



# Credit Continuum

ANALYSIS

September 2019

*Against an uncertain macroeconomic outlook, we believe a focus on higher-quality credits could offer investors some downside protection*

Central banks in developed economies are engaged in a new phase of monetary easing, justified by lasting trade tensions which is weighing on the corporate outlook, as well as lower inflation expectations. Although not coordinated, these moves appear to be in synchronicity as regional dynamics are converging on the downside.

As a result, the pile of negative yielding assets continues to grow with the Bloomberg Barclays Global Negative Yielding Debt Index now at over US\$16 trillion.<sup>1</sup> While the majority of this is in sovereign paper, the amount of negative-yielding corporate bonds is also growing, incorporating a significant portion of the European corporate bond market.<sup>2</sup>

However, these numbers do not reflect the situation of euro-based investors, who are faced with a much higher wall of negative-yielding assets due to the hedging costs attached to foreign currencies investment, in particular US dollar-denominated assets.

While hedging costs have declined in 2019, we believe the fall in US sovereign yields has been even more spectacular lately, removing value from abroad investments.

In our view, although macro fundamentals remain vulnerable to trade tensions, monetary policy stimulus is gaining intensity and offsetting risks of a global/US recession. In parallel, investors' demand for fixed income and carry remain strong. Record issuance in the investment grade market is being met with solid demand, which has reversed the spread widening we saw in the first weeks of August. High yield issuance is smaller and is also being easily absorbed.

In our view, the combination of stable recession risk, strong technicals and moderately expensive valuations may continue to support inflows into credit markets as the search for yield and carry strategies become crucial for both institutional and retail investors. However, we believe investors should remain vigilant and be selective, and maintain a bias for good quality credit.

1. Source: Bloomberg, as of 12th September 2019
2. Source: ICE BofA ML Euro Corporate Index (ER00), as of 13<sup>th</sup> September 2019



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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.

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