

2023 - A GREAT YEAR IN CREDIT MARKETS

Stable credit spreads

Markets. One of the dominant market themes in 2023 has been concern regarding growth slowdown or, potentially, recession. Entering 2023, the consensus view was that we were looking into a mild winter recession. As economies proved resilient, expectations shifted towards central banks needing to tighten monetary policy sharply to bring core inflation down. When the recession came, it would be deep.

During Q2, the outlook for a soft landing of the economy changed. The monetary policy transmission mechanism would take time, and the economies proved resilient. In September, there were increasing signs that the high inflation appeared to have peaked. This prompted the major central banks, such as the Federal Reserve and the European Central Bank, to signal that the tightening of key policy rates could have been paused for the time being and that we were facing an interest rate level that could be characterised as "higher-for-longer". During October, concerns grew about a potential economic growth slowdown, and as in November, and especially in December, market participants began to position themselves to the effect that inflation no longer posed a problem for central banks. On the contrary, central banks would start easing monetary policy in 2024. Interest rates had peaked and fell sharply. Credit markets reacted with a fall in credit premiums.

Concerns about an upcoming economic growth slowdown gradually grew during Q4. With the financial reporting for Q2 and Q3, it became clear that companies headquartered in Europe were facing declining demand. This resulted in lower than expected turnover and earnings for several companies, whose share prices and credit spreads were subsequently penalised. In general, profit margins were high but declining. Interest coverage was declining and would most likely continue

to decline as companies refinance their low-coupon debt. Companies generally have large cash holdings, which, in addition to limiting the need for new funding, also generate positive returns. Conversely, things are better for US companies, which have so far managed to outperform earnings expectations.

Lower interest rates generated positive returns

The Portfolio. Q4 saw positive returns, and returns for the year were positive. In credit markets, credit spreads remained unchanged, while interest rates declined over the quarter. A key performance driver was the lower interest rates, and the fixed income from the bonds.

Analysing returns shows that the strongest positive contributions derived from bonds with maturities of more than seven years. In terms of credit quality, the companies with the lowest credit ratings and capital bonds performed best. Within Investment Grade, gross and net issues in 2023 amounted to EUR 525bn and EUR 128bn respectively. Issuance was comprised of EUR 256bn (gross)/EUR 69bn (net) from financial companies and EUR 269bn (gross)/EUR 859bn (net) from non-financial companies. The credit bond market has been characterised by high activity measured by gross issues, where activity reflected companies' ongoing need for refinancing. In terms of net issuance, activity was at the low end compared to the last 10 years. Entering 2023, companies had a low financing requirement and during the year have not had much appetite for debt-financed acquisitions.

Demand as measured by inflows to credit funds has been positive for Investment Grade during the quarter and for the year. Inflows have largely been driven by retail investors. Because of the higher interest rate levels and higher credit spreads, investment grade credit looks more attractive.

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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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