Investment involves risk, including loss of capital
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Fixed Income / Euro Credit

Euro Credit Market Views transcript

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What has been happening in the euro credit market?

The era of quantitative easing, near zero rates and volatility suppression by central banks appears to be over. And in this context, we have a bias towards high quality, more liquid investments. Investment grade corporate bonds have experienced strong returns year to date despite a huge rise in central bank rates. The ICE BofA Euro Credit index rose by 3.23% this year, supported by the resilience of company results and, more broadly, of the European economy.
With a 4.28% yields, valuations remain a key factor, fueling optimism for investors in the European credit markets. Over the course of 2023, the asset class has seen more than €6 billion in inflows. We expect this trend to continue given the attractiveness of the asset class in more risk adverse environments. Corporate spreads, on the other hand, have remained range-bound in 2023 between 80 and 95 basis points, if we adjust for the volatility events.
They have held stable throughout the year because of a mix of positive news with quarterly earnings surprising on the upside and negative news around market sentiments and fear on future growth.

What are the main themes going forward?

So there are essentially three themes that will play a role in the coming quarters. First of all, the paths for economic growth remain uncertain. We believe the risk for a mild recession in developed markets has increased due to tighter credit conditions, geopolitical tensions and uncertainties with major economies like China and the US. Data is already showing an increasing, but still limited, number of bankruptcies in the first half of 2023 due to interest rate expenses, stricter lending conditions and capital access limitations. However, this should remain limited within the high-quality segment of the fixed income markets.
Second, inflation is expected to decelerate gradually, and this should impact central banks' policies. Even though disinflation is a feature in most economies, it has proven more persistent than expected. Mindful of the 2022 inflation shock, we sense that central banks will not want to ease rates too soon for fear of inflation returning. This should support a scenario where yields will continue to remain at attractive level for a prolonged period of time.
And third, the consumer resilience will be crucial to support the economy. Despite the bleak economic outlook, consumer spending seems resilient on the back of strong employment. So far, this has helped companies to pass on higher costs to consumers. Should this fade away, this could impact economic growth and company earnings.

What could this mean for investors?

As we expect the markets to remain challenging for the foreseeable future, we believe the best approach is to remain active. Yield levels for high quality bonds are now close to the long term average for equity real returns, yet potentially with significantly less volatility and more downside protection than equities. Overall, this may help investors to construct prudent, resilient portfolios with potentially attractive returns.

Source: AXA IM as of September 2023

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