

Active Fixed Income at a Glance

The latest monthly views from the Active Fixed Income team

June 2024

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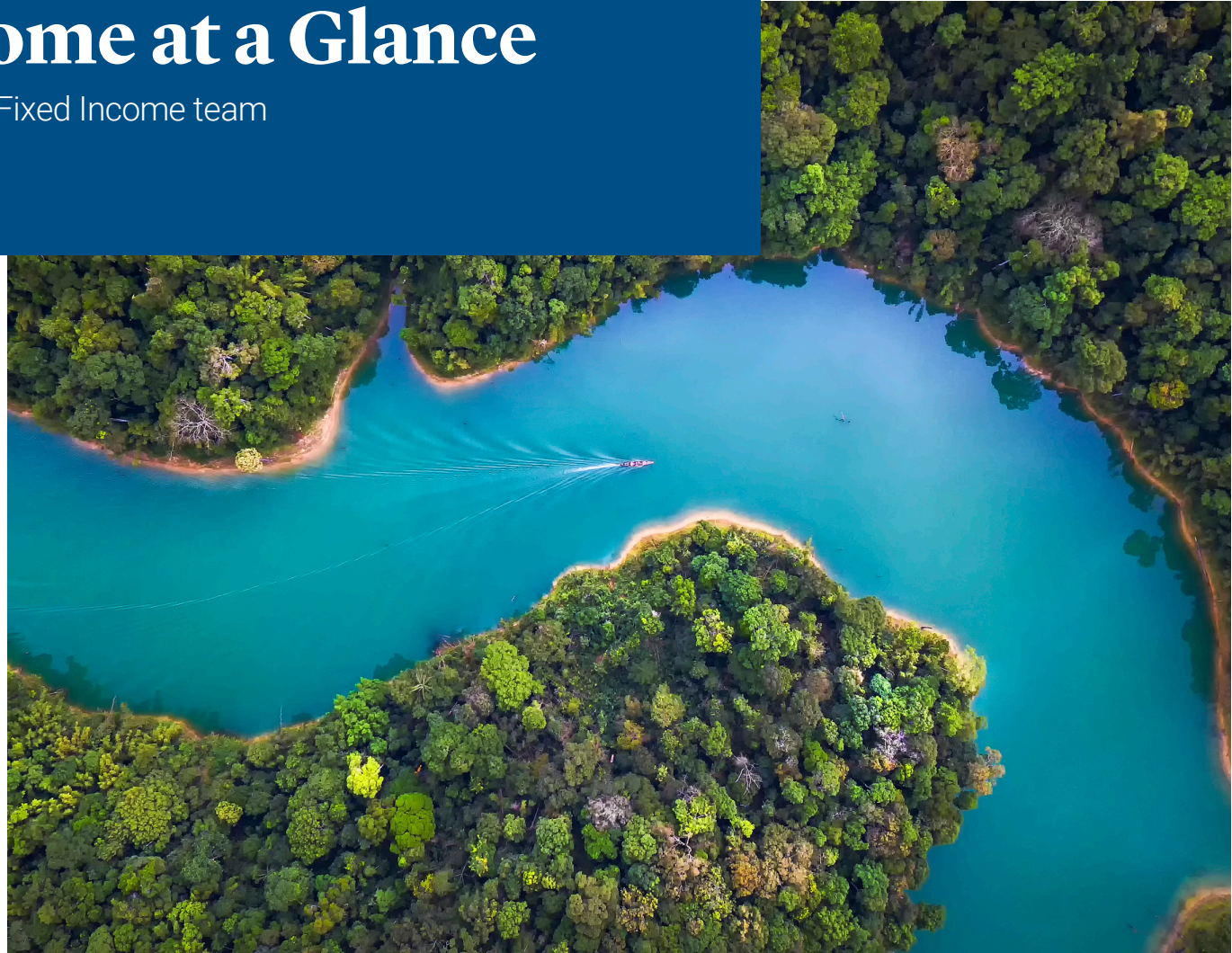
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Outlook

We continue to see an absence of a near-term catalyst that could shake the narrative that inflation is coming down, while growth remains positive. This puts the macro and monetary policy backdrop into goldilocks territory, which is somewhat supportive of credit spreads in the short run, despite tight valuations.

There was an expectation that credit supply would decrease, however this has failed to materialise so far. Seasonal factors, such as a slowing pace of new issuance in the summer, may continue to provide support for credit markets but this feels like a rather weak argument. Most of the teams see risks as balanced and have maintained a neutral short-term score.

Changes in scores

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



Upgraded

- Emerging market debt (EMD) (from 0 to +1)



Downgraded:

- UK credit (from +1 to 0)



Unchanged:

- Global high yield (GHY) (+2)
- EU credit (0)
- US credit (0)
- Global credit (0)

Source: LGIM as at 31 May 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



Strategy	Score	This month	Last month	Investment view	Strategy positioning
Global credit	-3 -2 -1 N +1 +2 +3	■		<ul style="list-style-type: none"> Maintained as neutral in the absence of a near-term catalyst that could derail the soft-landing narrative 	<ul style="list-style-type: none"> Focus on deleveraging issuers whose bonds are trading wide in relation to their expected rating Maintain modest overweight in duration
US credit	-3 -2 -1 N +1 +2 +3	■		<ul style="list-style-type: none"> Goldilocks backdrop remains supportive of range-bound credit spreads despite tight valuations Maintain modestly overweight credit, but look to see a decline in supply which has been expected but has not yet materialised 	<ul style="list-style-type: none"> Some concerns around the sharp fall in ISM manufacturing (which usually precedes a recession). Underlines our cautious, neutral stance, with a preference for high-quality sectors
UK credit	-3 -2 -1 N +1 +2 +3	▼		<ul style="list-style-type: none"> Score downgraded on stretched valuations (sterling corporate spread approaching lowest level in 10 years) While also recognising yield attractiveness and long-end negative swap spreads are favourable for the asset class 	<ul style="list-style-type: none"> Maintained beta at current level with a focus on carry Key activity focusing on rotation. Upping quality (banks), switching BBB into A and selling names with rich valuations Added some Euro new issues particularly at the long end for diversification
EU credit	-3 -2 -1 N +1 +2 +3	■		<ul style="list-style-type: none"> Demand still strong, and supply has followed, especially with the return of 'reverse Yankees' Treading cautiously based on past rally while acknowledging strong technical and positive momentum 	<ul style="list-style-type: none"> Portfolio beta has remained steady at around 1.1x Added what, we believe, are attractive new issues, especially at the long end where credit curves are steep
EMD	-3 -2 -1 N +1 +2 +3	▲		<ul style="list-style-type: none"> Last month saw volatility measures recede sharply. As we move further into the summer, this should remain the case creating a supportive environment for carry, in our view Beyond that, our concerns around the impact of US elections leave us cautious 	<ul style="list-style-type: none"> Modestly overweight duration and beta relatively unchanged over the month Booked profits in select high yield names and rotated into Latin American investment grade credits to increase duration
GHY	-3 -2 -1 N +1 +2 +3	■		<ul style="list-style-type: none"> Yields are still providing an attractive entry point for many, and prices are low versus history, thus supporting demand Corporate fundamentals strong and economy stable, in our view 	<ul style="list-style-type: none"> Retaining our preference for Europe over the US and maintain an overweight to emerging markets (mainly via exposure in Asia) The strategy has a higher spread than the benchmark and positioned to benefit from higher income bonds



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Market commentary: May 2024

The beginning of May saw the **return of a soft-landing narrative for the US economy**, with inflation data coming into line with expectations, the increase in monthly payrolls lower than expected and downward revisions to retail sales data. The US Federal Reserve (Fed) also announced a slower pace of quantitative tightening.

All this led to a **fall in US Treasury yields**, but there was some retracement in the second half of the month following hawkish Fed rhetoric and several weak Treasury auctions.

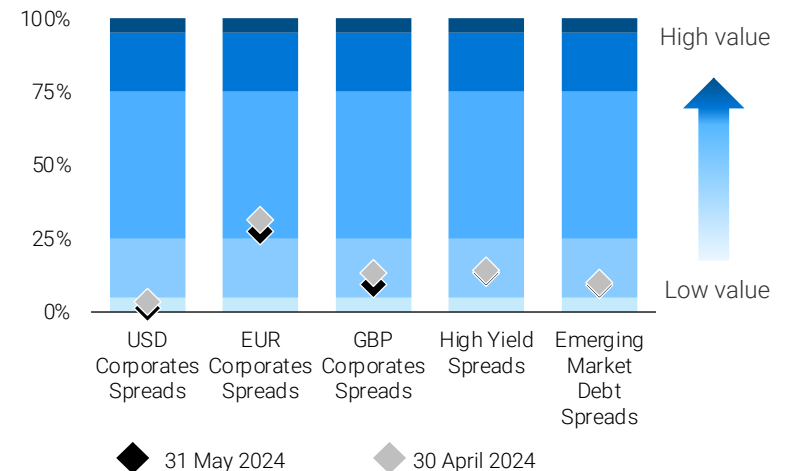
In Europe, economic data was generally stronger than expected, with the European Central Bank initiating its widely anticipated June rate cut.

However, investors reduced their expectations of any future cuts, leading to a modest rise in German bund yields during the month. Amid this backdrop **credit spreads tightened further**, albeit at a slower pace compared to prior months. Credit returns were 0.3% across all major markets, but total returns were dispersed given the diverging path of interest rates across major economies.

Key market moves

	May 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	85	5.5	-3.0	1.9	0.3	-14.2	-1.1	1.4
Euro-Aggregate Corporates	4.6	108	3.9	-3.5	0.3	0.3	-21.7	-0.1	2.0
Sterling Corporates	6.3	114	5.6	-5.3	1.0	0.3	-17.4	-1.0	1.6
Global Aggregate Corporates	6.1	95	5.1	-3.2	1.4	0.3	-17.7	-0.4	1.6
EM USD Aggregate	6.2	253	7.2	-1.3	1.7	0.3	-14.6	1.6	3.5
Global High Yield	4.0	375	8.3	-0.8	1.2	0.3	-11.3	3.2	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 May 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.



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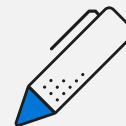
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LGIM blog

Marc Rovers, Head of European Credit and Lan Wu, European Credit Portfolio Manager, discuss the outlook for the European banking sector in their most recent [blog](#)

Alex Mack, Head of Rates and Inflation, examines what effect a Labour government may have on UK [gilts](#)



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Source: LGIM as at 30 May 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.

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Contact us

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



Key risks

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