L'ACTU PRODUIT

FOCUS ON HIGH YIELD

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POINTS TO REMEMBER:

- **What can we expect from the fall in interest rates?**
- **What are the investment opportunities?**
- **Short-term or long-term?**
- **Should we favour credit or debt?**

After the shock that credit suffered in 2022, it has registered two positive years in terms of yield, what can investors expect in the new scenario of falling rates?

Falling rates typically create a **positive environment** for credit markets and are likely to be a key driver of performance going forward. In 2022 and 2023, **spread compression** was the primary contributor to returns, supported by improved fundamentals and **strong inflows** into the asset class. By the end of September, **EUR High Yield** (HY) spreads closed at **342 bps** (below the 10-year average of 404), while **USD HY spreads** closed at **303 bps** (vs 439). (source: Bloomberg) A similar picture was seen in investment grade (IG).

For the rest of 2024 and into 2025, the main performance contributors will shift to **carry and duration**. Current yields of **5.7% for EUR HY** and **5.5% for USD HY** (net of hedging costs) are well above the 10-year average, making them **attractive in the current risk environment**. These yield levels provide a cushion against potential **spread widening**. In a falling rate scenario, bonds with longer duration will see an additional benefit to performance.

Finally, **default rates** in high yield are expected to remain **stable** due to resilient macro conditions and the fact that many companies have already refinanced their near-term debt maturities.

Source: Groupe La Française at 30/09/2024

Where do you see the greatest investment opportunities?

This is a challenging question, as there is no clear-cut "greatest opportunity" at current spread levels. Predicting external shocks is also inherently difficult. That said, **there are always pockets of opportunity**. We believe issuers with business models sensitive to rate cuts and resilience to a slowing macroeconomic environment will perform well. **Non-cyclical sectors** such as utilities, healthcare, telecommunications, and specialized consumer staples are likely to benefit. We are, however, a bit more selective when it comes to cyclical names given the current backdrop.

In recent years, investors have been betting more on short-term credit, do you think it is time to increase the duration of portfolios?

Yes, considering recent **rate cuts** and the **more accommodative policy** stance by central banks, it would be reasonable to increase duration. We find the **belly of the curve** (bonds with maturities in the **3- to 5-year range**) particularly attractive, as they can contribute **positively to performance**. However, we are cautious about moving to the long end of the curve, where we don't see an **adequate yield pick-up** to justify the additional risk.

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What is more interesting at times like the present, betting on credit or public debt?

In our opinion, credit is undoubtedly more attractive due to its **higher carry**, offering **better potential returns** in our base-case scenario of a **soft landing**. Public debt is largely a **duration play**, but in terms of **total and risk-adjusted returns**, credit is likely to outperform. We see limited value in **longer-dated public debt**, which is why we consider that **credit remains the better choice**.

Source: Groupe La Française at 30/09/2024.