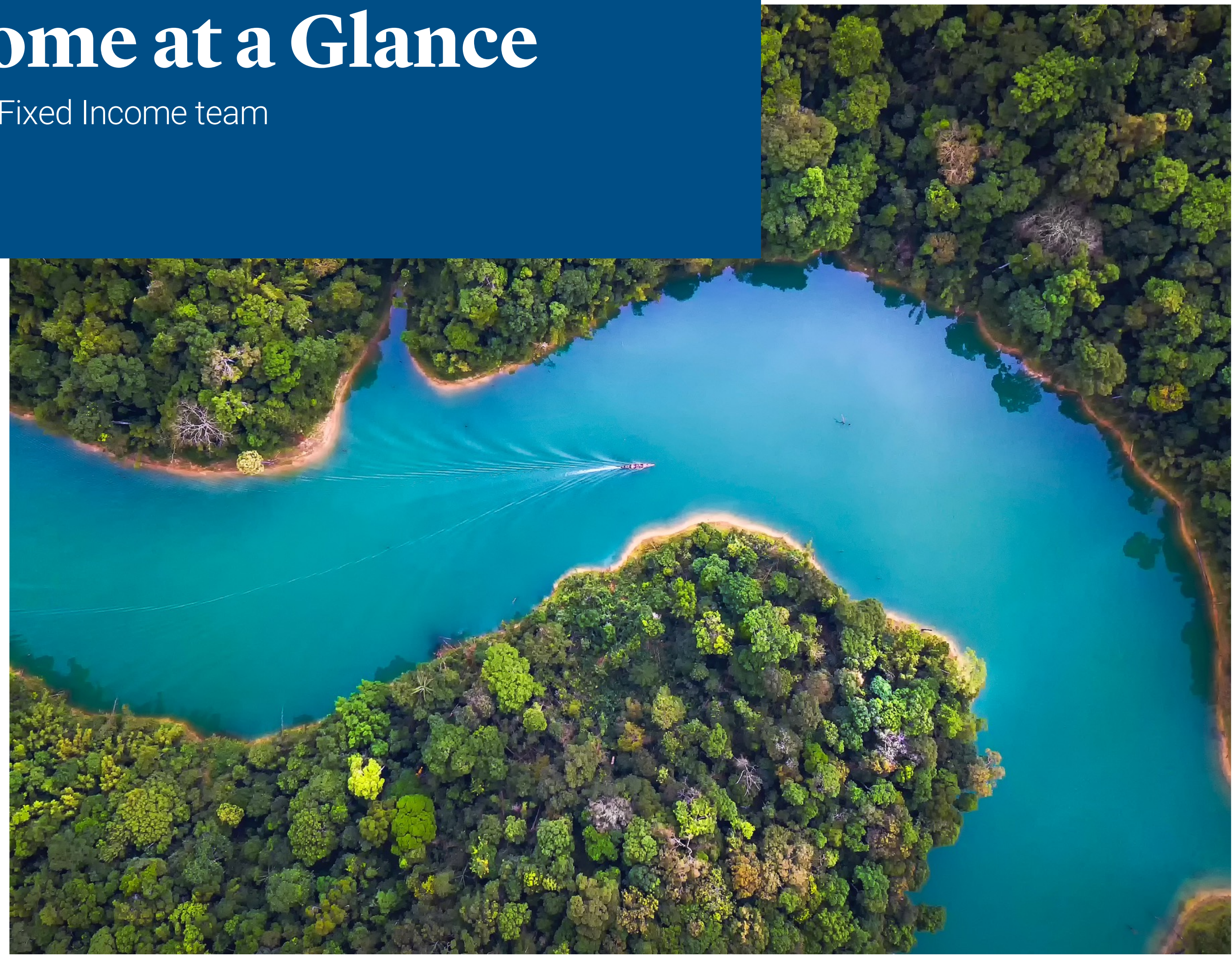
Active Fixed Income at a Glance

The latest monthly views from the Active Fixed Income team

April 2024



LGIM

In summary

Outlook

Our Investment Grade teams have maintained, or moved to, **+1** scores given strong evidence that high credit yields are attracting buyers in spite of continuing tight credit spreads. Given the widespread belief that **credit spreads are stretche**d, there is increased **scrutiny of corporate fundamentals,** while credit quality may have already deteriorated in certain areas of the credit market. We believe that much **good news is already priced into markets,** leading us to be cautious **in the medium term, despite short-term tailwinds.**

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:

- UK credit (from 0 to +1)
- US credit (from 0 to +1)

Downgraded:

Unchanged:

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

Source: LGIM as at 31 March 2024 - can be subject to change at any point.
Definitions of scores can be found in the appendix.

The LGIM credit scorecard

▲ Upgraded ▼ Downgraded ▬ Unchanged

Strategy	Score (This month / Last Month)	Investment view	Strategy positioning
Global credit	This month: +1; Last month: +1 (Unchanged)	• Demand remains yield-driven and strong • Macro conditions currently appear favourable for credit • Increase in long-end corporate issuers show corporate treasurers are amenable to locking-in higher cost of debt for longer	• Maintain US credit underweight/EUR credit overweight • Increased allocation to pharma given M&A activity, which created some valuation opportunities • Took some profits on US and European banks given improved valuations
US credit	This month: +1; Last month: N (Upgraded)	• Valuations remain unattractive from a spread perspective, but attractive all-in yields continue to be a dominant driver of demand • Resilient economic data suggest that the primary risk to a soft landing is not a hard landing, but a reacceleration of growth	• Went tactically overweight credit mid-March, with the view that the increase in supply should begin to moderate, while demand is likely to remain robust • Increased exposure to media, utilities and reduced overweight in pharmaceuticals
UK credit	This month: +1; Last month: N (Upgraded)	• Concerns on stretched valuations and rate volatility outweighed by continuing positive flows • Asset class of choice for UK defined benefit pension funds that continue their journey to buyout, thus supporting demand	• Maintaining an overweight risk exposure, with select profit-taking on issuer outperformance • Rotating out of richly valued, long-dated sterling corporates into attractive euro new issuance
EU credit	This month: N; Last month: N (Unchanged)	• Perfect soft-landing consensus (decent growth / falling inflation) leaves room for negative surprises • Balancing strong demand for credit, driven by attractive all-in yields, with concerns about the number of single name stories	• Increasing holding in preferred names via attractive new issues, especially in non-financials • We remain overweight financials, but with a quality skew and less focus on banks
EMD	This month: +1; Last month: +1 (Unchanged)	• Despite the rates selloff, EM spreads have rallied, led by high yield credits • Further faith in the Fed's ability to engineer a soft landing in US, while delivering rates cuts, has led to strong participation from crossover investors	• We remain cautious on our duration positioning, maintaining flexibility to act in different scenarios • Focus on credit selection within high yield/distressed universe and carry trades
GHY	This month: +2; Last month: +2 (Unchanged)	• Attractive yields and prices support demand for for the asset class • Increased upgrades from rating agencies supportive of our view that defaults will remain low	• Maintaining our underweight to US and overweight to EM and Europe • Targeting a higher income in the strategy versus benchmark, through an allocation to higher spread names across the globe

Source: LGIM as at 31 March 2024 - can be subject to change at any point.

Market commentary: March 2024

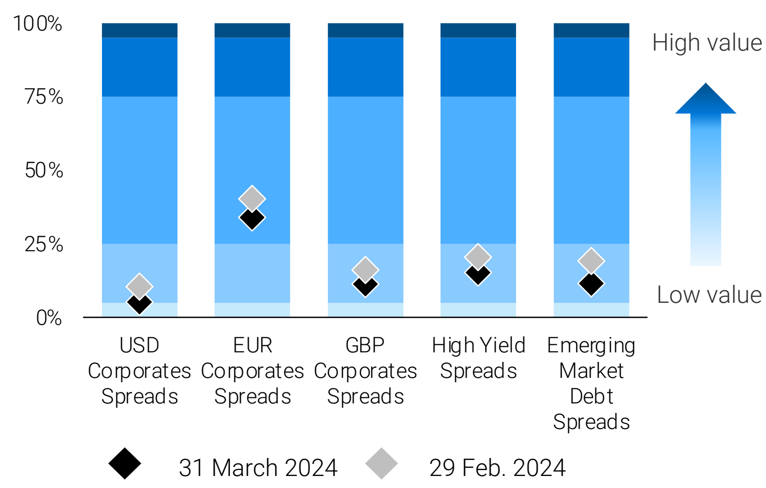
The US Federal Reserve, the European Central Bank and the Bank of England all kept rates unchanged, but the **rhetoric was generally dovish**, suggesting that interest rate cuts could happen before long. Government bond yields were generally a little lower over the month thanks to the dovish support from central bankers. **Economic data was mixed over the month**, with the US outperforming, while Germany remained the notable laggard in Europe.

Global credit markets had a strong month, supported by the dovish central bank rhetoric. The **US investment grade market** had been suffering from **new issuance indigestion**, but this cleared during March. Despite tight credit spreads, there was significant demand from yield-sensitive investors looking to lock-in relatively high total yields. Emerging market debt and global high yield credit returns outperformed again amid the risk-on moves.

Key market moves

				March 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	90	5.3	-6.2	1.3	0.6	-8.8	-0.4	0.9
Euro-Aggregate Corporates	4.6	114	3.7	-6.2	1.2	0.6	-17.5	0.5	1.5
Sterling Corporates	6.4	119	5.3	-4.7	1.8	0.3	-14.1	0.1	1.3
Global Aggregate Corporates	6.2	100	4.9	-5.7	1.3	0.5	-12.5	0.1	1.1
EM USD Aggregate	6.3	264	7.0	-4.7	1.7	1.1	-11.0	1.5	2.5
Global High Yield	4.1	382	8.1	-3.3	1.6	1.0	-9.8	2.6	2.9

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 March 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

LGIM blog

What's behind the weakness in bunds and the compression in European credit spreads? Read our latest blog from Simon Bell, Fund Manager, Active Fixed Income here.

Furthermore, Martin Reeves, Head of Global High Yield and Sophia Hunt, Fixed Income Product Specialist, wonder whether global high yield could enjoy another year of 'goldilocks' conditions. Read the blog here.

Listen on LGIM Talks

In our latest *Fixed income in focus* podcast, we chat to Uday Patnaik, Head of Emerging Market Debt, and Erik Lueth, Global Emerging Market Economist about why, despite a solid macroeconomic backdrop, investor positioning in EM debt is still light. Listen here.

Sign up!

Go to your regional LGIM fund centre for your latest fund alert preferences. You can sign up here.

Source: LGIM as at 31 March 2024 - can be subject to change at any point.

Assumptions, opinions and estimates are provided for illustrative purposes only. There is no guarantee that any forecasts made will come to pass.

Appendix – scoring methodology and definitions

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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.

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