationals 0.58%	Sovereign 3.23%	Agencies 0.75%	Corporate -1.25%	Euro Aggregate 5.98%	Corporate 2.77%	Emerging Markets -2.51%	Local Governments -18.23%	Sovereign 7.13%	Local Governments 2.61%
Foreign Sovereign	Local Goernments 7.23%	Collateralized 0.38%	Supranationals 3.06%	Collateralized 0.68%	Inflation Linked -1.46%	Convertibles 5.29%	Foreign Sovereign 2.62%	Euro Aggregate -2.85%	Sovereign -18.46%	Agencies 7.09%	Agencies 2.51%
Inflation Linked	Euro High Yield 5.83%	Financials 0.29%	Agencies 2.86%	Euro Aggregate 0.68%	Financials -1.47%	Supranationals 5.24%	Financials 2.39%	Sovereign -3.46%	Convertibles -18.8%	Supranationals 6.64%	Convertibles 2.13%
Local Governments	Inflation Linked 5.27%	Agencies 0.13%	Local Governments 2.37%	Local Governments 0.23%	Euro High Yield -3.82%	Local Governments 4.05%	Euro High Yield 2.29%	Local Governments -3.68%	Emerging Markets -18.8%	Local Governments 6.42%	Supranationals 1.97%
Sovereign	Emerging Markets 5.12%	Corporate -0.56%	Collateralized 2.17%	Supranationals 0.2%	Emerging Markets -7.38%	Agencies 3.75%	Agencies 2.19%	Supranationals -4.12%	Foreign Sovereign -19.21%	Inflation Linked 5.93%	Sovereign 1.88%
Supranationals	Convertibles -8.92%	Convertibles -2.83%	Convertibles -2.31%	Sovereign 0.17%	Convertibles -10.39%	Collateralized 2.78%	Collateralized 1.9%	Convertibles -8.95%	Supranationals -20.23%	Collateralized 5.56%	Inflation Linked 0.08%

Past performance is not a reliable indicator of future performance. Markets could develop very differently in the future.

Source: Candriam, Bloomberg, JP Morgan, ICE BofA
All-maturity euro index, while strategy uses a 1-10 year maturity

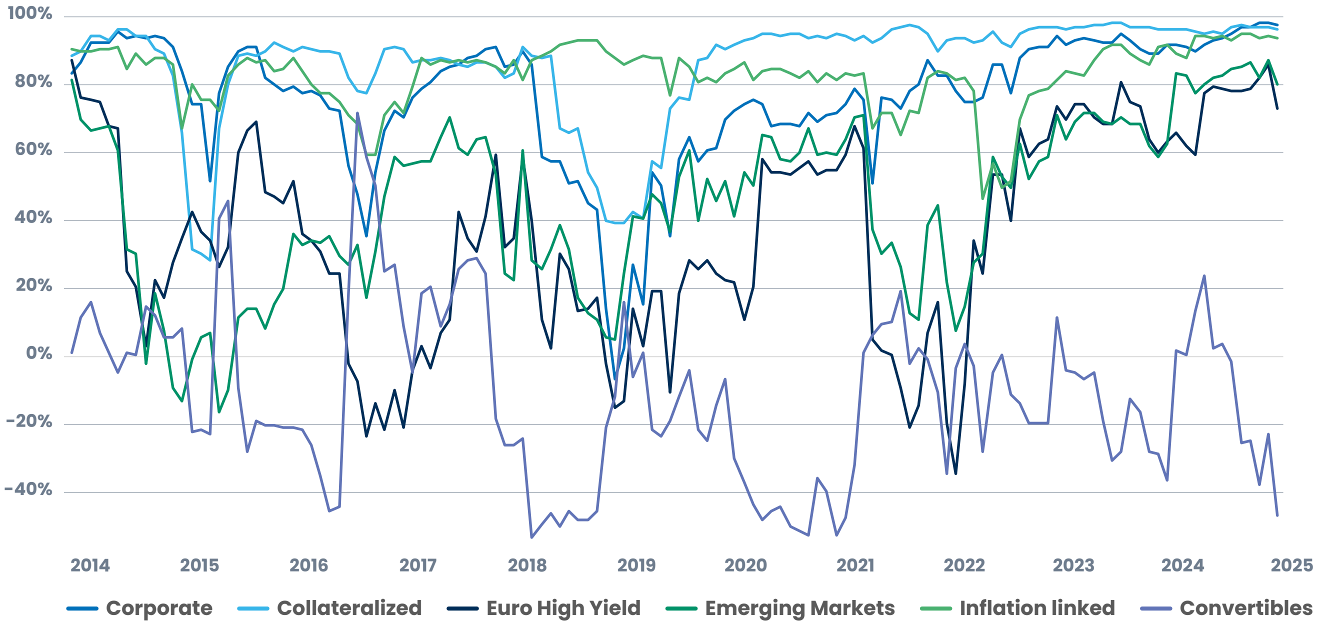
For example, in 2021, inflation-linked and high yield bonds generated positive performances, while some segments included in the Bloomberg Euro Aggregate 1-10 Total Return reference index, such as sovereigns, produced negative returns. Other examples of the benefit of active management include the outperformance of sovereigns in 2018 (normally below index average risk and return) and convertibles in 2024 (another example of a non-core segment being attractive relative to the reference).

The instability of the correlations among euro fixed income asset segments over the past decade further demonstrates the potential for active management. Figure 4 shows the 12-month moving average (rolling average) of six of these segments. To illustrate the full potential of the broad asset class, note that half of the sectors in Figure 3 are not included in the Bloomberg index we use to demonstrate the market sizes in Figure 2.

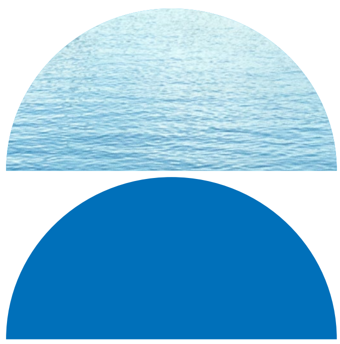
Finally, active management of duration can also enhance portfolio diversification. We emphasize the medium-term sector of the yield curve. Long enough duration to benefit flexibly from episodes of decreasing yields and flexibly capture opportunities to enhance yield when the yield curve is steep. Not too long, in order to manage the rate sensitivity of long duration bonds. We are convinced that active and agile management of duration can improve the risk-adjusted return potential of medium- duration euro aggregate portfolios.

Figure 4: Correlations of Euro Sovereigns vs Other Euro Fixed Income Sectors

12-month moving average, 2014 to 2024



Source: Candriam, Bloomberg, as of 24 March 2025



4. Can History Rhyme?

"History doesn't repeat itself, but it often rhymes", said the American novelist Mark Twain 150 years ago. Less lyrically, regulators continuously remind us that past performance is no indicator of future returns. Yet we believe extensive experience in euro aggregate portfolio management does help when looking for the rhythm and rhymes. Our current approach, launched in 2018, benefits from over three decades of Candriam experience in aggregate strategies, stretching back to our predecessor companies.

With the lower-for-longer interest rate era potentially behind us, we see some investors raising their fixed income allocations. Drawing on the analyses in Figures 1, 3, and 4, we believe investors can **benefit from an actively-managed, diversified euro fixed-income portfolio.** By strategically spreading investments across different types of bonds, investors can reducing risk and volatility and build a more resilient and potentially more rewarding portfolio. The characteristics of each type of bond in the euro markets means they can react in substantially different ways depending on market conditions, interest rates, credit risk, inflation, and specific events such as the banking and Covid crises and the post-Covid inflation. As these events demonstrated, concentrating investments can sometimes be very painful.

Our preferred approach is to enlarge the investment universe beyond a reference index such as the Bloomberg Euro Aggregate 1-10 Total Return (Figure 2). For example, strategically timed allocations to inflation-linked bonds, high yield, emerging markets and convertibles offer diversification benefits (Figure 4) and potential return enhancement (Figure 3).

It is our Conviction that euro-based investors should begin to rebuild core fixed income exposure through a diversified, actively-managed, highly flexible, medium duration strategy. Why all those adjectives?

- **A core euro fixed income portfolio** should take advantage of the **broad euro fixed Income investment universe**, including sovereign, corporate, SSA[7] and covered bonds.
- **Diversification** into inflation-linked, high yield, emerging market, and convertible bonds can reduce risk and potentially enhance performance.
- **Active management and flexible allocation** over time can help portfolios to better navigate volatility and take advantage of opportunities arising within the broader universe.
- **An intermediate duration** ("not too short, not too long") strategy may provide a balanced solution for investors seeking the interest income and diversification benefits of bonds while limiting the short-term drawdown risks that may arise with an all-maturity solution.
- **Sustainable** investors may prefer a strategy with a carbon footprint goal.[8] It's in the name – CANDRIAM, Conviction and Responsibility in Asset Management.

7 - SSA includes sovereign, sub-sovereign, supranational, and agency issues.
8 - The strategy aims to have a carbon footprint lower than its benchmark.

Ready to meet our team? Enjoy the 60 Seconds with the Portfolio Manager.

Not enough on how we use our Convictions while managing portfolio risk? You can find the technical explanation along with a case study on our Euro Aggregate strategy here.

The main risks of the strategy are:

- **Risk of capital loss:**

  There is no guarantee for investors relating to the capital invested in the strategy in question, and investors may not receive back the full amount invested.

- **Interest rate risk**
- **Credit risk**
- **Index Provider Risk**

The risks listed are not exhaustive, and further details on risks are available in regulatory documents.

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