Fixed Income Quarterly Update, October transcript

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Hello and welcome to the quarterly video dedicated to Fixed income markets. Have you been wondering what's happened in the global fixed income markets over the past quarter? Let's take a look and I will share our perspectives for the upcoming months.

Market environment

In the third quarter of 2024, central banks remained a key driver to the fixed income market narrative, with both the European Central Bank (ECB) and the Federal Reserve (Fed) taking decisive steps in their monetary policy adjustments. As we expected, the ECB continued its easing cycle, cutting rates again by 25 basis points in September, while the Fed kicked off with a 50 basis points rate cut, without fueling fears about the health of the US economy. In the Euro Area, the September inflation print indicated weaker-than-expected inflation, particularly in core components, suggesting further downside over the coming quarters.

This is very much aligned with the ECB President Lagarde's increased confidence in meeting the inflation targets. As a result, we adjusted expectations to a 25 basis points rate cut at the next ECB meeting and a back-to-back 25 basis points rate cut through the first part of 2025 to 2% .

These announcements and expectations are backed up by trends of some key indicators of long-term inflation, such as the five-year five-year inflation swap as you can see on this chart. The eurozone's five-year five-year forward inflation swap fell below 2.1% close to the ECB target while the UK equivalent dropped to its lowest level since 2016. This decline reflects reduced concerns about stagflation and a shift towards fears of a demand-driven slowdown, particularly from China.

Perspectives

Credit markets were rather stable quarter on quarter in the Euro Area and in the US with some spread volatility, particularly in August. We saw some disruptions in the Asian carry trade, where investors borrow in low-interest-rate currencies to invest in higher-yielding assets. As concerns about tightening liquidity and potential shifts in interest rate expectations mounted, many investors unwound their positions, leading to a sell-off in risky assets, such as credit. Another significant news in the credit markets was the active supply which came at a strong pace throughout the quarter and notably in September.
Issuance is getting close to €80 billion for the Euro Credit Investment Grade market, falling just short of the €80.5 billion printed in September 2019. Despite the headwinds, technicals remains strong both in Europe and in the US as we continue to notice significant flows into the asset class on the back of attractive all-in yields.

Preferred strategies

Considering the current environment, we believe these few strategies are worth highlighting for investors: First: Euro Credit Investment Grade and High Yield. We expect a scenario of slowing but still positive growth, supported by strong fundamentals and technical factors, which should help offset the somewhat tight valuations.
While spreads seem fair, we believe credit remains appealing for investors due to the attractive all-in yields currently available. Additionally, expected interest rate cuts should create a favourable environment for the credit markets driving a slightly longer duration positioning in portfolios. In the high-yield space, despite tight valuations, overall fundamentals are solid, and default rates remain manageable.

Second : US High Yield. With resilient fundamentals, including a low 1% default rate and strong credit momentum, the US High Yield market remains supported by attractive yields and technical demand. With the Fed's 50 basis point cut in September and more to come, easing rates will further reduce financing costs, creating a favourable environment for high-yield issuers.
As we look ahead to the last quarter of 2024, we remain cautiously optimistic, with the potential for further central bank actions and clearer inflation trends likely to drive market direction. However, we also expect some volatility due to the upcoming US Presidential election, potential trade tensions, and developments in France around the new budget.

Thank you for watching, and we look forward to keeping you updated on the fixed income markets.

Source: AXA IM as of October 2024