Fixed Income Market Update, June transcript

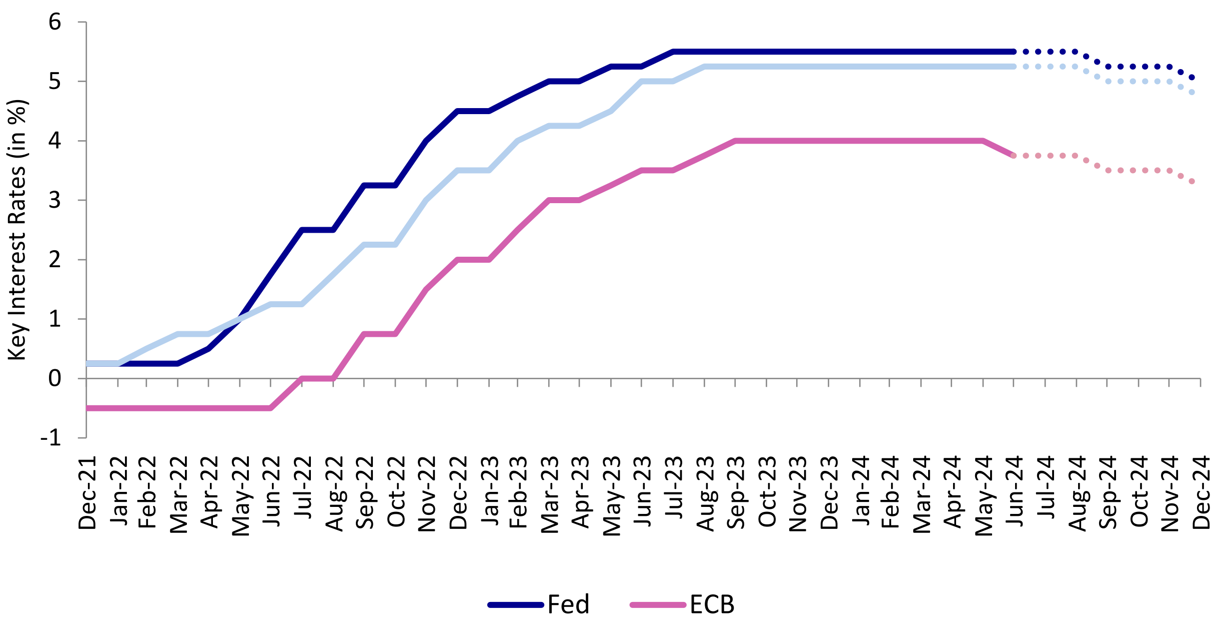
Marion Le Morhedec – Global Head of Fixed Income, AXA IM Core

Hello and welcome to the quarterly video dedicated to fixed income markets. I will comment on what happened in the global fixed income markets over the second quarter of 2024 and share our perspectives for the months to come.

Market Summary

Central banks continue to play a crucial role in shaping the fixed income landscape. Following its first rate cut in nearly five years in June, the ECB (European Central Bank) reduced policy rates by 25 basis points, bringing the deposit trade to 3.75% as you can see on this chart.

Central Bank Policy Rates



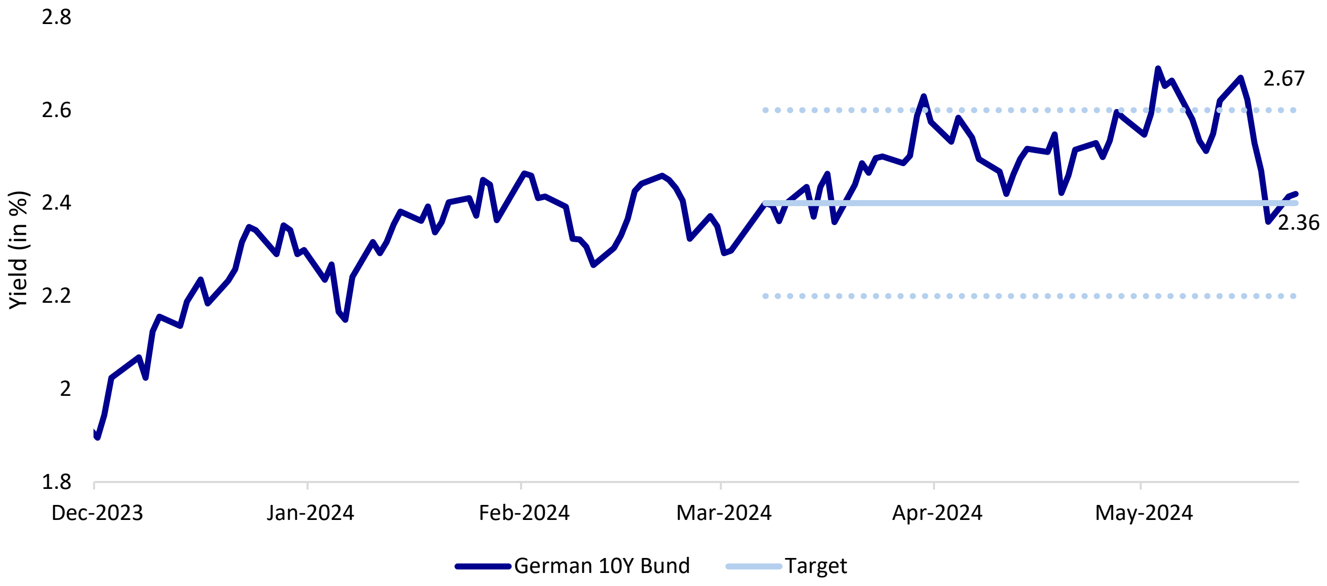
Source : AXA IM, Bloomberg, as of 17/06/2024.

This will probably mark the beginning of a cautious easing cycle, although the ECB has stated that it will remain data dependent. Headline inflation in the eurozone started to show signs of cooling, but core inflation, particularly in services, continues to remain high, which requires attention.

In the US, the Fed (Federal Reserve) left its benchmark interest rate unchanged as it waits for more evidence of softer inflation. In the second quarter of the year, global government bonds delivered mixed performance due to investor concerns about potential policy shifts and their impact on global trade dynamics. The resilience of the economy and the strong labour market was a common theme for both the US and the euro area, which has driven central banks to review their path for interest rate cuts. European government bond markets experienced significant volatility.

As you can see there, 10-year German Bund Yield sold off by 30 basis points from 2.30% at the beginning of the second quarter to 2.67%, prior to the European elections, until their rally to 2.36% in a flight to quality mode.

German Bund Yield 10Y

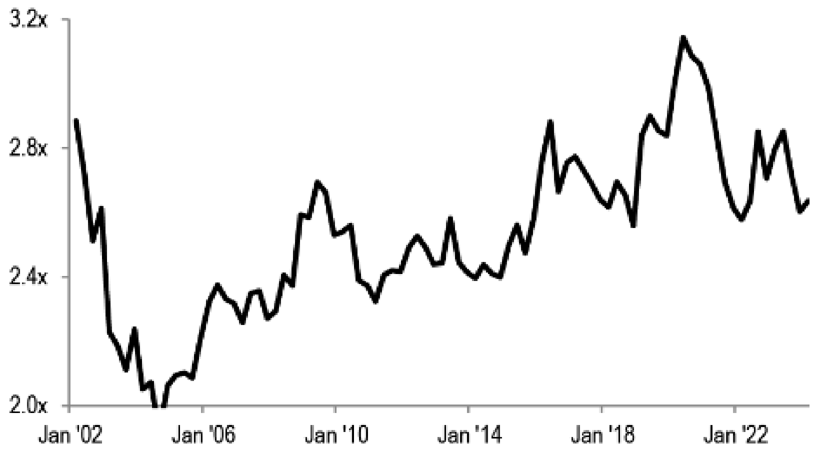


Source : AXA IM, Bloomberg, as of 17/06/2024.

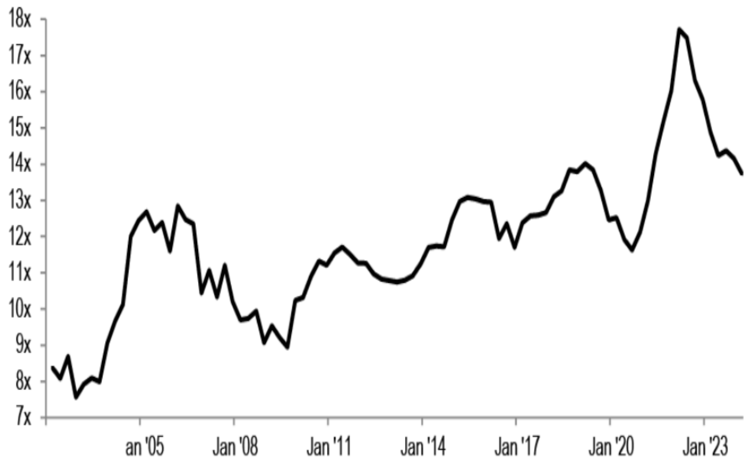
Similarly, other European government bond spreads experienced increased volatility following these results. This could bring back some value in the semi core and peripheral markets where spreads have been tight. In the corporate credit space, earnings have remained relatively robust throughout the first quarter of 2024.

Companies continue to prove resilient, with earnings reports often exceeding market expectations. This resilience has been supported by the end of destocking for cyclical sectors, a positive consumer demand, strong liquidity and solid credit reissues such as net leverage and coverage ratios as you can see on the charts.

Net Leverage of European IG Corporates



Coverage Ratio of European IG Corporates



Source: AXA IM, Bloomberg, as of 31/05/2024.

In financials, banks have performed particularly well, benefiting from growing net interest income, good asset quality despite a modest increase in the cost of risk and strong capitalisation ratios.

There has been some discrepancy with better performance from Spanish and Italian banks, weaker trends in the UK and decent trends in the Nordics and France. The fixed income markets have responded to these dynamics with a generally positive excess returns as investors remain cautiously optimistic about the potential for further rate adjustments and economic stability.

Where are you seeing opportunities in fixed income?

Considering the current environment, we believe a few strategies are worth highlighting for investors.

1. Euro Credit investment grade and High Yield.
Investment grade corporate bonds still appear attractive, given average yields close to 4% in the euro area. Positive growth, combined with resilient fundamentals and solid technicals, are offsetting a slightly tight valuation backdrop. We think that absolute performance for credit remains attractive from an investor perspective given the healthy all-in yields. High yield valuations look rich, but aggregate fundamentals remain healthy with a tolerable default rate.

2. US High Yield.
The US high yield market is also worth considering due to significant improvements in credit quality and favourable economic conditions. The high yield bond landscape has seen a shift towards more resilient BB- and B-rated issuers and stable default risks. Additionally, the Fed rate cuts anticipated by the markets, although they have been pushed back to later in the year, are expected to boost bond prices considering the elevated yields in the US high yield market.

Looking ahead, we expect the fixed income markets to continue to navigate this complex landscape with a focus on inflation dynamics, central bank policies and corporate earnings. Our perspectives remain cautiously optimistic as we move into the second half of 2024.

Thank you for watching and we will keep you updated with the developments to come in fixed income.

Source: AXA IM as of June 2024