2024, WHICH STRATEGIES TO BOOST DURATION?


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CREDIT STRATEGIES: AN OPPORTUNITY TO BOOST DURATION

Investment grade (IG) credit offers positive attributes in the current context.
We back this positive opinion with an analysis of the economy and defaults, the 2 biggest factors that tend to drive credit spreads over the long term. Our findings say (1) there is no risk of recession in the eurozone for 2024, (2) corporates are supported by persistently strong fundamentals, and (3) the market is anticipating excessive defaults versus Ostrum AM's forecasts [~3.5% in the high yield segment, which is well below the historic average].
IG credit is less vulnerable to lacklustre growth versus other asset classes like equities. Refinancing issuance has been well placed since the start of the year, demonstrating the asset classes' current attractive risk-reward profile. Repricing of sovereign bond yields, driven by macroeconomic data which has been robust in the US and in-line in Europe, also gives some fresh momentum to investment grade carry strategies.
IG credit strategies can provide a buffer against volatility while at the same time offer investors high quality duration exposure. Ostrum AM proposes IG strategies, with an average duration of 4.5 (and up to 7).
Given that the pivot in monetary policy is now on the horizon, IG long duration credit exposure can be considered to lock-in current attractive yields, providing an opportunity to position in an asset class that will benefit fully in a lower interest rate environment.

EMERGING SOVEREIGN DEBT: CARRY AT AN ATTRACTIVE LEVEL

Emerging market debt, and particularly debt issued in hard currencies like USD and Euro, can be prioritized for investors seeking duration strategies with attractive carry.
The next move by the Fed will undoubtedly be a rate cut, which should drive the entire US rate curve to lower levels. The US part of foreign debt, with duration of 6.5, will therefore benefit from this trend.
Half of the emerging hard currency debt market is now Investment Grade, and we have seen a period of significant spread tightening, leaning one to say the opportunity is limited. However, there is no reason for these debts to deteriorate. Growth is on track (Brazil, Mexico, India), or has at least stabilized (China). Economic data (fiscal deficits, current account, currency reserves, etc.) has improved considerably, and emerging countries' central banks have gained in credibility. The High Yield emerging debt market must still be considered with caution, but there is backing from IMF and supra-nationals while high "carry" indicates deterioration could be avoided. Some opportunities exist: Argentina, Costa Rica, Angola… Another positive point for 2024? net calls (issuance) to the market to finance their foreign debt should be very limited.
We identify only one cloud on the horizon: the absence of investment flows over the past few months, a trend which nonetheless contrasts with the recent success of the primary market.
In sum, with YTMµ of 8%, it is clearly thcarry on the asset class that remains highly attractive.

SUSTAINABLE INVESTING: RECONCILING PERFORMANCE & ENGAGEMENT

Investing in sustainable bonds is an opportunity to combine performance with engagement for a better world.
In terms of performance, after a long period of rising yields, the asset class is in a strong position, offering attractive yields. Relative performance of sustainable bonds is comparable to conventional bonds. Thus, there is no additional cost to investing in this asset class that seeks to protect the environment, with positive social impact.
The sustainable bonds market is expanding sharply, driven by a combination of growing investor demand and an increase in issuers keen to become involved in this segment. The high pace of growth is also in response to the huge financing needs for the energy transition if we are to achieve zero carbon by 2050. The Next Generation EU program is evidence of the strong political support for sustainable finance. Growing awareness for the need to act for the planet has also been accompanied by an increasingly favourable regulatory context for sustainable investing, such as the new European green bonds standard (EUGBS).
In the current context, we note increasing appetite for duration. We believe that sustainable bond strategies are highly pertinent. Ostrum AM is a leading player in the sustainable bond asset class, with €35bn under management.

*YTM: Yield to Maturity, brut.

ADDITIONAL NOTES

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