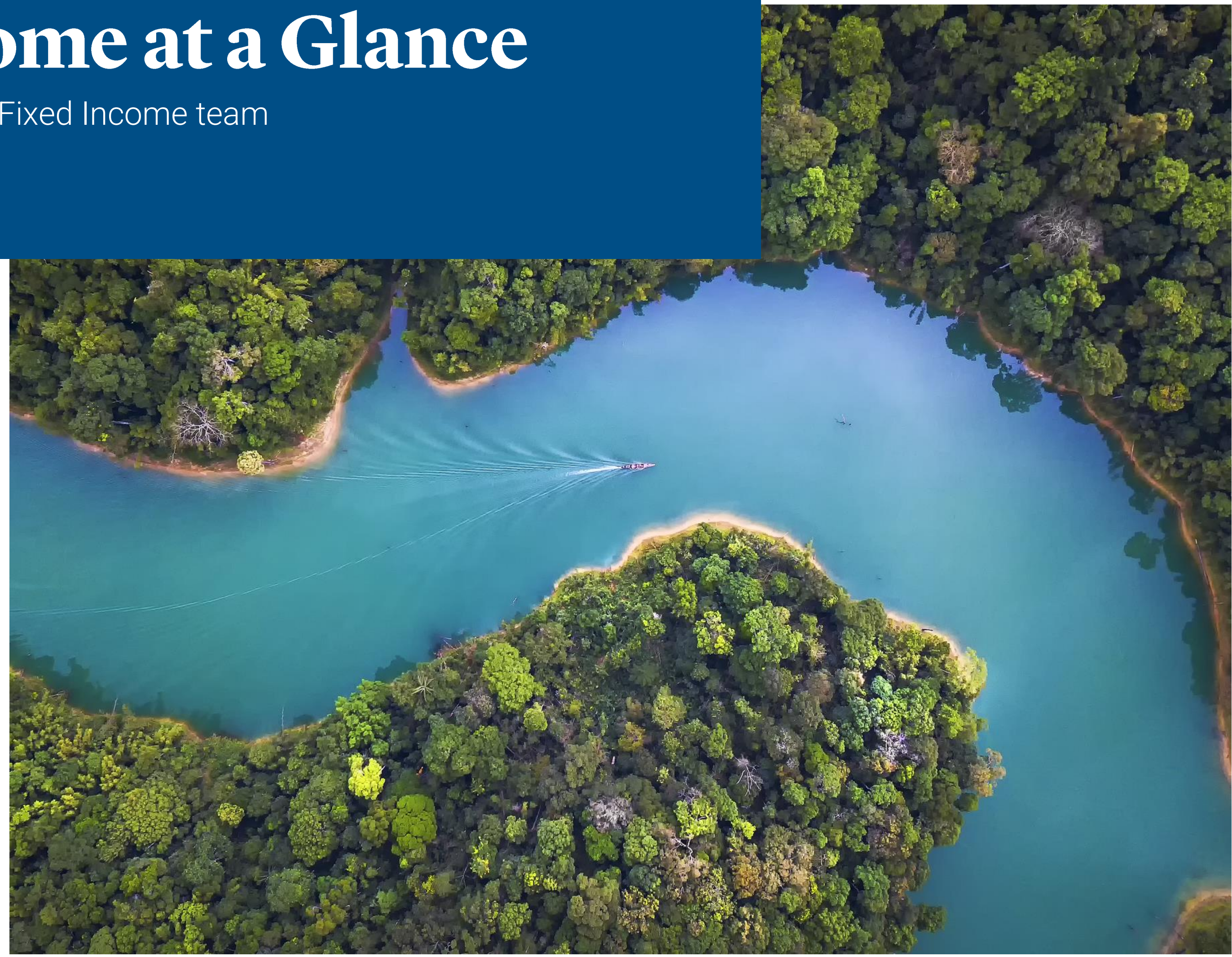
Active Fixed Income at a Glance

The latest monthly views from the Active Fixed Income team

July 2024



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In summary

Outlook

Looking ahead, recent weaker US economic data (in the form of manufacturing and retail sales) have upheld the prospect of a soft landing and the **possibility of a near-term interest rate cut** by the US Federal Reserve, possibly in September 2024. In isolation, this should continue to **support asset valuations**. While we believe that much good news is already priced in, the absence of a near-term catalyst that could disrupt the soft-landing narrative leads us to maintain a neutral stance over the short to medium term for pan-European, global and US credit strategies. Our teams have positioned the strategies for a **cautious harvest in carry** through the summer, with **no changes to our credit appetite scores for June**.

Changes in scores

Our scores express the team's expectations for excess (credit) returns over a one- to three-month horizon. The scores range from -3 to +3.

Upgraded

Downgraded

Unchanged:

- Emerging market debt (+1)
- Global high yield (GHY) (+2)
- EU credit (0)
- UK credit (0)
- US credit (0)
- Global credit (0)

Source: LGIM as at 30 June 2024 - can be subject to change at any point.
Definitions of scores can be found in the appendix.

The value of an investment and any income taken from it is not guaranteed and can go down as well as up. You may not get back the amount you originally invested. Assumptions, opinions and estimates are provided for illustrative purposes only. There is no guarantee that any forecasts made will come to pass.

The LGIM credit scorecard

▲ Upgraded ▼ Downgraded ▬ Unchanged

Strategy	Score (This month / Last month)	Investment view	Strategy positioning
Global credit	-3 -2 -1 **N** +1 +2 +3 (This month: N; Last month: N)	• A softer CPI print and US consumer data have removed the largest risk to global credit • Still tail-risk concern on US election outcome • Downgraded supply/demand backdrop	• Tactical increases in hedging around French elections • Maintain marginal long-credit beta ahead of summer
US credit	-3 -2 -1 **N** +1 +2 +3 (This month: N; Last month: N)	• Volatility returned to investment grade credit over the last month, as spreads backed up to levels last seen at the beginning of the second quarter • We are neutral on US credit, but note that demand has softened from its recent peak as yield-focused buyers have moved to the sidelines	• To turn more constructive on credit we would need to see a larger back-up in spreads, given elevated uncertainty on the macro and geopolitical fronts
UK credit	-3 -2 -1 **N** +1 +2 +3 (This month: N; Last month: N)	• Relative cheapness of sterling bonds versus euro on a cross-currency basis on UK election risk and some sector vulnerabilities • Balancing historically attractive sterling yields c. 5.60% versus rich spreads	• Positioning focused on our overweight in securitised assets, and neutral exposure in financials (favouring senior bonds) • Maintained a 4-6% allocation in euro-denominated issues
EU credit	-3 -2 -1 **N** +1 +2 +3 (This month: N; Last month: N)	• The June spread widening wasn't deemed sufficient to turn more positive on our credit score as the European Central Bank delivered a 'hawkish cut.' Hence, we remain neutral and did not use the recent widening of spreads as a buying opportunity	• Positioned underweight France (and Italy) prior to snap election news and have remained so • Continuing our neutral positioning at portfolio level, with a somewhat higher beta 1.1x versus 4% cash/bunds and a more defensive sector positioning ahead of a potential summer grind
EMD	-3 -2 -1 N **+1** +2 +3 (This month: +1; Last month: +1)	• Supportive macro, ratings and technicals imply good prospects for carry over the summer • Thereafter, the focus shifts towards US elections. The risk is that any rally in rates is short-lived given the likelihood that both presidential policies are likely to be inflationary	• Modestly increased beta via carry trades in BB and B names • Added some tactical trades for short term, where we saw opportunities to generate alpha
GHY	-3 -2 -1 N +1 **+2** +3 (This month: +2; Last month: +2)	• We believe yields continue to provide an attractive entry point and prices low versus history, thus supporting demand • Corporate fundamentals are strong and economy stable, in our view	• Underweight US and neutral on Europe. Retained overweight to emerging markets (mainly via exposure in Asia) • The strategy continues to have a higher spread than the benchmark and is positioned to benefit from higher income bonds

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Market commentary: June 2024

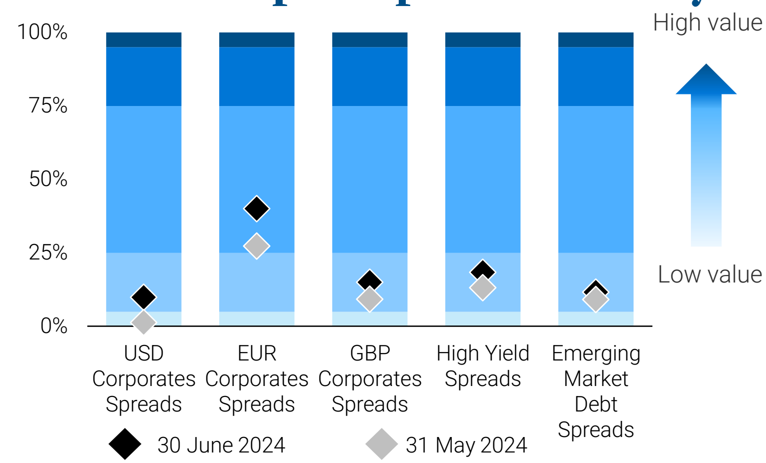
Over the course of the month, US 10-year Treasury yields fell by 12 basis points (bps) to just under 4.4%. This was on the back of weaker US economic data, with unemployment rising and industrial production and retail sales below expectations. The US Federal Reserve (Fed) kept interest rates unchanged as expected. However, earlier on the same day US CPI data was lower-than-expected and may not have been fully factored into the Fed's decision.

In Europe, the European Central Bank made its first interest rate cut of the cycle, reducing the base rate by 25bps. However, the more impactful news for markets was the initial success of right-wing parties in the European parliamentary elections and the subsequent decision by President Macron to call a snap parliamentary election in France. This led to a risk-off reaction, with German government bond yields falling, while the spread between French and German 10-year bond yields widened by over 30bps during June. The electoral uncertainty also impacted French corporate bond markets and equities. Credit markets were generally weaker over the month, weighed down by heavy issuance in 2024, tight starting valuations and more specific widening of French names.

Key market moves

				June 2024 (%)			YTD 2024 (%)		
	Duration (yrs)	Spread (bps)	Yield (%)	Spread change	Total return	Credit return	Spread change	Total return	Credit return
Investment Grade									
U.S. Corporates	7.1	94	5.5	10.9	0.6	-0.6	-4.9	-0.5	0.8
Euro-Aggregate Corporates	4.6	120	3.8	10.8	0.7	-0.4	-13.2	0.5	1.6
Sterling Corporates	6.3	123	5.6	7.1	0.7	-0.4	-11.5	-0.3	1.2
Global Aggregate Corporates	6.2	104	5.0	9.8	0.7	-0.5	-9.6	0.3	1.2
EM USD Aggregate	6.3	262	7.2	3.3	0.6	-0.5	-11.8	2.2	3.1
Global High Yield	4.0	386	8.3	2.8	0.7	-0.2	-8.8	3.9	3.6

Valuations: Spread percentile analysis



Source for key market moves: Bloomberg Barclays index returns are USD hedged for global indices and in local currency for the others as at 30 June 2024.
Source for spread percentile analysis: Bloomberg. Historical ranges based on spread data since 31 December 2006.
For the definition of credit returns and total returns, please refer to the appendix.

Past performance is not a guide to the future. Capital at risk. The value of an investment and any income taken from it is not guaranteed and can go down as well as up; you may not get back the amount you originally invested.

Insights from the Active Fixed Income team

Podcast

Colin Reedie, Head of Active Strategies, outlines his thoughts for the remainder of the year in Fixed income in focus – halfway there

LGIM blog

Marc Rovers, Head of European Credit and Lan Wu, European Credit Portfolio Manager, examine the state of European bank credit

Simon Bell asks what a change of government in France means for OAT spreads

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Source: LGIM as at 30 June 2024 - can be subject to change at any point.

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Appendix – scoring methodology and definitions

At our monthly investment strategy meeting, each credit team provides a risk assessment for their respective credit markets, arriving at a score within a range of **-3 to +3.**

The meeting typically involves discussion around the following topics:

- **Macroeconomic factors** – where we are in the economic cycle, rising/falling inflation
- **Monetary policy** – are central banks loosening or tightening financial conditions?
- **Technicals –** supply/demand dynamics for credit
- **Corporate fundamentals** – assessment of overall health of corporate balance sheets

Teams score independently of each other, although through debate and discussion forums they may influence the way they think about certain topics relative to their own markets.

Scores are expressed as a view of an individual market rather than a view relative to other markets.

Definitions

Total returns: returns inclusive of capital appreciation or depreciation and accrued interest (credit returns + returns from changes in government bond yields)

Credit returns: capital appreciation, or depreciation, driven by the change in the bond's credit spread and returns from accrued interest.

Contact us

For further information about LGIM, please visit lgim.com or contact your usual LGIM representative

Key risks

The value of an investment and any income taken from it is not guaranteed and can go down as well as up, you may not get back the amount you originally invested.

Important information

LGIM Global

Unless otherwise stated, references herein to "LGIM", "we" and "us" are meant to capture the global conglomerate that includes:
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