CANDRIAM
A NEW YORK LIFE INVESTMENTS COMPANY

A diversified euro debt strategy to counter market volatility

60 seconds with the fund manager

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This marketing communication is intended for non-professional investors.

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60 SECONDS WITH THE FUND MANAGER

Philippe Dehoux, Sylvain de Bus and Pierre Boyer explain how short-term bonds are making the most of what the euro fixed income market has to offer in the volatile environment ahead.

Could you give us an update on the euro fixed income markets?

After more than a decade of suppressed yields across European bond markets, valuations have finally turned. Following the rise in inflation across the globe and the hawkish stance of central banks, rates have seen a sharp increase in the Eurozone since September 2022. The short end of the curves has benefitted significantly from this move, and we expect yields to remain at relatively high levels over the foreseeable medium term, as inflation levels are expected to stay elevated. This impact has been felt across the eurozone, with both sovereigns and corporates experiencing the rise in rates. Even core markets (France and Germany) are exhibiting rates that have left the negative territory across the entire curve, while peripheral sovereign bonds are significantly higher as the countries will continue to benefit from the fiscal support provided by the "next generation program". However, in an environment with lower liquidity levels and heightened volatility, active management of duration and flexible allocation is key. Euro IG (Investment Grade) markets are likely to also exhibit attractive valuations both in terms of yields and spreads, with a strong potential to outperform sovereigns. It is important to note that we expect dispersion to increase, in the absence of central bank support, as fundamentals and idiosyncratic risks come to the forefront. In a context of markets impacted by secular trends such as deglobalisation, digitalisation and decarbonation, we expect company business models to experience disruption and ultimately result in winners and losers. A heightened level of selectivity, based on fundamental research with ESG[1] factors integration will be vital in extracting value from these markets.

Why should investors consider an allocation to short-term euro bonds?

European bonds remain a cornerstone of many investors' allocations but given the rise in supply and the market expecting a normalisation of ECB policy through a reduction in its asset-purchase programme and increases in rates, the fixed income markets could see further volatility ahead. Short-term bonds are less exposed to these concerns than longer-term issues, this may offer a stronger potential to provide better risk-adjusted returns than the broader market.

(1) Environnemental, Social & Governance.

How would you define the strategy?

It's a benchmarked strategy that invests primarily in European IG corporate and sovereign bonds with a duration of no more than 3 years and a residual term not exceeding 5 years. Our active management makes it a diverse and flexible strategy with a wide investment universe made of sovereigns, sub-sovereigns, financial, non-financial and covered issuers from which we seek to select the most attractive securities through our fundamental bottom-up analysis integrating ESG criteria, combined with our top-down process to define our interest rate strategy and credit allocation. It may represent an appealing alternative to Money Market or other strategies to optimise the current market conditions while favouring carry and risk-adjusted return.

How do you add value relative to the benchmark?

Our added value resides in our rigorous top-down process combined with our high conviction bottom-up selection. Our decision on the allocation between sovereign and corporate bonds is based primarily on our analysis of our position within the credit cycle, but we also consider valuations and technical. In our government bucket, we use active duration and yield curve strategies based-on proprietary frameworks (using macroeconomic, valuation and technical indicators) coupled with a robust country selection process integrating ESG criteria to evaluate the credit risk of each country. Our corporate bond selection is based on in-depth analysis of each issuer's quality, paying particular attention to their potential for downgrade to sub-investment-grade status. We analyse their business and financial profiles, with ESG criteria as well, resulting in the assignment of an independent in-house credit rating. Finally, we construct the portfolio according to issues relative value and a strict risk budgeting approach to ensure that the portfolio accurately reflects our views on the markets and that we spread risks appropriately. This has been instrumental in enabling us to minimise the portfolio's volatility and limit drawdowns over many years.

What are Candriam's credentials in managing this kind of strategy?

Candriam's strengths in managing this strategy lie primarily in our in-depth and long-standing Fixed Income expertise, both in sovereign and corporate bonds. Our team is made of seven sovereign analysts, and eight Investment Grade analysts on the corporate side, who average over 14 years of experience. Plus, rather than relying on credit ratings from external agencies, we use an internal rating system based on our own fundamental analysis. That has enabled us to avoid any defaults and fallen angels in the strategy since its inception in 2003. Another key strength is our risk management capabilities. As well as carefully considering the downgrade potential of all the corporate bonds we invest in, we follow strict internal risk guidelines.

Could the strategy appeal to ESG[2] investors?

The strategy uses advanced ESG integration through our securities analysis and selection, as well as a strict controversial activities exclusion. Candriam has long been a pioneer in ESG (+25 years), and the portfolio management team, as well as our analysts rely heavily on our in-house ESG team to understand an issuer risk profile as we are convinced, and as the market has proven many times, that a good ESG score makes a long-term difference on an issuer performance and creditworthiness.

(2) Environnemental, Social & Governance.

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.

The stated risk is not exhaustive, and further details on risks are available in regulatory documents.

Find out more about our funds and their risk profiles:

www.candriam.com