

# AFTER SUMMER COMES AUTUMN

## Stable credit spreads

**Markets.** One of the dominant market themes in 2023 was concern regarding growth slowdown or, potentially, recession. The world economy is facing a range of challenges, and September added a new one: Rising energy costs. Weaker fundamental key figures are increasingly difficult to ignore. The Chinese growth story is challenged, and growth remains disappointing in Europe. On the positive side, growth in the U.S. has turned out to be surprisingly resilient.

The Chinese growth story has for long been challenged. The Chinese market for high yield-rated corporate bonds has declined by around 45% since the middle of 2021 when uncertainty in the real estate sector really started to show. In the winter and spring, the weak macroeconomic trend was deemed to be only temporary, and central government intervention was expected to counter this negative trend. In Q3, key figures still revealed weak lending growth, low industrial production, low retail sales, declining car sales and a minor decline in the price of new houses.

Seemingly having peaked, high inflation has been yet another central market theme. In September, this prompted large central banks, such as the Federal Reserve and the European Central Bank, to signal that they may be about to pause their rate tightening cycles for the time being, and that we are looking into an interest rate level that can be characterised as "higher-for-longer". In response to these signals, the fixed income market has sent rates up.

The corporate sector reported good results for Q2. Earnings levels were high compared with pre-covid-19 earnings. However, the corporate sector generally expressed concern over higher energy prices, exposure to lower Chinese growth and consumers experiencing rising costs of living. Earnings margins are high yet declining. Interest coverage is falling and is very likely to continue the downward trend as companies re-finance their low-coupon debts.

## Higher interest rates led to negative returns

**The Portfolio.** Q3 saw negative returns, while returns for the year are positive. Credit market spreads tightened as interest rates rose over the quarter. A key performance driver was lower credit spreads and regular income from bonds, whereas the rising interest rates had the opposite effect.

A breakdown of returns shows that the largest positive contributions were delivered by companies with the lowest credit ratings (Investment Grade, BBB, and High Yield, CCC). Companies in these rating segments are the least interest rate sensitive and were less affected by rising interest rates. In terms of corporate capital structure, subordinated debt outperformed (senior) preferred debt. The interest rate sensitivity is lower for capital securities (preferred debt) than for senior bonds, and at the same time, the higher current yields and credit spread tightening were positive contributors.

Gross and net issuance came to EUR 99bn and EUR 4bn, respectively, in Q3. Issuance was comprised of EUR 40bn (gross)/EUR -4bn (net) from financial companies and EUR 59bn (gross)/EUR 8bn (net) from non-financial companies. In net terms, issuance was very low – the lowest level recorded for any quarter in the last 10 years. The reason behind this is a low financing requirement among businesses and financial institutions alike. M&A activity has been low, and earlier this year, banks shifted from ECB funding to bond funding. Year-to-date, gross and net issuance have come to EUR 443bn and EUR 135bn, respectively.

Demand for credit, measured by the inflow into investment grade credit funds, was positive in September, for the quarter and for the year. Demand has been driven in part by the need for stable current yields at the higher interest rate level with stable credit spreads. Yields-to-maturity have not been higher since 2009.

See performance and fund data

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## Strategy

Global Investment Grade invests in global corporate bonds, cf. the fund's prospectus. Bond selection is based on the value approach, meaning that the team focuses on bonds issued by companies with healthy long-term earnings power and strong balance sheets as well as an expected ability to service outstanding debt. The portfolio is diversified across sectors, regions and credit ratings. At least 2/3 of the portfolio are invested in Investment Grade bonds.

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