This document is intended for professional investors
Written in December 2023

# 2024 outlook
# Duration and the climate transition: risk or opportunity for sovereign bonds?

**Isabelle Sanson**

Head of Sovereigns & Inflation management

With major central banks crossing the finish line on aggressive tightening cycles, Ostrum Asset Management (Ostrum AM) expects 2024 to be rich in investment opportunities but signals there are still multiple risks to be managed. Amongst the usual suspects are credit, duration and volatility, but there are also others to consider such as the configuration of yield curves and the growing risks related to the climate transition.

## How are sovereign bonds likely to shape up in this context?

For many investors, sovereign bonds tend to be a significant weight in portfolios, representing defensive positioning, and providing a buffer against other risks that may be associated with asset classes like credit or equities. That said, sovereigns still have their own risks and one that stands out is duration. Duration is a critical element as it is an amplifier in terms of both risk and performance. Investors are well aware of this risk. When central banks raise rates, investors shy away from longer maturity bonds to avoid duration risk. Considering that 2022 was marked by impressive ECB rate increases, it is a good year for illustrating how duration can affect performance on eurozone sovereign bonds with 1–3-year maturities finishing the year down around -2.50% and 3–5-year maturities down around -7%. Longer dated bonds were down even more significantly, posting losses of more than -15% for 7–10-year maturities.

In 2023, the aggressive move on rates continued but also was finalized. For the sovereign bond asset class this is good news as performance has turned back to positive with longer duration bonds outperforming year-to-date. However, the cross over the finish line on rates has left its mark on the yield curve which is now inverted. This inversion has been driven by the front end of the curve and is a result of the speed and amplitude of the rate hikes.

Participants are now focused on anticipating market drivers and forward-looking scenarios: **What is the impact of higher rates**? considering there are delays between rates hikes and their impact on the economy, there is still a risk of recession. **Public deficits**? government financing will be more costly with refinancing rates across maturities now at higher levels. **Where do we stand on the ECB's PEPP exit?** The end of reinvestments, initially forecasted for the end of 2024, should finally take place in July. **Yield curves?** The mood is for normalization, thus bull or bear steepening to reintroduce the risk premium. **Duration?** Adding duration is directional. In 2023, investors added duration as we neared 3% on German 10 years. And finally, **where do we stand on climate change?** We are still behind the curve. Significant investments are needed to meet the 2030-2050 deadlines.

Ostrum AM is monitoring all of these elements as sources of risk and opportunity in the coming year. In addition, while the market sees inflation contained, Ostrum AM still sees tail risks, coming in part from a more heterogenous environment where countries and regions now prioritize energy independence and also in part from the ongoing uncertainties regarding the cost of the energy transition. This tail risks, for Ostrum AM, imply that ECB rates will stay higher for longer than anticipated and when official rates do move lower, we can no longer anticipate negative rate scenarios like we had in the past. Instead, we may be entering a new era with short term rates floored at higher levels. A 3% level, for example, may represent the new normal going forward.

## Growing risks related to the energy transition?

In November 2022, Fabio Panetta (1), Member of the Executive Board of the ECB stated that the price effects associated with the energy transition will be largely determined by technological developments and policies implemented by governments globally. In a May 2023 ECB report (2) on climate change and sovereign risk, it was raised that a late-push transition will imply higher credit risk. According to the report, transition risk factors, such as carbon emissions and energy consumption are not yet reflected in country ratings. The report calls for financial stability, saying it is important for rating agencies to incorporate all relevant climate-related variables into credit assessments to reduce the risk of abrupt repricing and allow investors to reflect sovereign climate-related risk adequately.

Ostrum AM's risk assessments on sovereigns include ESG materiality. Research teams apply proprietary methodology to rate both conventional and GSSS bonds (ie green bonds). The objective is to identify sovereign countries who are leading in terms of all ESG pillars. Ostrum AM proposes SFDR Article 8 sovereign portfolios with ambitious targets related to the climate with an objective to reduce the carbon intensity of portfolios. Country selection takes into consideration climate risk factors.

The duration risk/opportunity set is an integral part of Ostrum AM's sovereign bond investment process with position taking varying from strategic to tactical day to day management of investment portfolios. Considering that interest rate and yield curve movements fluctuate over time, Ostrum AM's sovereign investment team will adapt portfolios to the changing environment. To reduce the sensitivity of the portfolio, the team can shift into shorter maturities or use hedging instruments. As yields rise, the investment team may decide to overweight longer maturity bonds. Investment decisions will also depend on investment team's view of the yield curve. Invest decisions systematically take into consideration each country's carbon intensity and how each implemented change will impact the overall carbon intensity score of the portfolio relative to its reference index.

(1) https://www.ecb.europa.eu/press/key/date/2022/html/ecb.sp221116~c1d5160785.en.html
(2) https://www.ecb.europa.eu/pub/financial-stability/fsr/special/html/ecb.fsrart202305_03~f51dd11fd7.en.html

**Sovereign bonds markets: which opportunities for 2024 in a context where US & European governments debts have more than doubled in a decade?**

**Dieudonné Djimi, Global Interest Rates & Currency Portfolio Manager at Ostrum Asset Management,** discusses Outlook for sovereign bond markets in 2024.

➔ *https://www.ostrum.com/fr/news-insights/insights/marches-des-obligations-souveraines-quelles-opportunites-pour-2024-dans-un*

## Additional notes

### Ostrum Asset Management

Asset management company regulated by AMF under n° GP-18000014 – Limited company with a share capital of 50 938 997 €. Trade register n°525 192 753 Paris – VAT: FR 93 525 192 753 – Registered Office: 43, avenue Pierre Mendès-France, 75013 Paris – www.ostrum.com

This document is intended for professional investors, in accordance with MIFID. It may not be used for any purpose other than that for which it was conceived and may not be copied, distributed or communicated to third parties, in part or in whole, without the prior written authorization of Ostrum Asset Management.

None of the information contained in this document should be interpreted as having any contractual value. This document is produced purely for the purposes of providing indicative information. This document consists of a presentation created and prepared by Ostrum Asset Management based on sources it considers to be reliable.

Ostrum Asset Management reserves the right to modify the information presented in this document at any time without notice, which under no circumstances constitutes a commitment from Ostrum Asset Management.

The analyses and opinions referenced herein represent the subjective views of the author(s) as referenced, are as of the date shown and are subject to change without prior notice. There can be no assurance that developments will transpire as may be forecasted in this material. This simulation was carried out for indicative purposes, on the basis of hypothetical investments, and does not constitute a contractual agreement from the part of Ostrum Asset Management.

Ostrum Asset Management will not be held responsible for any decision taken or not taken on the basis of the information contained in this document, nor in the use that a third party might make of the information. Figures mentioned refer to previous years. Past performance does not guarantee future results. Any reference to a ranking, a rating, a label or an award provides no guarantee for future performance and is not constant over time.

Under Ostrum Asset Management's social responsibility policy, and in accordance with the treaties signed by the French government, the funds directly managed by Ostrum Asset Management do not invest in any company that manufactures, sells, or stocks anti-personnel mines and cluster bombs.

### Natixis Investment Managers

This material has been provided for information purposes only to investment service providers or other Professional Clients, Qualified or Institutional Investors and, when required by local regulation, only at their written request. This material must not be used with Retail Investors.

To obtain a summary of investor rights in the official language of your jurisdiction, please consult the legal documentation section of the website (im.natixis.com/intl/intl-fund-documents)

**In the E.U.**: Provided by Natixis Investment Managers International or one of its branch offices listed below. Natixis Investment Managers International is a portfolio management company authorized by the Autorité des Marchés Financiers (French Financial Markets Authority - AMF) under no. GP 90-009, and a public limited company (société anonyme) registered in the Paris Trade and Companies Register under no. 329 450 738. Registered office: 43 avenue Pierre Mendès France, 75013 Paris. Germany: Natixis Investment Managers International, Zweigniederlassung Deutschland (Registration number: HRB 129507): Senckenberganlage 21, 60325 Frankfurt am Main. Italy: Natixis Investment Managers International Succursale Italiana, Registered office: Via San Clemente 1, 20122 Milan, Italy. Netherlands: Natixis Investment Managers International, Nederlands (Registration number 000050438298). Registered office: Stadsplateau 7, 3521AZ Utrecht, the Netherlands. Spain: Natixis Investment Managers International S.A., Sucursal en España, Serrano n°90, 6th Floor, 28006 Madrid, Spain. Sweden: Natixis Investment Managers International, Nordics Filial (Registration number 516412-8372- Swedish Companies Registration Office). Registered office: Covendrum Stockholm City AB, Kungsgatan 9, 111 43 Stockholm, Box 2376, 103 18 Stockholm, Sweden. Or,

Provided by Natixis Investment Managers S.A. or one of its branch offices listed below. Natixis Investment Managers S.A. is a Luxembourg management company that is authorized by the Commission de Surveillance du Secteur Financier and is incorporated under Luxembourg laws and registered under n. B 115843. Registered office of Natixis Investment Managers S.A.: 2, rue Jean Monnet, L-2180 Luxembourg, Grand Duchy of Luxembourg. Belgium: Natixis Investment Managers S.A., Belgian Branch, Gare Maritime, Rue Picard 7, Bte 100, 1000 Bruxelles, Belgium.

**In Switzerland**: Provided for information purposes only by Natixis Investment Managers, Switzerland Sàrl, Rue du Vieux Collège 10, 1204 Geneva, Switzerland or its representative office in Zurich, Schweizergasse 6, 8001 Zürich.

**In the British Isles:** Provided by Natixis Investment Managers UK Limited which is authorised and regulated by the UK Financial Conduct Authority (FCA firm reference no. 190258) - registered office: Natixis Investment Managers UK Limited, Level 4, Cannon Bridge House, 25 Dowgate Hill, London, EC4R 2YA. When permitted, the distribution of this material is intended to be made to persons as described as follows: in the United Kingdom: this material is intended to be communicated to and/or directed at investment professionals and professional investors only; in Ireland: this material is intended to be communicated to and/or directed at professional investors only; in Guernsey: this material is intended to be communicated to and/or directed at only financial services providers which hold a license from the Guernsey Financial Services Commission; in Jersey: this material is intended to be communicated to and/or directed at professional investors only; in the Isle of Man: this material is intended to be communicated to and/or directed at only financial services providers which hold a license from the Isle of Man Financial Services Authority or insurers authorised under section 8 of the Insurance Act 2008.

**In the DIFC**: Provided in and from the DIFC financial district by Natixis Investment Managers Middle East (DIFC Branch) which is regulated by the DFSA. Related financial products or services are only available to persons who have sufficient financial experience and understanding to participate in financial markets within the DIFC, and qualify as Professional Clients or Market Counterparties as defined by the DFSA. No other Person should act upon this material. Registered office: Unit L10-02, Level 10 ,ICD Brookfield Place, DIFC, PO Box 506752, Dubai, United Arab Emirates

**In Japan**: Provided by Natixis Investment Managers Japan Co., Ltd. Registration No.: Director-General of the Kanto Local Financial Bureau (kinsho) No.425. Content of Business: The Company conducts investment management business, investment advisory and

agency business and Type II Financial Instruments Business as a Financial Instruments Business Operator.
**In Taiwan**: Provided by Natixis Investment Managers Securities Investment Consulting (Taipei) Co., Ltd., a Securities Investment Consulting Enterprise regulated by the Financial Supervisory Commission of the R.O.C. Registered address: 34F., No. 68, Sec. 5, Zhongxiao East Road, Xinyi Dist., Taipei City 11065, Taiwan (R.O.C.), license number 2020 FSC SICE No. 025, Tel. +886 2 8789 2788.
**In Singapore**: Provided by Natixis Investment Managers Singapore Limited (NIM Singapore) having office at 5 Shenton Way, #22-05/06, UIC Building, Singapore 068808 (Company Registration No. 199801044D) to distributors and qualified investors for information purpose only. NIM Singapore is regulated by the Monetary Authority of Singapore under a Capital Markets Services Licence to conduct fund management activities and is an exempt financial adviser. Mirova Division (Business Name Registration No.: 53431077W) and Ostrum Division (Business Name Registration No.: 53463468X) are part of NIM Singapore and are not separate legal entities. This advertisement or publication has not been reviewed by the Monetary Authority of Singapore.
**In Hong Kong**: Provided by Natixis Investment Managers Hong Kong Limited to professional investors for information purpose only.
In Australia: Provided by Natixis Investment Managers Australia Pty Limited (ABN 60 088 786 289) (AFSL No. 246830) and is intended for the general information of financial advisers and wholesale clients only .
**In New Zealand**: This document is intended for the general information of New Zealand wholesale investors only and does not constitute financial advice. This is not a regulated offer for the purposes of the Financial Markets Conduct Act 2013 (FMCA) and is only available to New Zealand investors who have certified that they meet the requirements in the FMCA for wholesale investors. Natixis Investment Managers Australia Pty Limited is not a registered financial service provider in New Zealand.
**In Colombia**: Provided by Natixis Investment Managers International Oficina de Representación (Colombia) to professional clients for informational purposes only as permitted under Decree 2555 of 2010. Any products, services or investments referred to herein are rendered exclusively outside of Colombia. This material does not constitute a public offering in Colombia and is addressed to less than 100 specifically identified investors.
**In Latin America**: Provided by Natixis Investment Managers International.
In Uruguay: Provided by Natixis Investment Managers Uruguay S.A., a duly registered investment advisor, authorised and supervised by the Central Bank of Uruguay. Office: San Lucar 1491, Montevideo, Uruguay, CP 11500. The sale or offer of any units of a fund qualifies as a private placement pursuant to section 2 of Uruguayan law 18,627.
**In Mexico**: Provided by Natixis IM Mexico, S. de R.L. de C.V., which is not a regulated financial entity, securities intermediary, or an investment manager in terms of the Mexican Securities Market Law (Ley del Mercado de Valores) and is not registered with the Comisión Nacional Bancaria y de Valores (CNBV) or any other Mexican authority. Any products, services or investments referred to herein that require authorization or license are rendered exclusively outside of Mexico. While shares of certain ETFs may be listed in the Sistema Internacional de Cotizaciones (SIC), such listing does not represent a public offering of securities in Mexico, and therefore the accuracy of this information has not been confirmed by the CNBV. Natixis Investment Managers is an entity organized under the laws of France and is not authorized by or registered with the CNBV or any other Mexican authority. Any reference contained herein to “Investment Managers” is made to Natixis Investment Managers and/or any of its investment management subsidiaries, which are also not authorized by or registered with the CNBV or any other Mexican authority.
**In Brazil**: Provided to a specific identified investment professional for information purposes only by Natixis Investment Managers International. This communication cannot be distributed other than to the identified addressee. Further, this communication should not be construed as a public offer of any securities or any related financial instruments. Natixis Investment Managers International is a portfolio management company authorized by the Autorité des Marchés Financiers (French Financial Markets Authority - AMF) under no. GP 90-009, and a public limited company (société anonyme) registered in the Paris Trade and Companies Register under no. 329 450 738. Registered office: 43 avenue Pierre Mendès France, 75013 Paris.
The above referenced entities are business development units of Natixis Investment Managers, the holding company of a diverse line-up of specialised investment management and distribution entities worldwide. The investment management subsidiaries of Natixis Investment Managers conduct any regulated activities only in and from the jurisdictions in which they are licensed or authorized. Their services and the products they manage are not available to all investors in all jurisdictions. It is the responsibility of each investment service provider to ensure that the offering or sale of fund shares or third party investment services to its clients complies with the relevant national law.
The provision of this material and/or reference to specific securities, sectors, or markets within this material does not constitute investment advice, or a recommendation or an offer to buy or to sell any security, or an offer of any regulated financial activity. Investors should consider the investment objectives, risks and expenses of any investment carefully before investing. The analyses, opinions, and certain of the investment themes and processes referenced herein represent the views of the portfolio manager(s) as of the date indicated. These, as well as the portfolio holdings and characteristics shown, are subject to change. There can be no assurance that developments will transpire as may be forecasted in this material. The analyses and opinions expressed by external third parties are independent and does not necessarily reflect those of Natixis Investment Managers. Past performance information presented is not indicative of future performance.
Although Natixis Investment Managers believes the information provided in this material to be reliable, including that from third party sources, it does not guarantee the accuracy, adequacy, or completeness of such information. This material may not be distributed, published, or reproduced, in whole or in part.
All amounts shown are expressed in USD unless otherwise indicated.

Natixis Investment Managers may decide to terminate its marketing arrangements for this product in accordance with the relevant legislation

www.ostrum.com

Ostrum ASSET MANAGEMENT

An affiliate of: NATIXIS INVESTMENT MANAGERS