

# Newsletter

## High Yield

May 2024

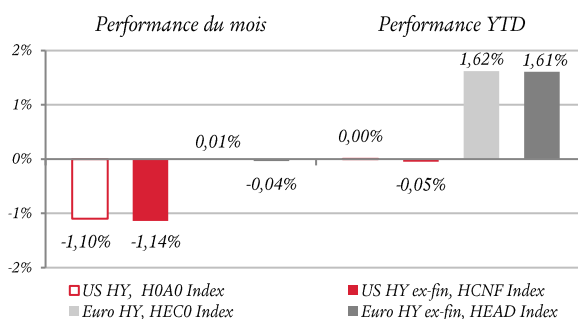
Against a backdrop of rising geopolitical tensions and persistently high US inflation, risk aversion was more pronounced in equities (-4.1% for the S&P 500). On the other hand, the high-yield markets held up better, especially in Europe, where performance was flat and premium yields stable. In the US, despite declining by 0.96% (in local currency), these markets are seeing their risk premiums increase by 6 bps, although they remain at historically low levels. However, the technical factors for high-yield are reversing: increased primary issues and outflows from high-yield funds. Finally, government yields rose sharply with +50 bps on US treasuries and +30 bps on the Bund.

## Highlights of the month

### Performance

The high-yield markets ended the month of April out of step, with a clear underperformance by the high-yield US market against a backdrop of persistent inflation at -1.1% (in EUR) versus 0% for high-yield EUR bonds. This difference is explained by the sharp rise in US 10Y rates to +48 bps versus +29 bps for the Bund. The US high-yield risk premiums widened by 6 bps while they are virtually stable in Europe at -2 bps.

### PERFORMANCE OF THE HIGH-YIELD MARKETS



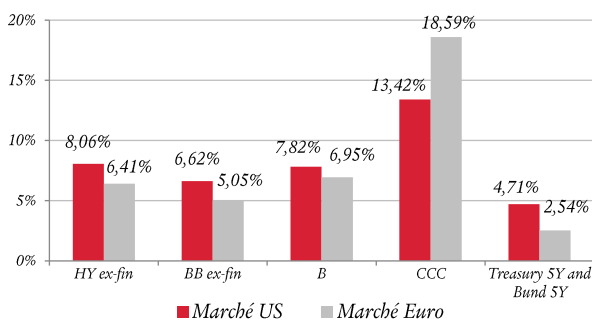
Source: Swiss Life Asset Managers – 30.04.2024

### Rating Segments

In Europe, the BB segment largely outperformed the other rating categories at +0.17% versus -0.39% for the B Euro and -0.38% for the CCC Euro, despite an uptrend over the period.

As regards high-yield US, all categories are in negative territory with BB US at -1.07% (in EUR), B US at -0.95% (in EUR) and CCC US at -1.69% (in EUR).

### YIELD TO WORST\*



Source: Swiss Life Asset Managers – 30.04.2024

**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

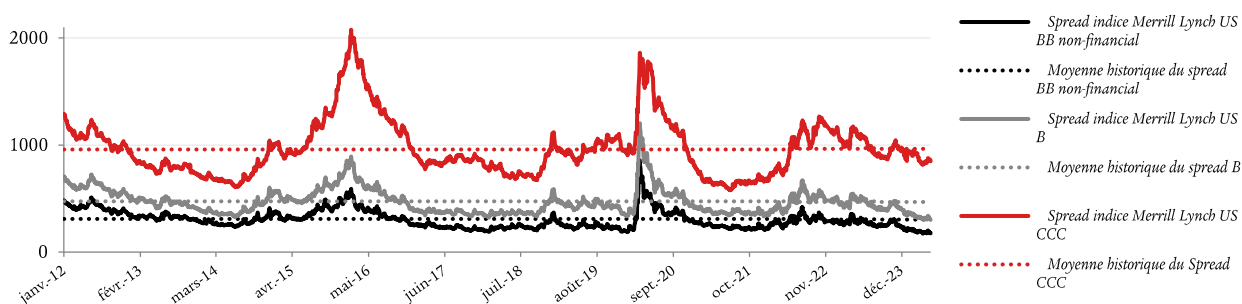
In April, the energy (+1.17%) and technology (+1.03%) sectors outperformed in Europe while in the US, healthcare (-0.14%) and transportation (-0.07%) sectors outperformed.

In Europe, disappointments are concentrated in telecoms (-3.16% on the HY US; -0.88% on the HY EUR), media (-3.04% HY US; -0.51% EUR) and leisure (-1.06%), and retail in the US (-1.25%).

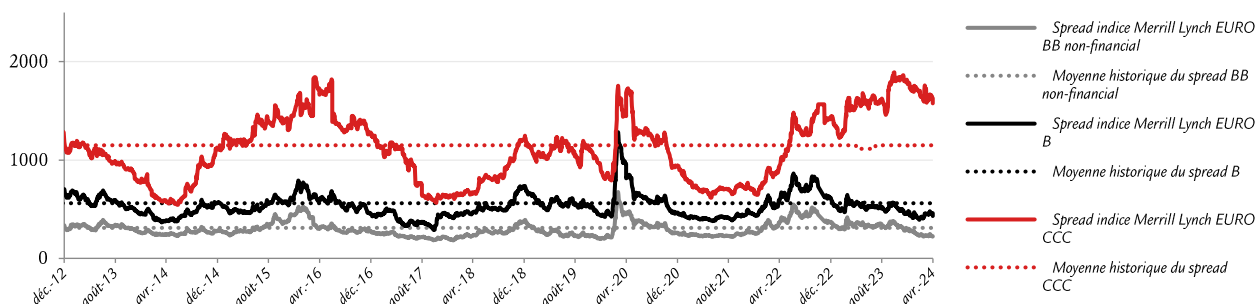
## Primary market

With 17 issues amounting to EUR 9.3 billion, including EUR 1.6 billion in hybrids, the primary EUR high-yield segment is continuing the acceleration observed in March. It focuses mainly on BB issues (76%) with some idiosyncratic portfolios such as Auchan and Eutelsat. On the US high-yield market, the number of issues rose to 36 (from 27) for a total of USD 27.6 billion (from USD 19.2 billion), marked by opportunistic refinancing with a B and CCC rating for 44% of the total, including in particular the primary Bombardier and Transocean bonds.

### DEVELOPMENT OF SPREADS IN THE UNITED STATES



### DEVELOPMENT OF SPREADS IN EUROPE



## Default rate and changes in the pool

In the United States, there was only one default: the hard discount retailer “99 Cents Only Stores” for USD 350 m. The only new fallen angel in Europe was French water supply company Saur, downgraded to the high-yield category for a volume of EUR 1.25 billion. No fallen angels were reported this month in the US. The most emblematic of the rising stars is the British manufacturer of aircraft engines Rolls Royce, which has regained its investment-grade status that it lost during the pandemic for an amount of USD 2.0 billion and EUR 1.3 billion. We also note the rise in hybrid bonds issued by British American Tobacco for EUR 2.0 billion. Finally, on the HY US market, the American electricity producer and secondary distributor, First Energy, was upgraded with a volume of USD 4.8 billion.

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## Our strategy

*“The uptrend in volatility has been short-lived”*

**Édouard Faure**  
Head Credit Management

### *1. High-yield strategy*

The market experienced renewed volatility during the month of April. There are several reasons for this move: first, higher-than-expected inflation figures in the US coupled with strong employment figures have led investors to fear that the Fed would postpone rate cuts, while lower-than-expected GDP growth could be a sign of “stagflation”. Second, the resurgence of geopolitical tensions in the Middle East had an impact on risky assets. Finally, the technical factors for the high-yield asset class were less buoyant than in previous months.

Fears of a postponement of rate cuts by the Fed and the growing risks of “stagflation” had a direct impact on government yields: the German and US 5-year yields rose by around +30 bps and +50 bps respectively. Market participants now expect one or two rate cuts on the US side for 2024 compared to six at the end of last year. Hence, inflation staying above 3% supported by strong economic figures could rekindle the risk of an additional rate hike by the Fed, negatively impacting risk premiums.

Risk premiums remained broadly stable in April despite the increase in volatility. The negative high-yield performance is thus almost exclusively due to the interest rate effect. While the re-emergence of the Middle East conflict had a negative impact on risk premiums at the beginning of the month, they quickly returned to their end-March level, despite the outflows from HY funds and the significant increase in primary market volume.

Dispersion was still strong in April, as evidenced by the performance of the CCC indices. While large issuers have restructured or are in discussions with a view to restructuring (Altice France, Atos, Ardagh, Dish, Lumen...) some small companies appear to be at risk, in particular, those with a high level of indebtedness, operating performance under pressure and short maturities to be refinanced. Against a backdrop of higher-than-expected interest rates, refinancing now seems complicated, increasing the risk of default.

We took advantage of the significant move in sovereign rates to increase the duration of the portfolios by improving their credit quality. We believe that risk premiums are tight and that, even if the risk of further rate cut deferrals is still present, investing in high-quality issuers in sectors that are less cyclical (and thus more sensitive to interest rate movements) will help investors to benefit from future market movements. We took part in some new issues while being very strict about the returns offered. Indeed, we are seeing a significant decrease in issue premiums. We do not hesitate to pass if we consider them too weak.

### *2. Are defaults in Europe (finally) higher than those in the US?*

Historically, US high-yield default rates have been higher than EUR high-yield rates, with a median of 1.8% since 2005 in the US versus 1% in Europe. However, for the current year, the default rates for high-yield EUR stood at 2.3% versus 1.6%

in the US, a situation not seen since 2007. However, this point needs to be qualified as the high-yield EUR market is relatively new (the size of the pool prior to 2004 was limited to only EUR 50 billion compared to more than EUR 300 billion today) compared to its US counterpart. On the other hand, during periods of sharp rises in default rates, the US high-yield market systematically peaked higher than the euro high yield:

- during the global financial crisis of 2008–2009 with 18% on the HY US versus 16% for financials included on the HY EUR and 9% excluding financials;
- during the 2015–2016 energy crisis with 4.8% on the HY US versus 3.0% on the HY EUR; and
- during the 2020 Covid pandemic with 6.0% on HY US versus 3.0% on HY EUR.

While HY US defaults have thus historically been higher, the origin of this spread often cited as an example stems from the quality of the pool. However, this has evolved on both sides of the Atlantic: the share of BBs has fallen significantly in the HY EUR (from 61% on average to 56%), while it has risen slightly in the HY US (from 44% to 45%). At the same time, the share of CCCs increased in the HY EUR (from 8% to 10%) while it decreased in the HY US (from 17% to 15%).

Another explanation to bear in mind relates to the trends in defaults within the “B” segment, the heart of high yield, where there is a decoupling between the HY EUR, which currently stands at 4%, versus only 1.5% for HY US. In our view, this is due to a maturity wall to be refinanced sooner in Europe (compared to the US) and a more supportive macroeconomic trend in the US than in Europe.

Finally, the differences in sectoral composition make it possible to understand the divergence in default trends currently observed between Europe and the United States. Indeed, it stems from the greater weight of the financial sector in the European indices, with in particular the real estate sector falling into this category, which has recorded the most credit events over the past 12 months.

Default rates in Europe are now higher if we consider the amount of debt issued rather than the number of issuers. Issuers that defaulted in the current cycle include large issuers previously rated in the investment-grade category (Casino, Adler Real Estate, SBBB Real Estate) and which benefited from the low/negative interest rate phase to take on heavy debt. In the current environment, such issuers have become unsustainable with higher interest rates and weakened activity.

# 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<sup>1</sup>. 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.

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

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\* Yield to worst is the lowest yield that a bond will be able to offer to its holder, excluding default.

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