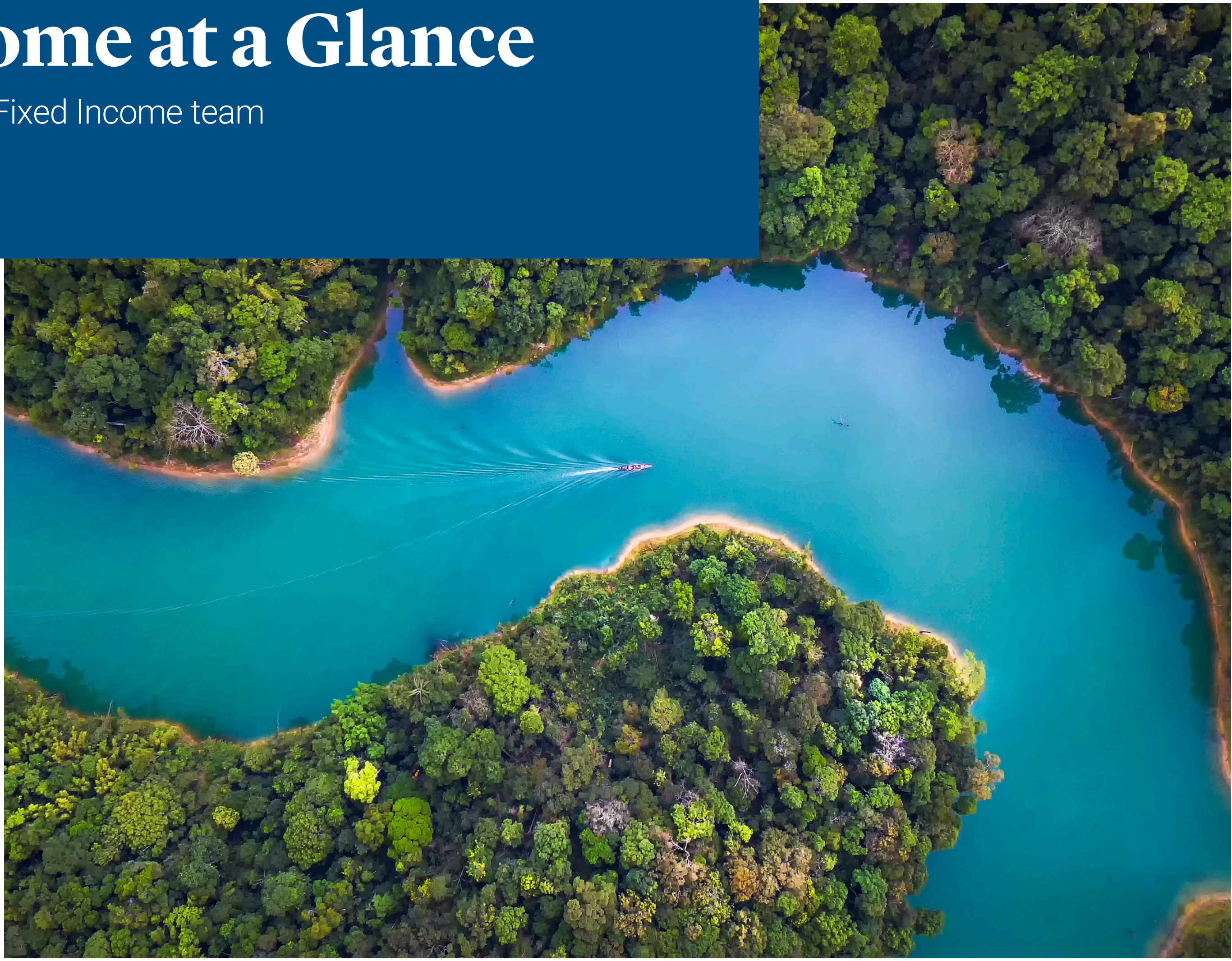
Active Fixed Income at a Glance

The latest monthly views from the Active Fixed Income team

March 2024



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Outlook

Economic momentum continues to be strong. Expectations for central bank policy rate cuts, which were pushed out beyond the first quarter, had only a limited impact on markets, with **credit spreads tightening further** in February. While demand for credit appears to be robust, with support from long-term buyers, we see early **signs of saturation**. There is also awareness that commercial real estate exposure could fuel the next banking crisis in the US and Germany - hence some teams have moved back to a neutral stance.

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:**

- EU credit (from -1 to 0)

▼ **Downgraded:**

- UK credit (from +1 to 0)

▬ **Unchanged:**

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

Source: LGIM as at 29 February 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	-3 -2 -1 N **+1** +2 +3 ▬	• Unattractively tight credit spreads, however higher overall yields keeping demand strong for now • Caution over fatigue in long-end US market	• Maintain US credit underweight/EUR credit overweight • Reducing financials, given some commercial real estate concerns in regional banks • Reduced long duration
US credit	-3 -2 -1 **N** +1 +2 +3 ▬	• More constructive on long-term economic backdrop, as macro headwinds meaningfully diminished • Some moderation of positive technical backdrop, largely due to the deluge of YTD supply	• Modestly constructive on intermediate credit in the short term, while we remain neutral on long-duration credit • Increasing exposures in US SIFI* banks and communications sectors, while reducing overweight in utilities
UK credit	-3 -2 -1 **N** *+1* +2 +3 ▼	• Team consensus that soft landing is fully priced in to sterling spreads, but demand remains strong • Negative on corporate fundamentals, as higher rates feeding through to corporates/real estate while spreads have recovered	• Added telecommunications and collateralised debt • Duration remains neutral
EU credit	-3 -2 *-1* **N** +1 +2 +3 ▲	• Valuations in EUR IG credit, on an option-adjusted spread basis, relatively cheap versus USD and GBP • Strong demand on the back of continuous inflows compensating for the absence of ECB buying	• Ongoing focus on portfolio quality with an underweight in BBB vs single A rated issuers • Selective participation in new issuance, with emphasis on bottom-up credit selection
EMD	-3 -2 -1 N **+1** +2 +3 ▬	• The probability of a hard landing seems low with US growth doing better than expected • We do not have concerns about systemic defaults and expect some of the countries in default to re-emerge later this year	• Continue to reduce duration and we are flat now versus benchmark • Continue to rotate out of investment grade and into high yield, where we see conviction
GHY	-3 -2 -1 N +1 **+2** +3 ▬	• While spreads have tightened, yields and prices are attractive • Expectation of defaults to remain low	• Maintaining our overweight to higher spread names across the globe • Increasing underweight to US and rotating into emerging markets

Source: LGIM as at 29 February 2024 - can be subject to change at any point. *Denotes systematically important financial institution.

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Market commentary: February 2024

The positive momentum in risk assets continued over February, with investors taking comfort that the recent improvement in economic data appears sustainable. The US labour market was a particular highlight, with the economy adding around twice as many jobs as analysts expected, indicating continued economic strength. In Europe, the positive tailwind from lower energy prices provided an ongoing positive income effect for households and helped to dampen down fears of a short-term resurgence in inflation.

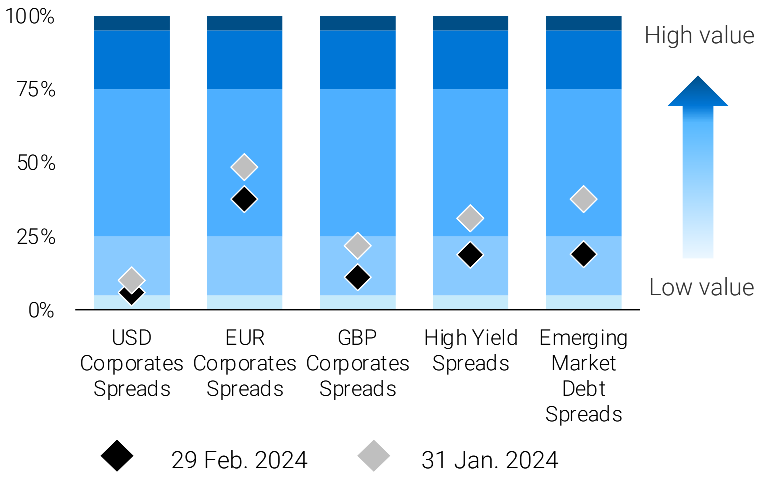
It was a **more difficult month for government bond markets**, as increasing confidence about the growth outlook in the US and stubborn inflation data prompted investors to reappraise their expectations for the number of likely interest-rate cuts over 2024.

High yield and emerging debt performed more strongly with a combination of lower interest-rate exposure and tightening credit spreads helping to drive performance. There was a partial retracement in credit spreads at the end of the month as heavy issuance started weighing on markets, especially in USD corporates.

Key market moves

				February 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	7.1	96	5.4	-0.1	-1.5	-0.1	-2.7	-1.7	0.3
Euro-Aggregate Corporates	4.5	121	3.9	-7.3	-0.9	0.5	-12.0	-0.7	0.9
Sterling Corporates	6.4	125	5.6	-5.1	-0.6	0.6	-9.8	-1.7	0.9
Global Aggregate Corporates	6.1	106	5.0	-3.6	-1.1	0.2	-7.3	-1.1	0.6
EM USD Aggregate	6.3	277	7.2	-7.8	0.4	1.6	-6.6	-0.2	1.5
Global High Yield	4.1	395	8.3	-8.7	0.9	1.8	-6.7	1.0	1.9

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 29 February 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.

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LGIM blog

Read our explainer blog on duration management in credit portfolios by Corinne Lewis-Reynier, Head of Fixed Income Investment Specialists.

Furthermore, Simon Bell, Fund Manager, Active Fixed Income, asks when could the European Central Bank start cutting rates?

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In our new 'Fixed income in focus' series, listen to Mat Rees, Head of Global Bond Strategies, talk technicals versus fundamentals on the pod.

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Source: LGIM as at 29 February 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

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.

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Contact us

For further information about LGIM, please visit lgim.com or contact your usual LGIM representative

Key risks

Important information

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