CANDRIAM
A NEW YORK LIFE INVESTMENTS COMPANY

Candriam Bonds Global High Yield

Market overview

Following a very strong rise in yields over the previous months, financial markets rallied strongly across asset classes as markets started pricing rate cuts in 2024 rather aggressively. A string of economic data highlighted that the transmission of restrictive monetary policy remains forceful across both sides of the Atlantic. In the US, despite the stronger than expected growth over Q3 at 5.2%, the economy showed showing signs of slowing down. Banks continued to tighten commercial credit, and indications were that households were pulling back on discretionary spending, and the labour market were gradually cooling.

In the EU, headline inflation slowed more than policymakers expected at 2.4%, though core inflation remains well above the ECB's target at 3.6%. The German economy contracted over Q3, driven by a drop in household spending. However, the ECB hinted at expectations of a temporary rebound in inflation figures due to base effects as high energy prices from the autumn of 2022 drop out of the data. They also added that the Euro Area will probably avoid a recession as improving purchasing power among consumers drives a rebound.

In terms of fundamentals, dispersion remains elevated between cyclicals and non-cyclicals and companies with pricing power or not as inflation costs continue to bite into margins.

On the technical side, Ford has been upgraded to Investment Grade and as the largest rising star ever will provide a strong support for High Yield markets into year end.

In this context, credit markets rallied strongly with US High Yield 70 bps tighter and European High Yield 50 bps tighter over the month together with a strong rally in rates. US Investment Grade posted a +5.6% performance which was the strongest month in 38 years.

Fund performance & Portfolio activity

In November, the strategy outperformed the benchmark in one of the best Monthly return of HY indexes in the last decade. Most of the outperformance came from our conviction on the long side (Teva, Charter, Virgin Media, Enel) while we managed to avoid the underperformers (Altice France, Ardagh). During the month, BBs were the best performers alongside large and liquid names benefiting from Ford upgrade' tailwind and benchmark rebalancing.

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. We remain OW euro HY with more attractive valuations, especially on corporate hybrids. 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 credit duration and an interest rate duration in line with the benchmark.

Fund outlook

Currently, we believe that spreads in the asset class do not adequately price the risks in the markets. The full extent of damage from tight monetary policy will be unknown until the peak in policy tightening is behind us. Fundamentals are expected to deteriorate especially for more levered companies that will face significantly higher interest costs as they will start to tackle their maturity wall. With much tighter conditions leading to deteriorating earnings and strengthening momentum in downgrades/defaults, we expect credit selection to be of utmost importance in this cycle.

We remain constructive on defensive sectors and high-quality credits where the combination of higher yields 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.

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