Bond Market Outlook

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September 2023

Marketboard

Summary

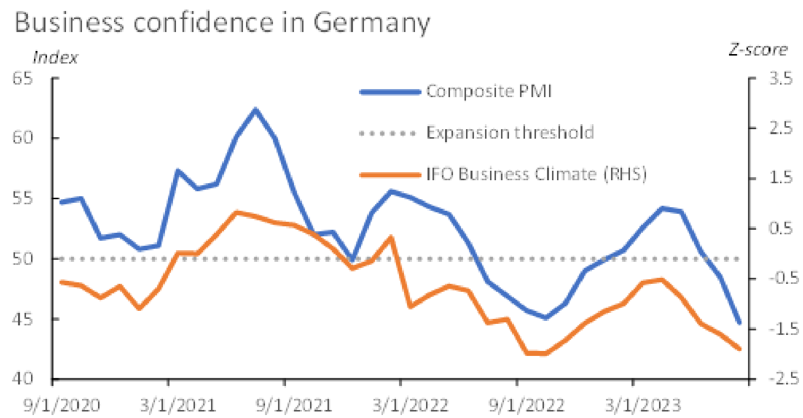
- Soft-landing and higher for longer
  - Risk assets have continued to outperform duration
  - US equity market performance still narrow (big-tech stock)
  - Credit spreads have narrowed since March
  - Emerging market resilience despite China weakness, policy uncertainty (Argentina, Turkey) and political risk (Gabon etc)

- Valuation concerns
  - Spreads as a % of yield is lower since 2007
  - Equity valuation rich, returns depend on earnings growth in 2024
  - Bonds are cheap but only on a buy to hold basis

The Euro area's real economy is struggling with stubborn inflation numbers

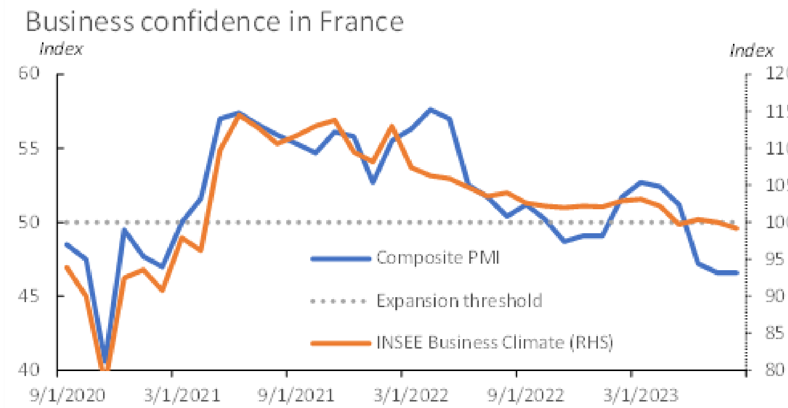
Core fell 0.2% in August, but remains in the 5%+ range in which it has been wallowing since end 2022

Germany sinks deeper



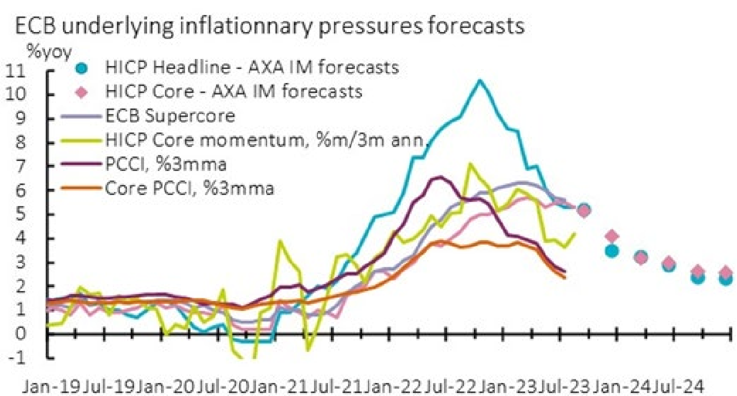
Source: Markit, Ifo, AXA IM Research, August 2023

France is relapsing



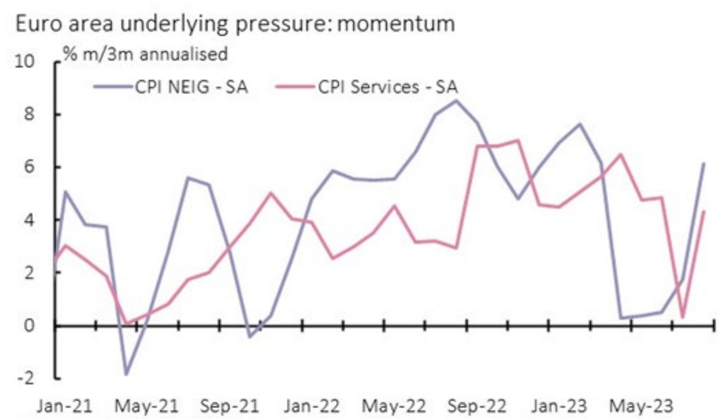
Source: Markit, INSEE, AXA IM Research, August 2023

"Sophisticated" measures of core moving decisively down, but "traditional" core still resilient



Source: Eurostat, ECB and AXA IM Research, August 2023.
NB: PCCI stands for Peristent and Common Component of inflation

Rebound in services and manufactured goods prices on a 3-mm annualized basis

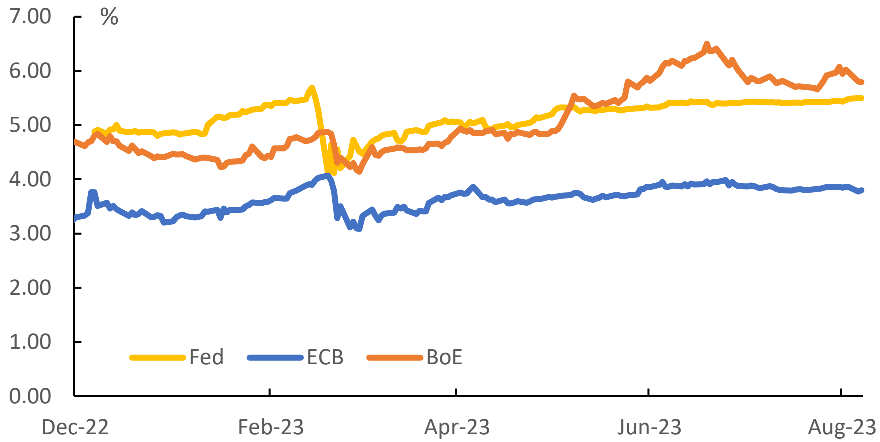


Source : ECB and AXA IM Research, August 2023

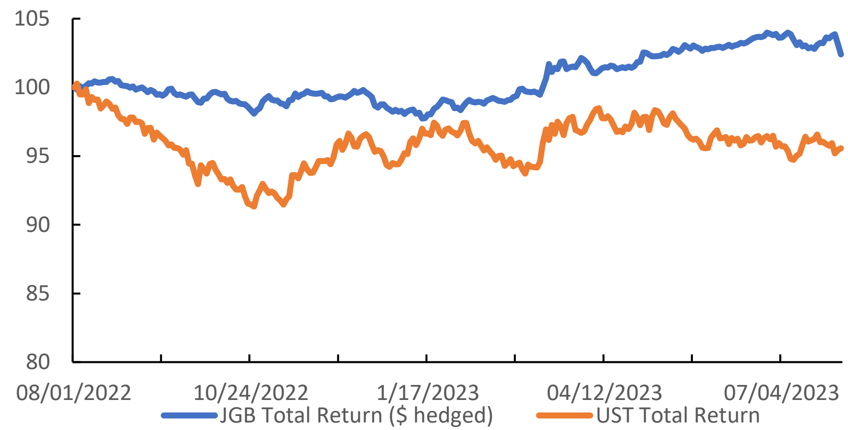
Marketboard – Charts - Rates

Cash continues to be most attractive "spot" investment

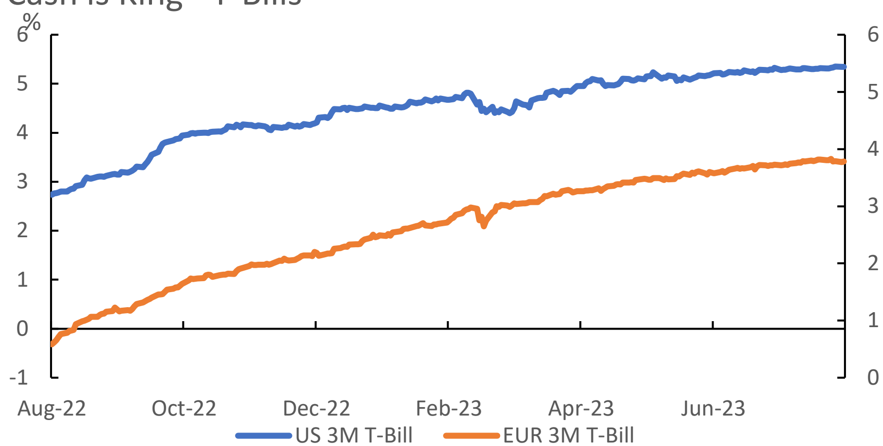
Peak Policy Rate Pricing



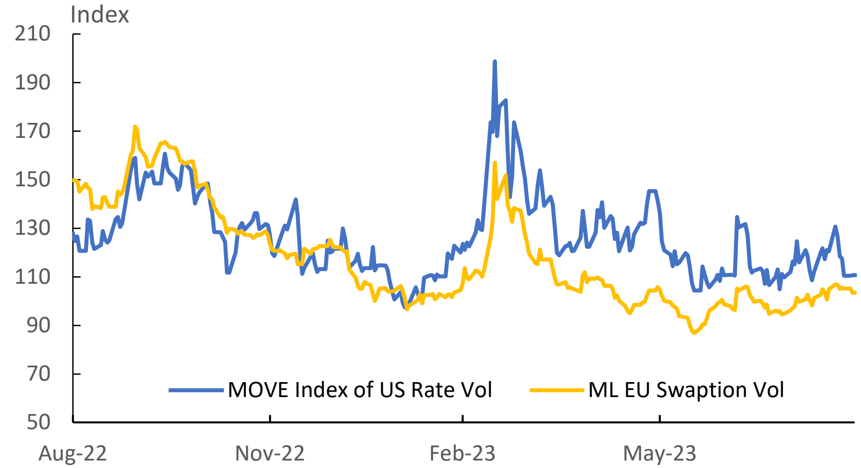
JGB ($ hedged) vs UST Total Return - 1Yr



Cash is King - T-Bills



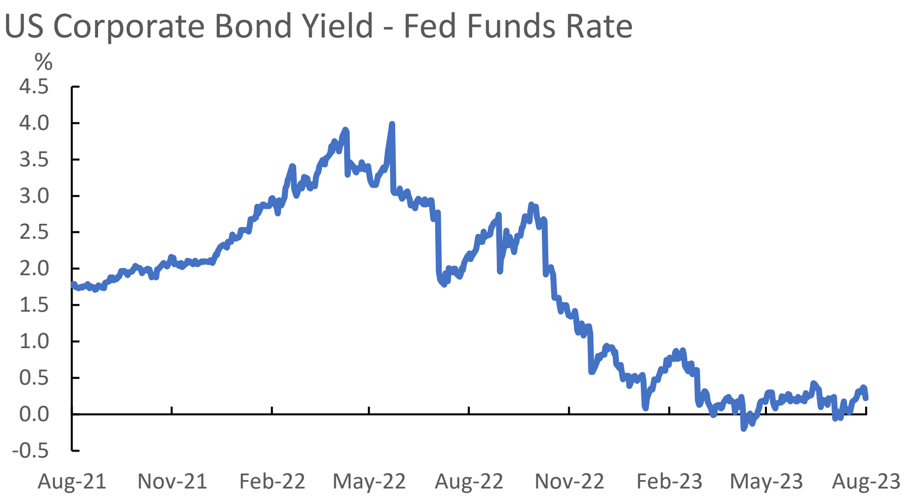
Interest Rate Volatility

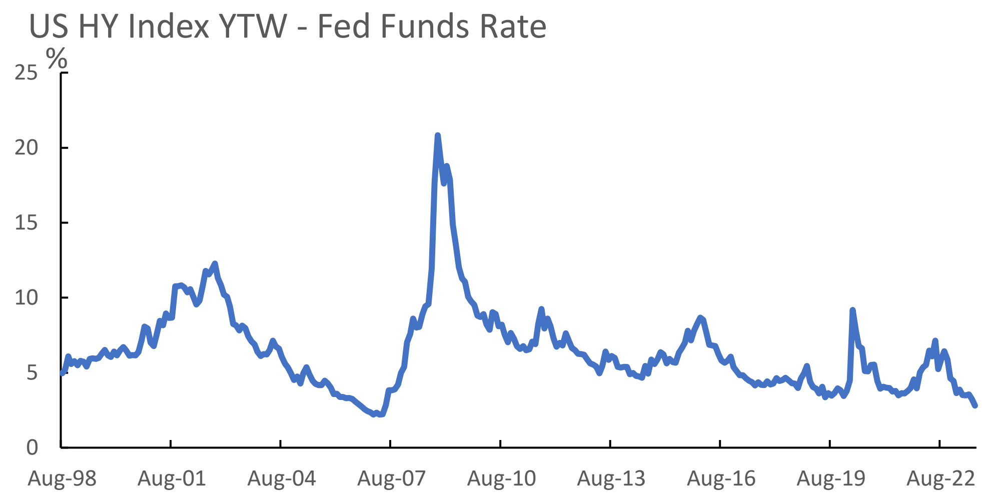


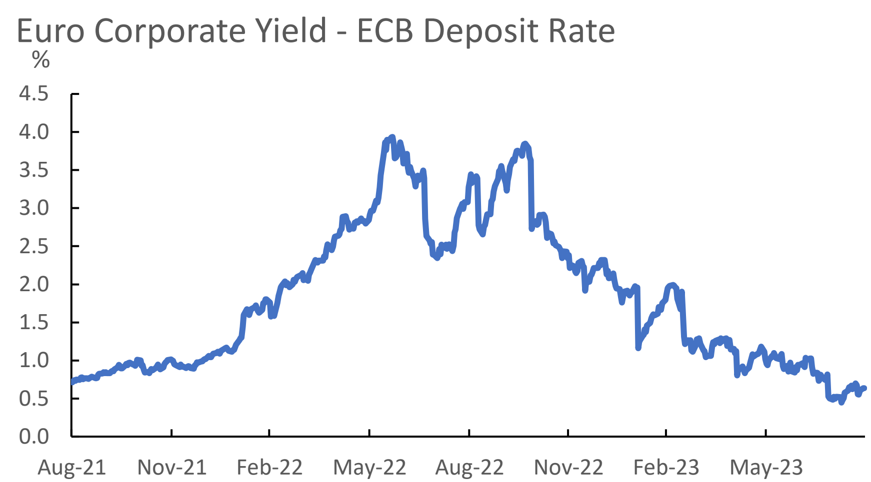
Source: Bloomberg; Datastream 6th September, 2023

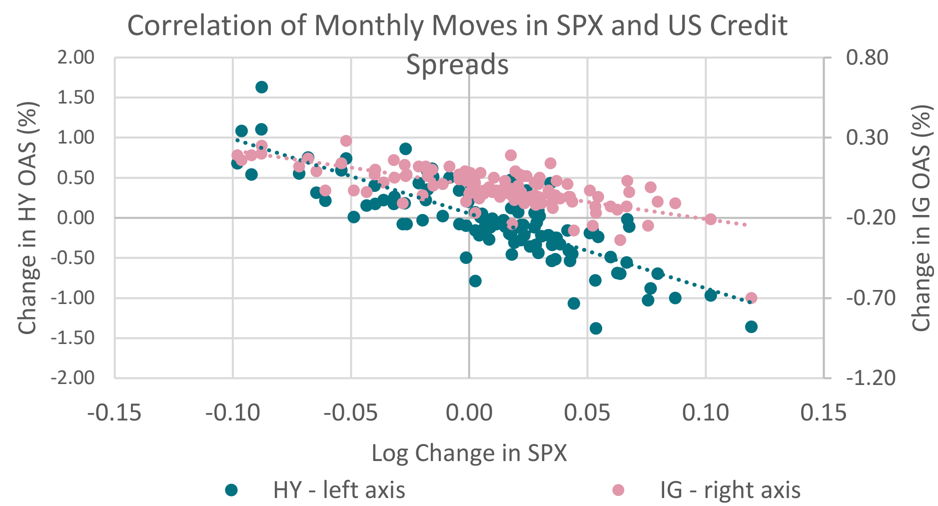
Marketboard – Charts - Credit

Relative value of credit to cash has deteriorated; spread widening and lower equity markets remain the risk









Source: Bloomberg; Datastream - 6th September, 2023

Investment Managers

Questions

- Are the current buffers against recession (labour market, fiscal policy (this year), headline inflation fall) enough?

- No major concern over Fixed Income markets until year end, any risk that could be underestimated ?

- What could be the consequences of a very cold winter and/or incapacity to reiterate last year gas savings on markets?

- European Credit did not attract as much inflow as what was expected so far, are the alternatives (for ex: Italy issuing to retail investors) that emerged through 2023 sustainable?

Marketboard

Stretch valuations again, case for hedging recession risk

Equities & Commodities	Rates & Inflation	Credit
• The Q2 earnings season eventually showed EPS growth of -6% for the S&P500 and -5.5% for the EuroStoxx universe. However, both sales and earnings surprised to the upside across all major US economic sectors. In Europe there were big misses in industrials and consumer discretionary. • The AI theme delivered with Nvidia reporting a major beat on EPS and massively revising up guidance. It sees exponential growth in demand for AI servers and chips. • Chinese equities have underperformed, reflecting the poor state of the Chinese economy. So far, policy guidance intended to increase domestic purchases of shares and ease IPO rules have had little effect. • Equity volatility, measured by the VIX, is at its lowest since pre-COVID. At the same time the SPX 12-m forward PE is close to its highest levels since early 2022. Earnings growth expectations for 2024 actually increased in the wake of Q2 results and guidance. • Concerns over El Nino have not yet led to material increases in futures prices for food commodities. Worth watching.	• Central bank rate expectations have remained stable over the summer but long-term yields have risen, reflecting the soft-rather than hard landing scenario. There has also been an upward revision in long-term equilibrium rate expectations. If inflation behaviour in the future is going to be more symmetric around CB targets (rather than persistently below it) then policy rates will need to be higher and perhaps adjusted more frequently. This requires a higher term premium. • Markets currently price peak official rates at 5.5% for the Fed and 4% for the ECB. Only modest easing priced in for 2024. • US and EUR long-term inflation break-evens have converged around 2.25%. Pre-COVID the market was 1.5%-2.0% for the US and 1.0% for Europe. Hard to see break-evens moving materially lower again given inflation risks, unless there is a harsh recession and deflation shock. • Japanese long-end yields have risen 50bps since June in the wake of changes to YCC. Hedged into USD and EUR, Japanese bonds are more attractive than for some time. Hedged in EUR and USD, JGBs have outperformed Bunds and Treasuries in 2023.	• Credit has outperformed in fixed income since March with spreads narrowing in both IG and HY. The modest widening in August has been reversed leaving all-in yields at their lowest levels relative to cash-rates. • CDS indices have also narrowed, suggesting little appetite for hedging credit portfolios. Spreads as a % of total yield are also at cyclical lows. • A hard-landing hedge would be to buy protection (CDS) and buy 2024 rate futures. A weaker economy should see credit spreads widen and more rate cuts get priced in. • The primary market has been quiet over the summer although Euro issuance has picked up. Increase sovereign and corporate issuance in the autumn is expected. So far, supply has been well digested but investors are starting to look at 2024 refinancing needs. • Emerging market debt has returned 4.5% in 2023, led by high yield names and led by short-duration buckets. Recent news events have had little impact on EM spreads. However, Asian HY continues to perform very weakly given China property issues.