



ANALYSIS

Credit Continuum

April 2019

Environment for credit appears supportive

Global markets have continued to perform strongly in the last few weeks, supported by several factors.

Accommodative Monetary Policy

The US Federal Reserve has confirmed it intends to keep rates stable for a prolonged period and will wait for strong signals before considering the next step.¹ Although the margin of manoeuvrability on rates is very limited in the eurozone, the European Central Bank has confirmed its intention to be ready to do more if needed later in the year, at least to support the banking system.²

Softer Inflation

Despite higher oil prices, both headline and core inflation have been soft throughout the first quarter, thus reducing the risk of higher rates/yields.³

Signs of Economic Recovery

We believe the first signs of (a possible) economic recovery have appeared and March's Purchasing Manager Indices in China highlighted a material reversal.⁴ Meanwhile service sectors have held up very well⁵ and eurozone industrial production data has also improved.⁶

Increased Inflows

Supply has been more active in the recent weeks but has been very well absorbed as demand for fixed income has resumed after the dramatic underweight in 2018.⁷

Supportive Fiscal Policies

More signs have appeared that fiscal policy responses in Europe will provide a backstop for 2019 growth, confirming that a slow growth/no recession scenario is the most plausible for this year, in our opinion.⁸

Positive Momentum for Credit

In our view, financial markets are welcoming these developments and both equity and credit markets have resumed a bullish mode after their mid-March hesitation.⁹ However, as full-year targets have been reached in the space of four months, there is always a risk of profit taking if the current macro momentum breaks.



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Michael manages the Muzinich Global Tactical Credit strategy. Prior to joining Muzinich in 2012, Michael was president and Head of the High Yield Division at Seix Advisors, Inc. At Seix Advisors, he was the founding partner of the high yield strategy that grew to over \$13 billion under his leadership. Previously, Michael served in various research and portfolio management capacities at American General Corp. and at Capital Holding Corporation. He earned a BA in Management Science from the University of California, San Diego and an MBA from Rice University.

We continue to believe we are in a late-cycle environment and would not be ready to increase our overall level of risk in portfolios at these valuations. Nevertheless, the improving fundamental news flow cannot be ignored.

Investment grade companies that have increased leverage over the past two years have now acknowledged the need to reverse this trend and to offer more guarantees to bond investors about their long-term commitment to their investment grade rating.¹⁰

Meanwhile we believe low supply in the high yield space is another demonstration of prudent debt and leverage management and is an indication that technical factors are turning more positive in 2019.¹¹

It is tempting to believe that all good news is being priced by the strong recovery in valuations since the start of the year, but momentum remains positive and therefore we believe is a good environment in which to be invested.¹²

More than US\$10tn of securities are now negative yielding in nominal terms globally, and the push for yield remains powerful in the context of a stabilizing macro backdrop.¹³

However, we continue to focus on high-quality issuers and to rely on stock picking in an environment which remains dominated by uncertainties, the fact we are late in the cycle, and where visibility in issuers' business models, cash generation profiles and medium-term horizon commitments are positive indicators of potential high-quality returns on our investments.

1. <https://tradingeconomics.com/united-states/interest-rate>
2. https://www.ecb.europa.eu/pub/economic-bulletin/html/eb201902-a070c3a338.en.html#IDofOverview_Eb1
3. https://www.imf.org/external/datamapper/PCPIPCH@WEO/OEMDC/ADVEC/WEO_WORLD/IND/YEM
4. <https://www.marketwatch.com/story/chinas-caixin-manufacturing-pmi-rises-in-march-2019-03-31>
5. <https://ihsmarkit.com/research-analysis/global-economy-buoyed-as-service-sector-offsets-manu-070319.html>
6. <https://tradingeconomics.com/euro-area/industrial-production>
7. Source EPFR Global, BofA Merrill Lynch Global Research, as of 10 April 2019.
8. <https://www.bloomberg.com/news/articles/2019-03-24/euro-area-s-floundering-economy-gets-a-little-fiscal-pick-me-up>
9. <https://www.creditmarketdaily.com/corporate-bond-market-returns-ig-hy/>
10. Source: Muzinich internal research.
11. BofA Merrill Lynch European High Yield Constrained Index (HECO), as of 31st March 2019
12. ICE BofA Merrill Lynch Global High Yield Constrained Index (HWOC), as of 31st March 2019
13. Bloomberg, Barclays Global Aggregate Negative Yielding Debt Market Value USD. As of April 10th 2019.

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