

mirova

Creating Sustainable Value

MONTHLY MARKET  
REVIEW & OUTLOOK  
May 2024

# Understanding all the nuances of events in April

After an exceptional end to the first quarter for risky assets, April began with some profit-taking before subsequently recovering. During the first fortnight, the Nasdaq and Nikkei corrected by around 10%<sup>1</sup> and the European indices by around 3%<sup>1</sup> against a backdrop of outperformance by defensive stocks.

The high valuation multiples of certain market segments and the excessive positioning of investors at the end of March can only partly explain this change in tone. In the first part of the month, geopolitical tensions flared up again, with Iran's first direct attack on Israel on 13 April. This pushed oil prices up to \$92 a barrel<sup>1</sup> and fuelled a rise in interest rates, stagflationary fears and a return to risk aversion. The VIX, the implied volatility index for US equities, made a quick foray above the 20% threshold<sup>1</sup> in the middle of the month. Tensions then eased, allowing the Brent crude oil price to end April at \$88<sup>1</sup>.

The second half of the month was more constructive, with European and US equities down by around -1.5% and -4.5% respectively<sup>1</sup> over April, thanks to robust economic growth and corporate earnings.

Companies have presented their quarterly figures and on average, EPS<sup>2</sup> significantly exceeded consensus. On both sides of the Atlantic, the leaders are delivering, led by technology in the US, while in Europe banks and insurance are demonstrating their solidity and defensive sectors are doing better than expected, notably pharmaceuticals and consumer staples. This quarter also saw a broadening of positive earnings revisions across all sectors, as well as an improvement in margins.

Moreover European investors warmly welcomed the latest PMI Services survey data, now in line with expanding activity, and stronger-than-expected GDP growth<sup>3</sup> in the first quarter, confirming that Europe is well on the road to recovery. Growth reached +0.3%<sup>1</sup> q/q<sup>4</sup> versus +0.1%<sup>1</sup>. In the United Kingdom, it was +0.6% q/q<sup>1</sup> compared with 0.4%<sup>1</sup>. Consumer confidence improved again in April, albeit at a slow pace. In other good news, headline inflation remained stable at 2.4%<sup>1</sup> y/y<sup>5</sup> in April in the eurozone, while core inflation continued to slow, from 2.9%<sup>1</sup> to 2.7%<sup>1</sup>, in line with expectations.

In the United States, although domestic demand remains vigorous, rising by 0.7%<sup>1</sup> in April and 3%<sup>1</sup> in Q1, there was a slight deterioration in the growth/inflation mix. The first GDP estimate came in at 1.6%<sup>1</sup> q/q, below the 2.5%<sup>1</sup> expected and the 3.4%<sup>1</sup> of the previous quarter, while inflation figures are no longer falling, at 0.4%<sup>1</sup> for April, compared with the 0.3%<sup>1</sup> expected, thus remaining at the same level for the third consecutive month. Over the year, CPI<sup>6</sup> inflation stood at 3.8% and the core PCE index at 2.8%, still above the Federal Reserve's target.

Quite logically, the ECB decided to keep interest rates unchanged at its last meeting, citing a lack of significant progress in the fight against inflation, while ruling out the possibility of an interest rate hike in the future, a statement that was very popular with investors.

We expect the Fed<sup>7</sup> to make one or two rate cuts between now and the end of the year, concentrated after the summer. As for the market, expectations of rate cuts between now and the end of 2024 fell from 67 basis<sup>1</sup> points to 27 bp in April, then rebounded to 40<sup>8</sup> bp<sup>9</sup> following the latest job creation figures, which were slightly below expectations.

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<sup>1</sup>Source: Bloomberg

<sup>2</sup> Earnings per share, a company's net profit divided by the number of shares in its capital

<sup>3</sup> Gross domestic product

<sup>4</sup> Quarter

<sup>5</sup> Year

<sup>6</sup> Consumer Price Index

<sup>7</sup> US Federal Bank

<sup>8</sup> Source: Bloomberg

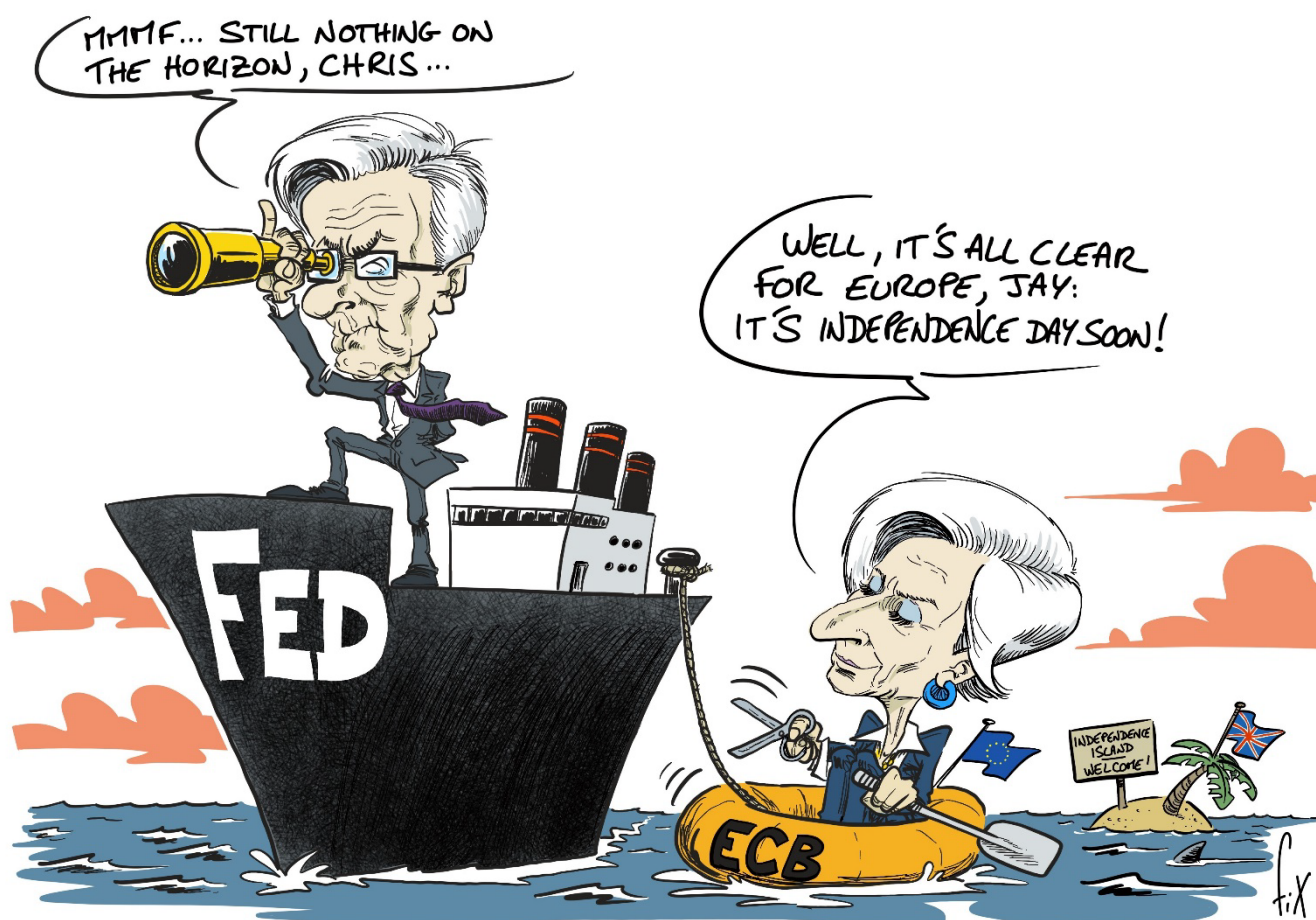
<sup>9</sup> Basis points



In Europe, the ECB<sup>10</sup> confirmed its optimism, with a first rate cut highly likely on 6 June. Christine Lagarde and her team are confident that inflation will return to 2% <sup>11</sup>and should therefore take a different path from the Fed. However, investors' average expectations of ECB rate cuts between now and the end of 2024 fell from 89bp<sup>11</sup> to 66bp<sup>11</sup> during April, thus eliminating a cut.

In the end, the German Bund lost 1.8%<sup>11</sup>, French OATs<sup>12</sup> lost 1.5% and Italian BTPs<sup>13</sup> lost 1.1%. The biggest fall was in 10-year US Treasury bonds: -2.4%<sup>11</sup>. Sovereign bond markets thus all fell in unison.

Other notable market movements in April included the sharp fall in bitcoin, which lost around 15%<sup>11</sup>. Conversely, copper, which is used extensively in the energy transition, gained 14%<sup>11</sup>, posting its best monthly performance since February 2021, buoyed by an imbalance between supply and demand.



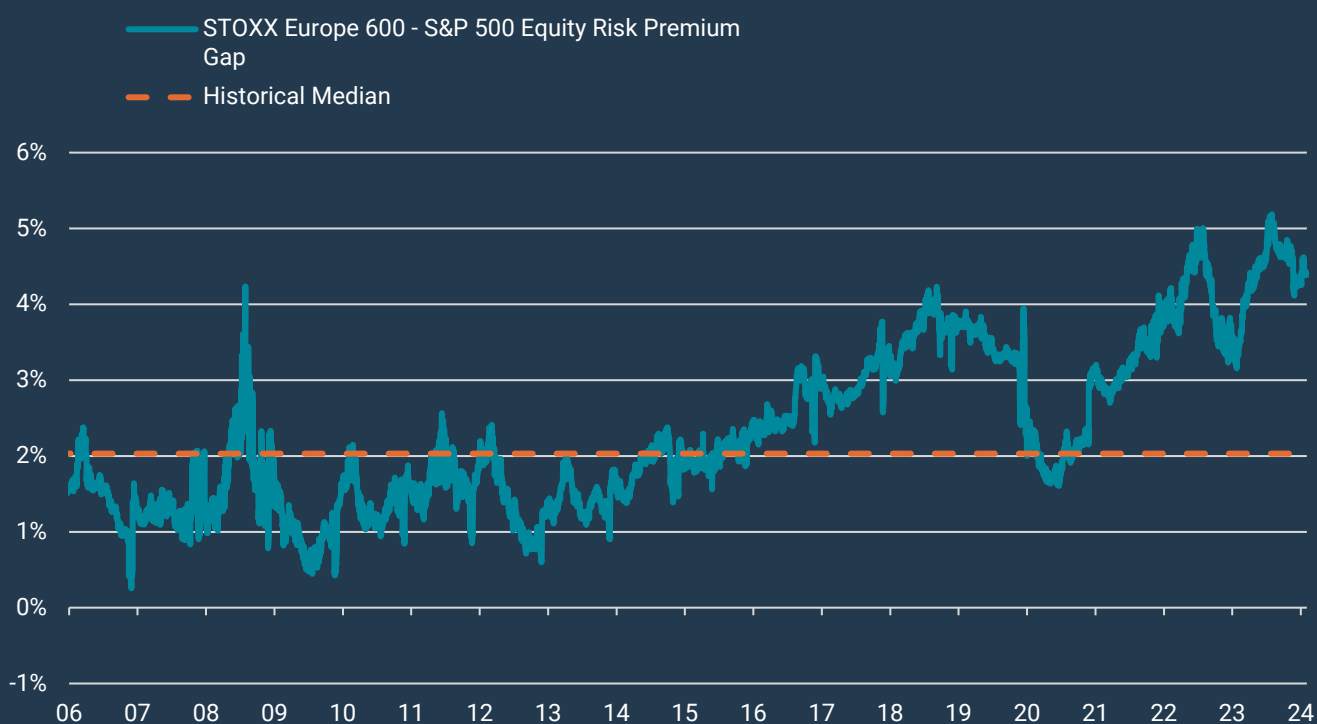
<sup>10</sup> European Central Bank

<sup>11</sup> Source : Bloomberg

<sup>12</sup> Similar Treasury bonds

<sup>13</sup> Italian government bonds

## Graph of the month: risk premium differential in favor of european vs. american equities



\* Equity risk premium based on the difference between the equity earnings yield (1/PE) and the 10-year interest rate

Source: Bloomberg

# Macro review and outlook

## Solid macroeconomic performance on both sides of the Atlantic

April confirmed our favourable macroeconomic scenario, as demonstrated by forecast and real indicators, particularly in Europe. The Federal Reserve and the ECB<sup>14</sup> clarified their policies for the coming months and are unlikely to adopt the same pace for their rate cuts.

### United States: the Fed at the helm

In the United States, the Federal Reserve maintained its key rate at 5.5%,<sup>15</sup> in the face of disinflation that seems to have paused. Following the FOMC meeting<sup>16</sup>, it is clear that the Bank will not cut rates immediately, adopting a "higher for longer" stance. However, this firmness does not seem to be causing concern on the market, for a number of reasons.

Firstly, fears of an acceleration in job creation leading to an overheating economy seem to have been allayed. The latest figures for April came in below expectations, and estimates for the previous two months were revised downwards. Average hourly earnings rose by 0.2%<sup>15</sup>, slightly less than the 0.3%<sup>15</sup> expected, reducing the year-on-year increase to 3.9%<sup>15</sup>, compared with 4.1%<sup>15</sup> in March. This is the lowest annual increase since June 2021. Average hourly earnings are not the Fed's preferred wage measure, as they are too noisy, but other indicators also point to an easing in wage pressures, notably a fall in the rate of voluntary resignations to below pre-pandemic levels.

Furthermore, the impact of external shocks such as rising oil prices or transport costs seems contained at this stage.

As a result, a large part of the disinflation could now come from the slowdown in rents, which account for over 40%<sup>15</sup> of the services price index, and which are likely to fall over the coming months/quarters.

In theory, the halt in disinflation could have raised fears of an interest rate hike, but Jerome Powell seems to have ruled this out at the last meeting. On the contrary, the Fed wants to reduce the pace of quantitative tightening, which the market has taken on board.

As for US consumption, it remains buoyant. US consumers' savings are melting away, particularly those of the most vulnerable households. Nevertheless, rising stock markets and property prices, as well as wage growth that continues to outpace inflation, are giving them a real boost to their purchasing power. For example, retail sales rose in March (and also in April), bringing the first-quarter increase to almost 3%<sup>15</sup> on an annualised basis. In addition, the share of private consumption in GDP over the quarter came in above expectations, demonstrating solid growth. Americans are also benefiting from a dynamic labour market. Job creation, few redundancies, an increase in the number of hours worked and less part-time work than in recent months: the job market data are reassuring.

The areas to watch are real estate and manufacturing. Sales of existing properties are suffering from interest rate levels and residential construction is weakening. Market inventories are rising, but this slowdown could also help to curb inflation. As for the ISM manufacturing index<sup>17</sup>, it failed to break through the 50-point threshold. The manufacturing sector has been struggling in the US for the past 18 months, with the exception of the automotive and high-tech sectors. Longer periods of high interest rates and a strong dollar could slow the manufacturing

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<sup>14</sup> European Central Bank

<sup>15</sup> Source : Bloomberg

<sup>16</sup> The Federal Open Market Committee is an arm of the US Federal Reserve responsible for overseeing all open market operations in the United States.

<sup>17</sup> Index reflecting the economic health of the manufacturing sector



recovery in the short term, but low inventories, fiscal stimulus through the CHIPS Act<sup>18</sup>, the need for housebuilding and an improving supply chain situation should encourage a gradual recovery. So the increase in the 'prices paid' component of the PMI indices is not a cause for concern at the moment; it has more to do with the temporary rise in the price of oil.

## Europe: good news on all fronts

With good news and pleasant surprises, the various publications from the eurozone in April were reassuring on all fronts. Although headline inflation remained unchanged at 2.4%<sup>19</sup>, core inflation fell, as did services inflation to 3.7%<sup>19</sup>, despite being stubbornly stuck at 4%<sup>19</sup> for five months, while the economy is finally rebounding after five quarters of stagnation. Real GDP came as a surprise, rising by 0.3%<sup>19</sup> in the first quarter, raising hopes of annual growth slightly lower than 1%<sup>19</sup>, well above consensus forecasts at the start of the year.

This combination of factors will allow the ECB to start cutting rates with greater confidence. A fall of 25 basis points<sup>19</sup> in June seems almost certain.

Market confidence also continues to be fuelled by positive publications from all eurozone countries. Germany is emerging from stagnation, with growth of 0.2%<sup>19</sup> over the quarter. Exports and construction investment are picking up again, and we expect inflation to fall back below 2%<sup>19</sup> by the summer. France stood out for its acceleration in household consumption, up by 0.4%<sup>19</sup>, compared with 0.2%<sup>19</sup> in the previous quarter. Growth in Italy and Belgium was 0.3%<sup>19</sup> and even 0.7%<sup>19</sup> in Spain and Portugal.

The improvement in the European situation can also be seen in the expansion of the PMI indices for the region, which reached 51.7<sup>19</sup> points in April for the composite index (compared with 50.3 in March)<sup>19</sup>, an 11-month high, exceeding that of the United States for the first time in a year. The figure for the services sector is 53.3<sup>19</sup>. France is at around 50, a threshold finally crossed by Germany, after nine months stuck below it. Southern Europe's momentum continues, with solid figures.

Another positive point is that the job market is doing well. Services are continuing to create jobs, and job cuts in manufacturing are slowing. Europeans are benefiting from an increase in foreign demand, which is boosting exports and supporting employment and real incomes. Finally, the black spots in the European economy - construction and property - could soon benefit from an easing of financing terms. All these data support the assumption of a rate cut in early June.

## UK: A catch-up is in sight

Having underperformed the US and the eurozone since the start of the pandemic, with the decline deeper in 2020 and the subsequent recovery more sluggish as a result of soaring energy and food prices, the UK economy has started to make up some of the lost ground. This is reflected in the first estimate of real GDP growth for the first quarter of 2024, at 0.6%<sup>19</sup>. Investment is making a comeback in the UK, where there has been an acceleration in services, while pressure on prices is easing, although it remains too high. In line with consensus, we expect the BoE<sup>20</sup> to make its first rate cut this summer, in early August, after the ECB but before the Fed.

<sup>18</sup> Chips Act: legislation designed to increase production rates, reduce costs for US consumers and stimulate innovation and employment

<sup>19</sup> Source : Bloomberg

<sup>20</sup> Bank of England



## China: growth at risk

China's real GDP growth of 5.3%<sup>21</sup> year-on-year failed to impress the market much. In fact, it was more impacted by the fall in retail sales and industrial production in China at the end of the first quarter. Investors and economists do not seem to approve of the choice of stimulating growth through a supply shock. The government has chosen to fuel the economy by favouring the manufacturing sector through production subsidies, which has automatically encouraged the rebuilding of stocks. This has the advantage of supporting businesses and jobs, at least in the short term. However, this means finding outlets for these stocks, mainly outside China. Faced with the reluctance of Westerners, who are preparing or announcing tax increases on Chinese imports, this policy could put pressure on prices and GDP. This is compounded by a slowdown in domestic consumption, which is returning to normal after the Chinese New Year.

Having stabilised the job market through fiscal stimulus measures, the government intends to maintain its support for the property sector, which has suffered greatly. We therefore expect interest rate cuts to continue between now and the end of the year. Sales have already started to stabilise in some towns. However, much more will be needed to reassure households. Moreover businesses and investors remain concerned about the lack of a fixed and stable regulatory outlook.

## The Fed and US elections: possible scenarios

The first US interest rate cut could come before the elections, in September or October, which is what the market is anticipating. There could also be another one after the elections, depending on the make-up of the two houses. If one of the parties wins a majority in both houses of Congress, this will leave the new President and his administration with plenty of room for manoeuvre when it comes to new fiscal stimulus, the priorities of which will differ depending on whether the Democrats or the Republicans have a majority. Their spending could boost inflation and convince the Fed to maintain its conservative stance.

Conversely, if Congress remains divided, the possible tax cuts sought by the Republicans, or the social spending planned by the Democrats, will be much more limited or even blocked. This could encourage the Fed to cut rates again.

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<sup>21</sup>Source: Bloomberg

# The Long View

## HY<sup>22</sup>: inexhaustible (out)performance or yet another show of exuberance?

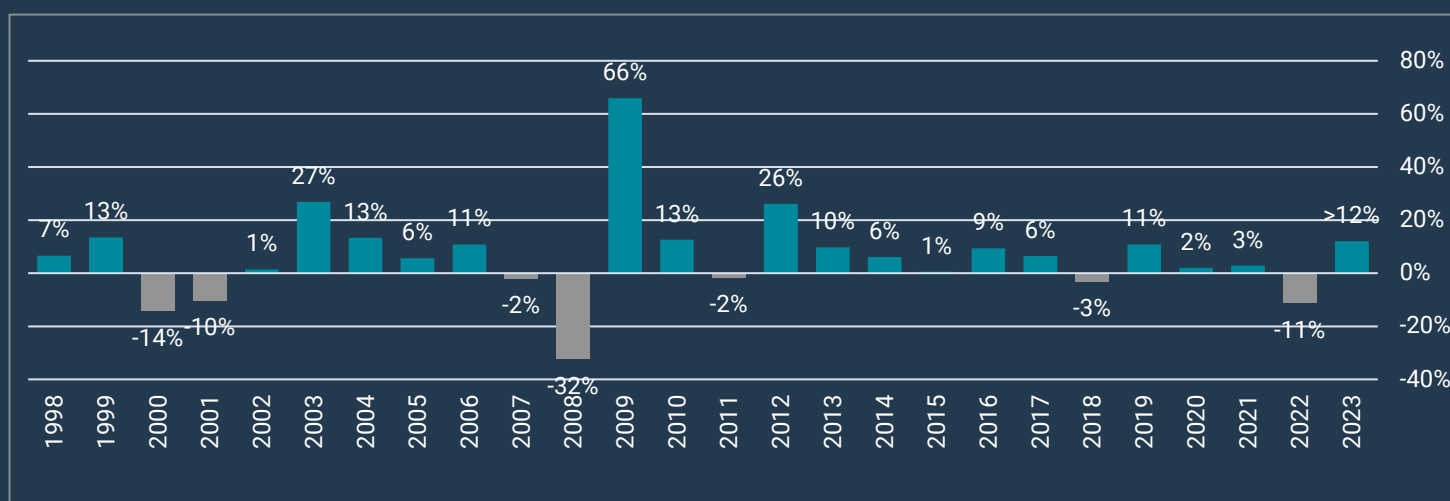
The recent spectacular performance of the High Yield (HY) segment, particularly since the summer of 2022, is raising scepticism if not questions. Its so-called relative cost has been the subject of debate for months, but has not curbed the upward trend. What some investors believe to be the result of market exuberance continued to surprise in 2022, then in 2023 and now again in 2024. Mirova, for its part, has made its choice: in our view, there are compelling reasons behind these performances and they could even augur well for the future. So how did we come to this conclusion?

Firstly, the HE40 index has delivered an average annual performance of 5.3%<sup>23</sup> since 1997. This puts the recent movements, which in historical terms are not so exceptional, into perspective. Holding HY is therefore part of a long-term strategy.

**Equivalent annual yield of 5.3% since inception in 1997 and growing**

Figures given refer to previous years. Past returns are not a reliable indicator of future returns

**Annual yield - HE40 High Yield EUR BB-BS index**



Source: Bloomberg, ICE 31/12/2023

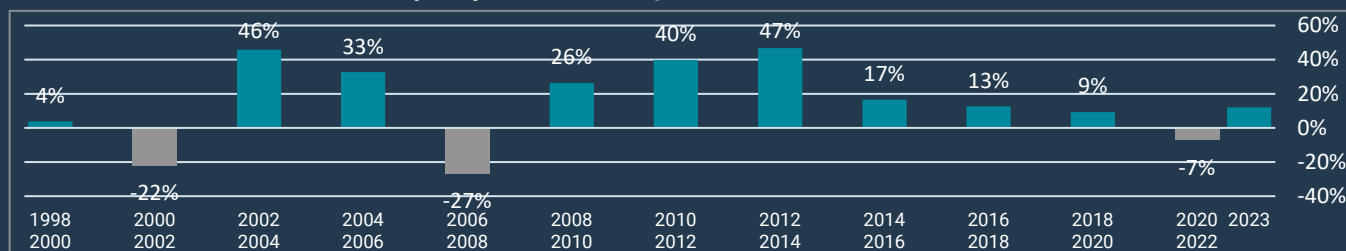
<sup>22</sup> High Yield

<sup>23</sup>Source: Bloomberg





3-year yield - HE40 High Yield EUR BB-Bs index



Source: Bloomberg ICE, 31/12/2023

## Once there were too many bond issues, now there are too few!

Three cyclical factors, which over time have become almost structural, have constantly reinforced the technical and fundamental factors of this bond asset class. The combination of these factors has produced a kind of new paradigm, which we believe is here to stay. It stems from a supply/demand imbalance, virtually zero correlation with rates and, subsequently, convexities favourable to holders. All this has laid the foundations for the outperformance of HY.

Let's look at these three factors again:

### 1. Covid has side effects...

The Covid episode has had significant implications. Between the downgrades of Investment Grade (IG) issuers to HY and the flight to liquidity of all these issuers, including IG, HY indices had swelled, reaching a peak in 2021.

As we know today, companies borrowed more than they really needed. However, geopolitical events subsequently "closed" access to the primary market in 2022-2023 due to risk aversion. Add to this the low debt levels resulting from refinancing over the 2020-2021 period with maturities of 5-7 years at very favourable rates, a degree of flexibility in CapEx<sup>24</sup> required after years of major investment, sluggish M&A in the absence of transforming acquisitions, and a significant number of rising stars<sup>25</sup> and we had ideal conditions for a contraction in supply.

### 2. The hard / soft / no landing debat

Our regular readers will know that Mirova decided long ago in favour of a soft landing scenario, but the market has dithered, leading to questions about the prospects for interest rate rises, which initially clouded the perception of HY.

Many market players see rising interest rates, commodity prices, input costs - in short, inflation - as extremely negative catalysts for HY. This was also reflected in the record outflows in 2022. In our view, this approach is sometimes misleading for those who adopt it, at least at present, because HY can boast zero correlation with interest rates over long periods. Many issuers are agnostic to the effects of inflation, if they do not take advantage of it through price transmission mechanisms, because of their hyper-specialisation, or because they are very far up the value chain.

<sup>24</sup> Capital expenditure

<sup>25</sup> Rising stars: issuers whose rating has been upgraded from speculative grade, i.e. equal to or below BB+/ Ba1, to investment grade, i.e. equal to or above BBB-/ Baa3

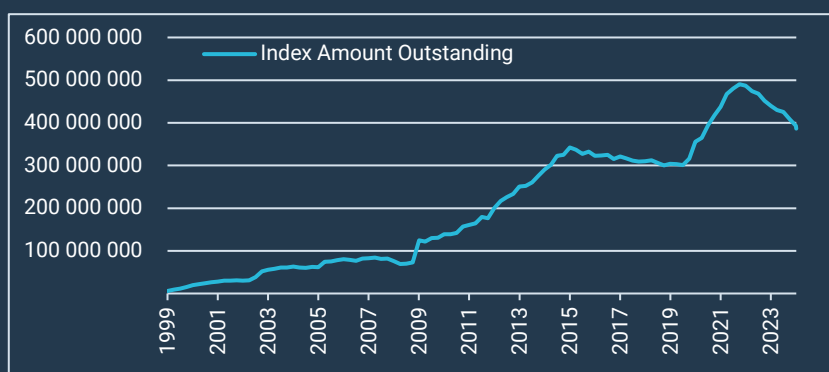
**(Very) low historical correlation between HY and movements in sovereign interest rates**

| From 2010 to 30/01/2023 | DBR 10Y | DBR 5Y | DBR 2Y | € Crédit IG | € BB-B |
|-------------------------|---------|--------|--------|-------------|--------|
| DBR 10Y                 |         | 0.05   | 0.01   | -0.18       | -0.03  |
| DBR 5Y                  | 0.05    |        | 0.02   | -0.14       | 0.03   |
| DBR 2Y                  | 0.01    | 0.02   |        | -0.08       | 0.02   |
| € Credit IG             | -0.18   | -0.14  | -0.08  |             | 0.69   |
| € BB-B                  | -0.03   | 0.03   | 0.02   | 0.69        |        |

Sources: Bloomberg at 30/01/23, correlation matrix tool, "CORR", Mirova

**3. The spectre of downgrading: who still believes in ghosts?**

No company wants to see its rating downgraded at a time when risk-free rates are soaring. Historic HY companies have not escaped this rule, and neither have their shareholders, who have succeeded in demonstrating financial flexibility. In many cases, the amount of debt has been significantly reduced during refinancing exercises, through capital injections from sponsors, asset sales or the use of cash on the balance sheet, thereby significantly limiting the impact of rising interest rates, all in order to maintain ratings and contain financial costs. Many HY companies have also restricted their distribution policies and lowered their net leverage targets. More than ever, companies are motivated to adjust their financial policies in order to maintain or even improve them.

*"He who matures early lives in anticipation"- Theodor W. Adorno***Technical effects like never before | HY has contracted by 21% in two years | The peak/off-peak variation could be as high as 40% if we got back to pre-COVID-19 levels**

Sources: Bloomberg at 31/03/24, Mirova

All these factors contributed to record attrition in the asset class. Indices fell so much under these effects that they easily offset the outflow.

Net demand - issues - redemptions - net inflows - rising stars + fallen angels<sup>26</sup> - has exploded since 2022. As a result, the index has contracted by 21% since its peak in 2021. For information, if it were to return to its former levels (those of 2019), this would mean a further 20% reduction in the index.

<sup>26</sup> Fallen angels: issuers whose rating has been downgraded from investment grade, i.e. equal to or higher than BBB-/ Baa3, to speculative grade, i.e. equal to or lower than BB+/ Ba1

### Expensive on the surface, attractive deep below?

HY derives a large part of its expected return i) from its current yield (or coupons/interest), ii) from variations in its spread, iii) to a lesser extent, from risk-free rates and iv) from call structures, i.e. convexity. It is still common to see more than three redemption options, with different dates and prices. The closer the date, the higher the price for compensating investors.

It should also be pointed out that HY returns are measured "at worst", i.e. at the minimum level that investors can expect. **All things being equal, it can only get better!**

To sum up, any redemption that takes place earlier than expected, given that most bonds are currently trading below par (meaning that the market expects redemptions on average at maturity, i.e. as late as possible), considerably increases the yield in the current configuration. This is not at all the case for most asset classes, including IG and subordinated debt.

### The latent potential of HY: call dynamics and convexity

Sources: Bloomberg at 31/03/24 on a sample of around 100 stocks, Mirova

If we correct spreads and yields for this effect, assuming premature redemption in one to three years, then HY, excluding subordinated bonds, can deliver up to 2.4% more yield than the worst-case yield. The effect is radical.

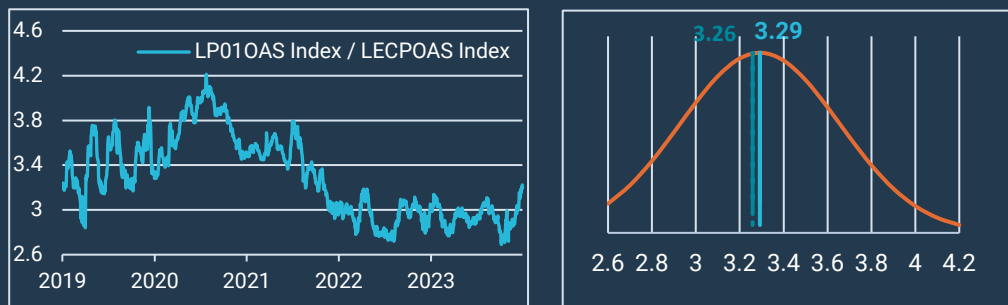


However, the fall in interest rates may make this assumption of early redemption more than plausible because, by increasing the price of bonds, it encourages issuers to refinance early. It should also be noted that single B issuers with a capital structure concentrated on one maturity are more than encouraged by the rating agencies to recall their bonds at least one year before maturity in order to avoid a downgrade to CCC on the liquidity factor.

Even as they stand, without recourse to these assumptions, HY spreads do not seem to us to be aberrant or extreme compared with other asset classes:

- multiples vs IG are at their median level of 3.3 ;
- CDS indices reflect a default rate of 1.9% in terms of number of issuers, in line with default rates over a sliding year.

**Carry trade and absolute high yield have returned to the 5%+ level. At 3.3, the HY vs IG multiple is very close to the historical average/median.**



Sources: Bloomberg at 31/03/24, on the above-mentioned indices, "HS" tool, Mirova

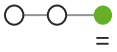
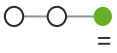
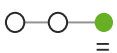

Let's not forget that the Euro HY universe remains better rated than many observers seem to think, as they often overlook the strong preponderance of BBs and comprise more contractual 'subordinates', often issued by companies rated IG (A, AA at senior level) than they think. All this means that current spreads need to be put into perspective, and caution should be exercised when making historical comparisons. Today, HY is tending towards better quality than its historical average, and the market does not seem to have fully taken this into account.



# Summary

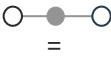
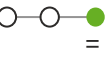
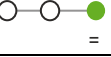
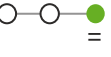


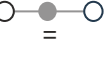
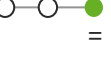
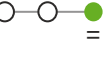
## Market views

### SUMMARY

| ASSETS CLASS | LONG-TERM   | CONVICTION | COMMENTS   |
|--------------|---|------------|--|
| Equities     |    | Strong     | <ul style="list-style-type: none"> <li>Outperformance of stocks in 2024 against a backdrop of disinflation, easing monetary policy, macro rebound on a global scale and strong performance of corporate results. Positive surprises from Europe</li> <li>Any substantial correction would be used to strengthen positions</li> </ul>   |
| Credit       |   | Moderate   | <ul style="list-style-type: none"> <li>Long credit because of advantageous carry with <i>spreads</i><sup>27</sup> remaining attractive. Technical factors still favourable (off-demand imbalance, relatively little refinancing in 2024)</li> <li>Moderate increase in default rates given macro resilience</li> <li>Preference for short-term trading range <sup>28</sup>scenario given the strong tightening of spreads in recent months</li> </ul>                            |
| Duration     |  | Moderate   | <ul style="list-style-type: none"> <li>Slight long duration due to the end of the monetary tightening cycle, a continuation of the disinflation movement and a diversification effect vs risky assets now beneficial. Attractive real rate levels in the absence of a growth acceleration scenario in the United States.</li> <li>Be careful, however, of the volatility on the US curve still too dependent on macro/inflation data. Preference for Eurozone and UK.</li> </ul> |
| Cash         |  | Moderate   | <ul style="list-style-type: none"> <li>Attractive short-term return/risk couple but should suffer from a reallocation to risky assets as policy rates drop and our scenario materializes.</li> </ul>   |

<sup>27</sup> Spread is the difference or difference between the two prices of an asset in the financial sector. On the one hand we have the value of the purchase and on the other we have the selling price.

<sup>28</sup> The Trading Range is a relevant indicator of the market especially for stochastic indicators.

| EQUITIES                        |   |            |  |
|---------------------------------|---|------------|--|
| ASSETS CLASS                    | MIDDLE/LONG TERM  | CONVICTION | COMMENTS   |
| US                              |    |            | <ul style="list-style-type: none"> <li>Successful soft landing scenario <sup>29</sup>resilient consumption via wealth effect, end of destocking and manufacturing rebound. Pause in terms of disinflation justifying an easing of monetary policy later than anticipated (September).</li> <li>Unfavourable valuations (risk premium, price/earnings ratio, etc.) partially offset by a trend of relatively positive revisions. Q1 results publications higher than expected</li> <li>Specific risk related to overrepresentation of the "Magnificent Seven". Expansion of future sector leadership</li> </ul> |
| Euro                            |    | Strong     | <ul style="list-style-type: none"> <li>Leading indicators clearly improving, macro rebound in progress. Continuation of the disinflation movement justifying an easing of monetary policy (June). Positive real purchasing power gains for consumption.</li> <li>Attractive valuation, under-held market, potential recovery of global trade favouring European exports</li> <li>Positive Earnings momentum. Q1 results publications higher than expected</li> </ul>   |
| United Kingdom                  |    | Strong     | <ul style="list-style-type: none"> <li>Improved growth prospects, continued disinflation consistent with future monetary policy easing (august)</li> <li>Attractive valuation, high dividend yield</li> </ul>  |
| Japan                           |   | Moderate   | <ul style="list-style-type: none"> <li>Ongoing rerating <sup>30</sup>related to the private sector liberalisation movement (improvement of governance).</li> <li>Higher wages and inflation expectations should support consumption</li> <li>Short-term risk remains of potential monetary tightening leading to an appreciation of the Yen. Lighten sectors benefiting from the weakness of the yen, strengthen banking</li> </ul>  |
| Emerging Markets                |  |            | <ul style="list-style-type: none"> <li>On the positive side, a rebound in global manufacturing PMI and Chinese growth above expectations, the beginning of a policy rate cut for certain emerging countries, risk premium and valuation reasonable relative to DM</li> <li>Negative, EPS growth <sup>31</sup>expected for 2024/2025 a little too optimistic while the relative revision dynamic vs developed countries remains negative. Penalized by the Fed's "higher for longer" narrative, strong dollar</li> <li>Fed pivot waiting to be more constructive</li> </ul>                                     |
| Growth vs. Value                |  |            | <ul style="list-style-type: none"> <li>Barbell positioning consisting of both high growth companies (techno, health, etc.) and highly discounted companies (banks, utilities, etc.). Preference for companies with positive margin and earnings revision dynamics</li> </ul>   |
| Quality vs. High Volatility     |  |            | <ul style="list-style-type: none"> <li>Quality underperformance against a backdrop of macro rebund and lower risk, aversion at risk in the event of a fall in interest rates</li> <li>Over-held style, at risk if rate relief</li> </ul>   |
| Small vs. large capitalisations |  | Moderate   | <ul style="list-style-type: none"> <li>Valuation of small caps attractive in relative terms (vs. large caps, history and macro conditions)</li> <li>Improved earnings momentum and start of outperformance which should increase if interest rate ease</li> <li>Preference for European small cap</li> </ul>   |
| Cyclical vs. Defensive          |  | Moderate   | <ul style="list-style-type: none"> <li>High cyclical vs. defensive valuation relative to history, offset by positive earnings revision momentum</li> </ul>   |

<sup>29</sup> A period when economic growth slows down, but the economy does not enter recession

<sup>30</sup> the changing of the price, value, etc. of something

<sup>31</sup> Profit per share



| CREDIT                 |           |            |   |
|------------------------|-----------|------------|---|
| ASSETS CLASS           | LONG TERM | CONVICTION | COMMENTS  |
| Investment Grade US    |           |            | <ul style="list-style-type: none"> <li>Preference for IG Euro in terms of valuation. Lower default rate.</li> <li>Refinancing needs: 2024 manageable; 2025/2026 more complicated</li> </ul>   |
| High Yield US          |           | Moderate   | <ul style="list-style-type: none"> <li>Levers in the high historical average while interest expense coverage ratios are falling, due to a decline in revenues and margins.</li> <li>The spreads of BB and B issuers are below their historical average (since the 2000s).</li> </ul>  |
| Investment Grade Euro  |           | Moderate   | <ul style="list-style-type: none"> <li>Reasonably priced quality assets that should continue to outperform in today's environment</li> <li>Preference for the IG Euro vs US because the relative rating enhancement dynamic is more favourable and the spreads less tight.</li> <li>Preference for short-term trading range scenario given the strong tightening of spreads in recent months</li> </ul>                         |
| High Yield Euro        |           | Moderate   | <ul style="list-style-type: none"> <li>Technical factors are still favourable (off-demand imbalance, no short-term refinancing problems). Relative valuation HY vs IG more favourable in EUR than in the US. Preference for EUR hybrids</li> <li>Short-term preferred range trading scenario given the sharp tightening of spreads in recent months</li> </ul>  |
| DURATION               |           |            |   |
| ASSETS CLASS           | LONG TERM | CONVICTION | COMMENTS  |
| 2-year US              |           | Moderate   | <ul style="list-style-type: none"> <li>End of the Fed tightening cycle, attractive real rates.</li> <li>However, the "higher for longer" narrative limits short-term potential. Continued disinflation in the second half of the year should reassure the market on this point..</li> </ul>   |
| 10-year US             |           |            | <ul style="list-style-type: none"> <li>In positive power of diversification and continuation of the movement of disinflation on the S2.</li> <li>Negative selling structural pressures (supply/demand imbalance, upward revision of potential growth...)</li> <li>Pentification scenario via a slight fall in short rates as the pivot approaches. Preferred trading range on the long part</li> </ul>                          |
| 2-year German          |           | Strong     | <ul style="list-style-type: none"> <li>End of the ECB tightening cycle: headline and underlying inflation in annualized pace over the past months converges towards the objective.</li> <li>Service price inflation has stalled after remaining at 4% since the beginning of the year.</li> <li>3 or 4 expected rate cuts including the first in June, in line with market expectations.</li> </ul>                             |
| 10-year German         |           |            | <ul style="list-style-type: none"> <li>Sovereign bonds diversification power and continued disinflation</li> <li>Steepening scenario resulting from continued normalisation of monetary policies coupled with a macro rebound in the second half that limits the potential for a decline over the long part of the curve</li> </ul>   |
| Europe peripheral debt |           | Moderate   | <ul style="list-style-type: none"> <li>Lower rates favourable to the sustainability of peripheral debts.</li> <li>Lower inflation and a status quo on the ECB's balance sheet cut reduce short-term concerns about Italy.</li> <li>Close to our target levels now</li> </ul>  |
| United Kingdom         |           | Moderate   | <ul style="list-style-type: none"> <li>Continuation of disinflation from higher levels than other developed markets; through lower energy prices and progressive normalisation of the labour market. Bank of England pause, in line with other central banks; attractive carry, especially on the long end</li> </ul>   |
| Japan                  |           | Moderate   | <ul style="list-style-type: none"> <li>Increased inflation expectations. Potential rate hikes. End of rate curve control</li> </ul>   |
| Emerging markets       |           |            | <ul style="list-style-type: none"> <li>Positively, disinflation dynamics and lower central bank key rates in some emerging markets but moderate appreciation potential vs cash USD in the short term. Preference for dollar-denominated debt</li> <li>In local currencies, exchange rate risk related to "higher for longer" Fed's narrative. Limited potential in the short term, more favourable in the long term.</li> </ul> |
| CASH                   |           |            |   |
| ASSETS CLASS           | LONG TERM | CONVICTION | COMMENTS  |
| EUR/USD exchange rate  |           |            | <ul style="list-style-type: none"> <li>Macroeconomic surprise dynamics favorable to the eurozone and the EUR in relative terms (cf. Citigroup Index)</li> <li>Timing and number of Fed vs. ECB rate cuts favorable to the dollar</li> </ul>   |



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