Newsletter

High yield

August 2024

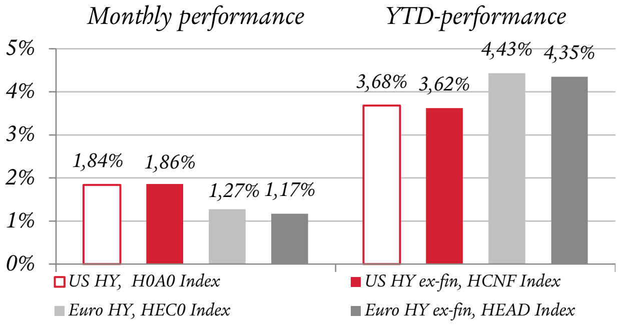
High-yield markets on both sides of the Atlantic ended July with a positive performance (+1.27% for HY Euro and +1.84% for HY US). The situation is the same as in June: risk premiums widened slightly, offset by a significant fall in sovereign yields and in particular short-term yields as the yield curve steepened. Initial conclusions from the results season saw a downward revisions of financial targets. Issuers operating in cyclical sectors have been particularly affected.

Highlights of the month

Performance

Despite a slight rise in risk premiums (+8 bps in EUR, +7 bps in the US), the EUR (+1.27%) and US (+1.84%) high-yield markets continued to perform well. The latter are benefiting more from the fall in interest rates (-46bps on US 5Y, -25bps on German 5Y) fuelled by inflation figures that are at their lowest level since the start of 2021 and a slowdown in macroeconomic data, which increases the likelihood of a rate cut by the Fed in September.

PERFORMANCE OF THE HIGH-YIELD MARKETS

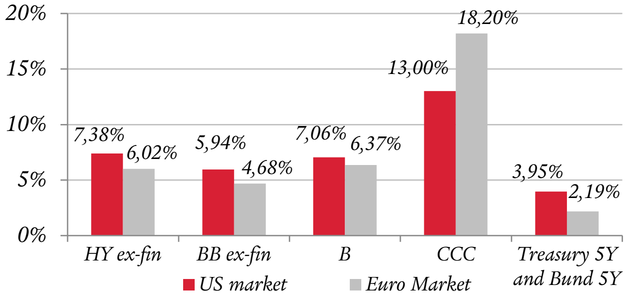


Source: Swiss Life Asset Managers – 31.07.2024

Rating segments

In Europe, the BB segment (+1.28%), which is more sensitive to interest rates, outperformed the B (+1.17%) and especially CCC (+0.82%) segments, which are still disadvantaged by certain idiosyncratic situations. By contrast, in the US market the CCC segment (+3.87%) clearly outperformed the B (+1.66%) and BB (+1.47%) segments thanks to the rebound in the telecoms sector, which is over-represented within the CCC segment (around 40%) and the surge in small & mid-cap stocks in the US equity market (Russell 2000 at +10.1%).

YIELD TO WORST*



Source: Swiss Life Asset Managers – 31.07.2024

Note: Source: Swiss Life Asset Managers France, Bloomberg. This presentation contains historic market data. Historical market trends are not a reliable indicator of future market behaviour. This data is provided solely by way of illustration. Depending on the publication date, the information presented may differ from the latest data. Performance in foreign currencies is hedged in euros.

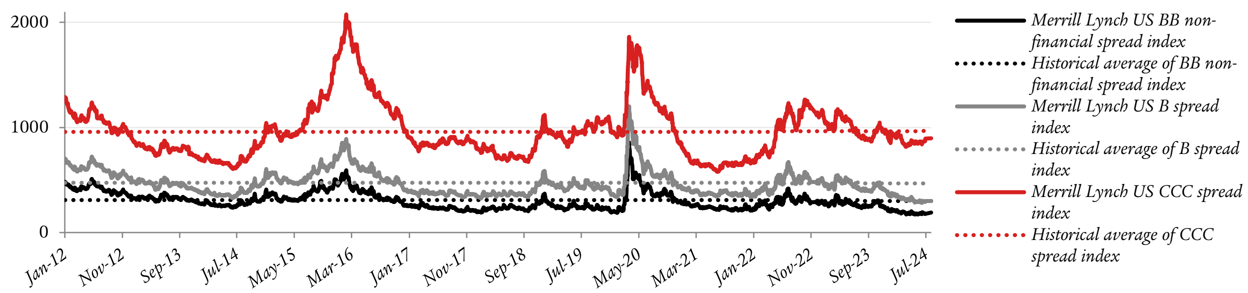
Sectors

In the US, the sectors in greatest difficulty since the start of the year have outperformed (telecoms +4.52%, cable and satellite TV +4.21%), while chemicals (+1.13%) and retail (+1.14%) underperformed. In Europe, the technology sector once again retained its laggard status (-0.59%), being the only one to underperform. Finance (+1.69%) and telecommunications (+1.51%) outperformed, while the primary industry (+0.83%) and consumer cyclical (+0.85%) sectors disappointed in the same way as in the US.

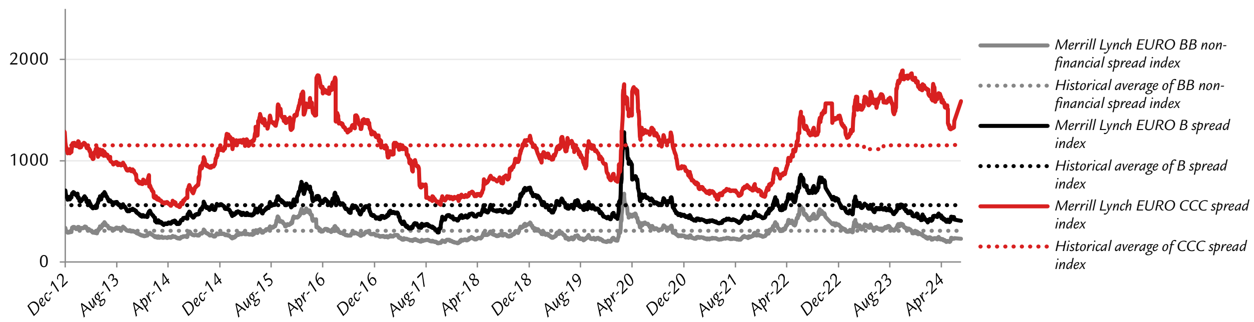
Primary market

As the summer period approached, US primary markets continued to slow to USD 11.3 billion (compared to USD 13.4 billion in the previous month), marked by a sharp deterioration in issuance quality with a high volume of CCC issues (21% of total) and, in terms of sectors, an over-representation of the energy sector (46%). By contrast, in Europe the primary market accelerated with an issuance volume of EUR 7.8 billion (vs. EUR 4.6 billion) but, as in the US, this was in the riskiest rating segment (57% B), even including the resurgence of CCC issues for EUR 350 million (Sani Ikos 7.25% 2030).

DEVELOPMENT OF SPREADS IN THE UNITED STATES



DEVELOPMENT OF SPREADS IN EUROPE



Default rate and changes in the pool

In the US, 99 Cents Only Stores – a low-cost retailer – defaulted on its USD 350 million bond, as did the cinema chain AMC (USD 3 billion) following a distress debt swap and the withdrawal of collateral for existing creditors. In Europe, there were several significant credit events, with the defaults of Atos (EUR 2.5 billion) following the initiation of a safeguarding procedure, Nordic real estate company SBB (EUR 4 billion) and Ukrainian energy group DTEK (EUR 325 million) following the distress debt swaps. In the US, the airline Delta Airlines (USD 1.7 billion) has been upgraded to the investment-grade category by Fitch and can therefore be included in investment-grade indices. There were no notable changes as regards rising stars or fallen angels in Europe.

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Our strategy

"Risk premiums remain tight"

Edouard Faure
Head Credit Management

1. High-yield strategy

The most noteworthy event in July was the significant fall in government yields. Indeed, inflation figures, at their lowest level since 2021, together with slowing economic activity, provide an ideal backdrop for central banks to make rate cuts. After the first rate cut by the ECB in June, the market now expects another cut in September and one more by the end of the year. In the US, Jerome Powell hinted in his speech that there was a strong likelihood of a cut in September. A further cut is also expected by the end of the year.

This sharp fall in government yields was accompanied by a steepening of the yield curve, although it was still inverted. Short-term interest rates have therefore fallen more sharply than long-term rates. Specifically, in the US the two-year market fell by 50 bps, the five-year market by 46 bps, the 10-year market by 38 bps and the 30-year market by 25 bps. In Europe, the German two-year market fell by 30 bps, the 5-year market by 25 bps, the 10-year market by 20 bps and the 30-year market by 18 bps.

These interest rate cuts helped to contain the slight widening of risk premiums in the high-yield market, which ended the month with a largely positive performance. As the high-yield market is a short-duration market (2.82 years for HY Euro and 3.17 years for HY US), it reacts particularly when there is a notable decline in short-term interest rates.
The slight widening of risk premiums can be explained by historically high valuations, which leaves little room for further tightening. Moreover, the start of the results season does not seem to be living up to expectations.
We are seeing a significant number of downward revisions to earnings expectations, especially in cyclical sectors and especially in the automotive sector (see point 2). Consumer-related sectors (including the retail market) also appear to be affected. The economic slowdown seen in macroeconomic data is thus starting to be reflected in corporate earnings.

We still believe that risk premiums are tight and do not want to add any more risk to these levels. We therefore remained cautious on the primary market, consisting mainly of B and CCC issues in July. For our fixed-term funds, we continue to invest subscriptions by taking advantage of opportunities on the secondary market and on some primary issues.

2. *The automotive sector is facing the challenge of transitioning to electric power*

The automotive sector is facing a series of challenges: sourcing problems, persistent wage inflation and slowing demand, especially for electric vehicles amid trade tensions between China and the West. This industry is a good barometer of consumer strength. It is often the first sector to show signs of fragility in an economic downturn. Ultimately, it is a major weighting in the ex-fin high-yield euro pool (12%), while it accounts for relatively little of the US high-yield market (2.6%), following Ford's upgrade to the investment-grade category.

While we saw relative resilience amongst market participants in the first quarter, second quarter figures reflect a number of difficulties that have led to a series of profit warnings, in particular a downward revision of annual revenues (of the order of -5%) and, in some cases, their margin levels. This was driven by a decline in global demand for electric vehicles (EVs), especially in Europe and the US. As a result, Tesla reported revenues that were down 3% over the first half of 2024. In addition, estimated earnings for the period 2024 to 2026 have been revised downwards between 20 and 25% in just one year. In gauging the extent of these difficulties, it should be noted that the latest projections for selected car manufacturers that they will dramatically scale back their EV production programs: -50% by 2025 compared to projections at the end of December 2023, -35% by 2026 and -30% to -35% between 2027 to 2030. In addition, Stellantis has clearly underperformed; it posted a 14% decline in sales over H1 2024, while its competitors averaged +1.0% (with a range of -4.2% to +13.2%). In terms of sub-contractors, German company ZF, one of the world leaders with EUR
46.7 billion in revenues in 2023, announced that it would reduce its targets by 5% for 2024, while maintaining its margin target with a EUR 6 billion cost-cutting programme for 2024–2025.
More recently, it announced a plan to reduce its workforce in Germany by around 25% (by between 11 000 and 14 000 jobs) by 2028. As a result, manufacturers are the most affected and are announcing additional cost-cutting measures in order to maintain their margins. We expect them to continue with their efforts due to the difficulties faced by car manufacturers whose margins are under pressure (-200 bps over H1 2024 compared to 2023). S&P has lowered its outlook on the rating of Forvia (formerly Faurecia); further action could also be taken by other rating agencies in this uncertain environment.

In terms of performance, European automotive equities put in a very strong performance (+15.4% at the end of March 2024), outperforming the Euro Stoxx 600 index by +750 bps. Over the same period, euro high-yield bonds in the automotive sector posted a performance of +1.01%, underperforming the high-yield corporate index by 62 bps. The underperformance of the automotive sector was even more pronounced at the end of July at -166 bps, or a performance of +2.67% since the start of the year for high-yield issuers compared to +4.33% for the high-yield corporate index.
It should be remembered that the quality of the sector is better than that of the index, with an average rating of BB in Europe and premiums of 235 bps vs. 365 bps. In terms of equities, the underperformance was even more pronounced, at only +0.72% at the end of July compared to +11.09% for the Euro Stoxx 600.

Given the uncertainties in the automotive sector, particularly in Europe, we remain cautious and will pay attention to any widening that could provide an entry point.

About Swiss Life Asset Managers

Swiss Life Asset Managers has more than 165 years' experience managing the Swiss Life Group's assets. This close link with insurance underpins its investment philosophy, the main objectives of which are to take a responsible approach to risks and to act each day in its clients' best interests. Swiss Life Asset Managers also offers this proven approach to third-party clients in Switzerland, France, Germany, Luxembourg, the UK and the Nordics.

As at 31 December 2023, Swiss Life Asset Managers managed EUR 275.4 billion in assets for the Swiss Life Group, with more than EUR 120.4 billion in assets under management on behalf of third-party clients. Swiss Life Asset Managers is a leading real estate manager in Europe[1]. Of the EUR 275.4 billion in assets under management, EUR 91.9 billion are invested in real estate. In addition, Swiss Life Asset Managers manages EUR 22.9 billion of real estate assets jointly with Livit. Thus, as at 31 December 2023, Swiss Life Asset Managers managed EUR 114.9 billion in real estate assets.
The clients of Swiss Life Asset Managers benefit from the commitment and expertise of more than 2200 employees in Europe.

A self-determined life
Swiss Life enables people to lead a self-determined life and look to the future with confidence.
This is also the goal of Swiss Life Asset Managers: we think long-term and act responsibly. With our expertise and experience, we develop future-oriented savings and investment solutions. We support our clients in achieving their long-term investment goals so that they, in turn, can take into account the needs of their own clients and build a self-determined financial future.

1 INREV Fund Manager Survey 2021 (based on AuM as at 31 December 2021).

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Do not hesitate to contact us if you have further questions:
In France : service.clients-securities@swisslife-am.com,
tel.: +33 (0)1 40 15 22 53
In Switzerland: info@swisslife-am.com

Swiss Life Asset Managers France
Portfolio Management Company
GP-07000055 of 13.11.2007
Public limited company with an Executive Board and Supervisory Board with capital of EUR 671.167
Registered office: Tour la Marseillaise, 2 bis, boulevard Euroméditerranée, Quai d'Arenc 13002 Marseilles
Main office: 153, rue Saint-Honoré , 75001 Paris