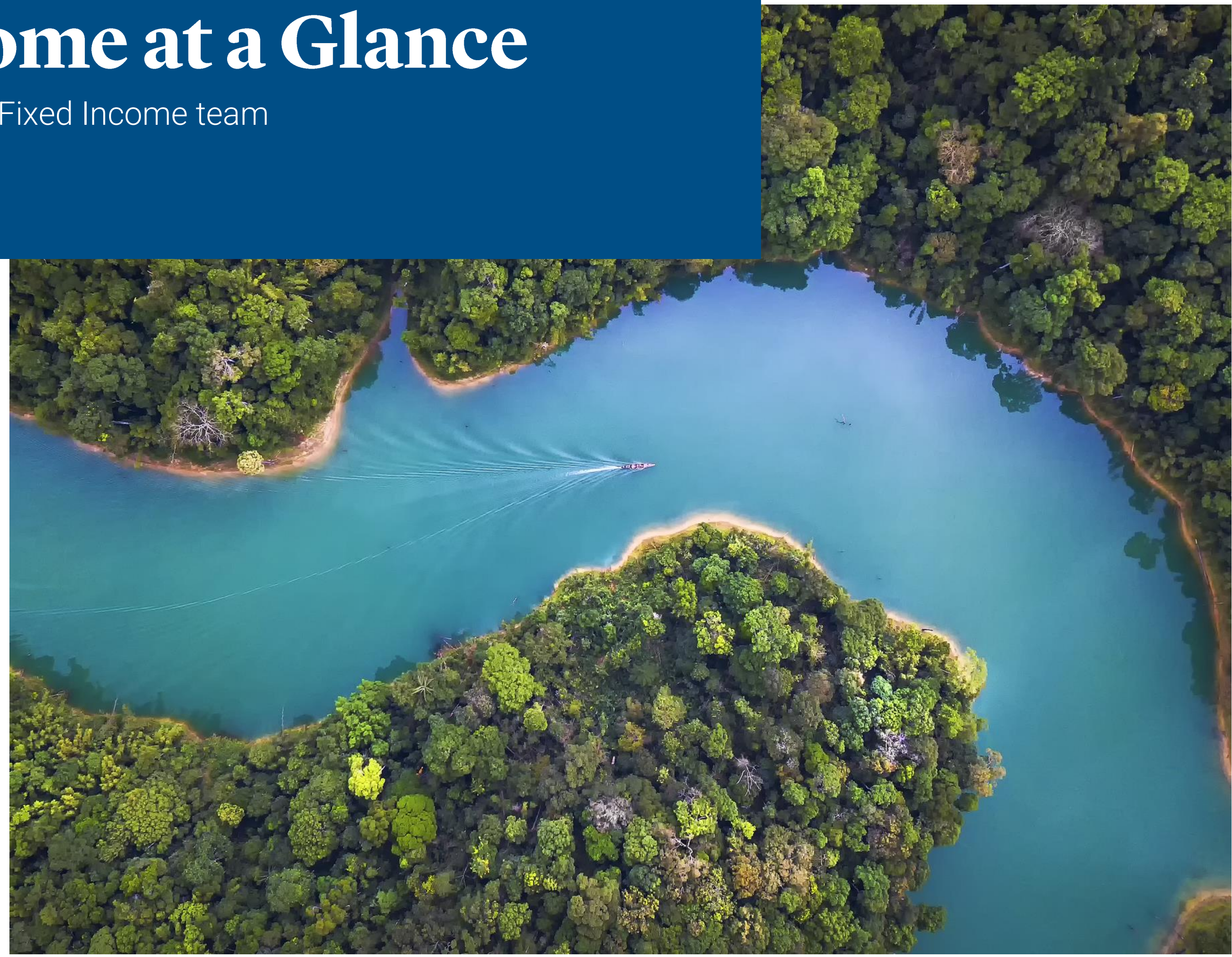
Active Fixed Income at a Glance

The latest monthly views from the Active Fixed Income team

August 2024



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.

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In summary

Outlook

The recent softening in both the labour market and macroeconomic data has cemented the team's belief that central banks have sufficient evidence that growth has peaked and will pursue interest rate cuts. While this has led to a correction in credit spreads in early August, we believe that lower rates will ultimately be positive for credit spreads, unless growth deteriorates faster than expected. With more attractive spreads met with concerns around growth, scores have diverged across teams. The Euro Credit team have downgraded their scores to -1, citing concerns on the macro backdrop. The Global, Sterling and US Credit teams maintained their neutral views, but adopted slightly more cautious stances. Global High Yield and EMD retain their positive scores as they see growth concerns overdone while yields remain in their views attractive.

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:

- EU credit (-1)

Unchanged:

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

Source: LGIM as at 13 August 2024 - can be subject to change at any point.
Definitions of scores can be found in the appendix.
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The LGIM credit scorecard

▲ Upgraded ▼ Downgraded ▬ Unchanged

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Strategy	Score (This month / Last month)	Investment view	Strategy positioning
Global credit	This month: N; Last month: N	• Score remains unchanged, but expression of positioning is slightly more constructive given the more attractive valuations	• Maintain marginal long credit beta ahead of summer • Tail-risk hedges implemented late July as macro data started deteriorating • Long duration cut after the early August moves
US credit	This month: N; Last month: N	• Score unchanged but reduced overweight in credit in the weeks leading up to the payrolls release as we believed valuations failed to reflect growing signs of an economic slowdown.	• Risk reduction has left leeway to take advantage of cheaper valuations, particularly through new issuance with more attractive concessions
UK credit	This month: N; Last month: N	• Marginally more value in sterling credit spreads over recent weeks, however absolute yields are slightly less enticing to yield-based buyers, reducing potential demand. Heightened volatility, especially with some specific names such as Thames Water	• Becoming more cautious – we expect a bumpy road ahead and long-term valuations not fully reflecting this in our opinion
EU credit	This month: -1; Last month: N; ▼ Downgraded	• The macro environment is weak and the market is not pricing in a growth slowdown. • Earnings season showed more sector dispersion and valuations are not attractive for yield buyers. • Carry trade unwound and the rise of credit events and downgrades increase volatility and caution.	• The continued relief rally from the French elections pushed option adjusted spreads to new lows - levels not seen since early 2022. • More cautious from a valuation point of view after summer rally. • Growing conviction on the higher quality theme and the underweight in cyclicals.
EMD	This month: +1; Last month: +1	• While recent sell-off has created value in EMD, volatility remains elevated. All-in yields still remain attractive at over 8% despite recent rally in rates.	• Increase duration overweight modestly to c.0.15 years versus benchmark by adding investment-grade names in Asia and Europe
GHY	This month: +2; Last month: +2	• Although spreads relatively tight, especially in the US, prices remain relatively low and yields attractive.	• The team remains optimistic and aims for higher income than the benchmark. We have reduced exposure to Europe in favour of the US and retain the overweight in emerging markets

Score scale: -3, -2, -1, N, +1, +2, +3

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Market commentary: July 2024

Economic data over July continued to support the notion that inflation will return to target, with another month of lower-than-expected inflation in the US. Meanwhile, American job growth continued, and GDP growth surprised to the upside. In Europe and the UK, economic data remains mixed, with positive signs that inflation is moderating but few indications of a major pick-up in growth.

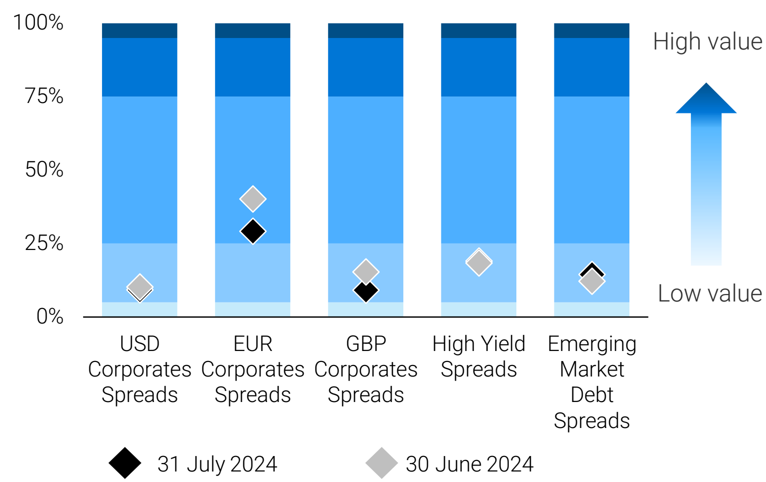
It was a positive month for fixed income assets, with both sovereign bonds and corporate credit performing well. European credit outperformed in particular following the French parliamentary election result.

The moves in government bond markets were more pronounced, with a large fall in short-dated yields as investors factored in more rate cuts. Indeed, the Bank of England was the latest major central bank to start cutting rates in July.

Key market moves

				July 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	7.2	93	5.1	-0.4	2.4	0.1	-5.2	1.9	0.9
Euro-Aggregate Corporates	4.6	110	3.5	-7.6	1.7	0.5	-19.8	2.3	2.1
Sterling Corporates	6.3	114	5.3	-6.9	1.8	0.2	-17.7	1.4	1.4
Global Aggregate Corporates	6.2	101	4.7	-2.6	2.2	0.2	-12.0	2.5	1.4
EM USD Aggregate	6.3	270	6.9	3.2	1.8	-0.3	-9.0	4.1	2.9
Global High Yield	4.0	393	8.0	1.9	1.8	0.2	-7.1	5.7	3.8

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 31 July 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

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Thought leadership

Colin Reedie and team consider whether there is something familiar about the current environment [Q3 2024 Active Fixed Income Outlook: back to the 1970s?]

LGIM blog

As Indian government bonds come of age, we explore what makes India such an outlier among emerging markets

Is net-zero credit an attractive risk management solution for insurers?

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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

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