

## 2 Euro HY: an essential asset class in a low-rate environment

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HY Euro's performance in recent months has been remarkable. The HY Euro Index tightened by 157bp in 2016 and 48bp since the start of 2017. So why is it still a good idea to take a position on HY? To answer this question, we'll look at the technical factors, the fundamentals, and this market's valuation.

### The economic environment is still good for the credit markets

The most recent data confirm our scenario of a gradual recovery for economic growth in the eurozone. The global PMI, which measures activity in the private sector each month, has hit a nearly six-year high. To quote Mario Draghi: "The risks surrounding the euro area growth outlook have become less pronounced."

At the same time, the Central Bank is clear: "A very substantial degree of monetary accommodation is still needed." This position is explained by the absence of any convincing signs up to now of a recovery in core inflation. The slow implementation of structural reforms and the need for balance sheet adjustments are also pulling back on economic growth in some eurozone countries, primarily Italy.

### The ECB's accommodating monetary policy gives significant support to the credit markets:

- The additional yield offered by corporate debt is attractive to investors in a low-rate environment.
- Through its corporate sector purchase programme (CSPP), the ECB is a major player in the Euro Investment Grade market.

### > The ECB is a major player in the euro corporate debt market

The ECB's Corporate Sector Purchase Programme (CSPP) was announced in May 2016 and put in place last June. The programme's success is due to several factors:

1. **Flexibility:** the ECB does not give a pre-defined volume for its monthly purchasing. The central bank gives itself maximum room to manoeuvre to adjust its purchasing according to market trends.
2. **Size:** purchases are distinctly higher than market expectations. The average amount of weekly purchases made since the programme began is about €1.8 billion. If that rate remains stable, the ECB should have close to 17% of the eligible universe by end 2017.
3. **Scale:** the ECB is active on the IG market as well as the HY market. IG-rated HY issuers are eligible.
4. **Depth:** the ECB's purchases cover all sectors except banks.

### Technical factors of the Euro High Yield market are still fine

Net flows recorded by Euro HY over the past twelve months were slightly negative, based on data published by the EPFR. Be aware that these figures do not include purchases of securities for non-High Yield dedicated funds. The low-rate environment offers significant technical support: in fact, there are many Investment Grade managers who create High Yield components to increase the yield on their Investment Grade funds. Moreover, these flows should be put in perspective with the trend in outstanding High Yield debt.

Net volume of new issues was negative in 2016. The size of the High Yield market has decreased by 7% in 2016 after strong growth between 2009 and 2015. This movement can be explained by:

### The essential

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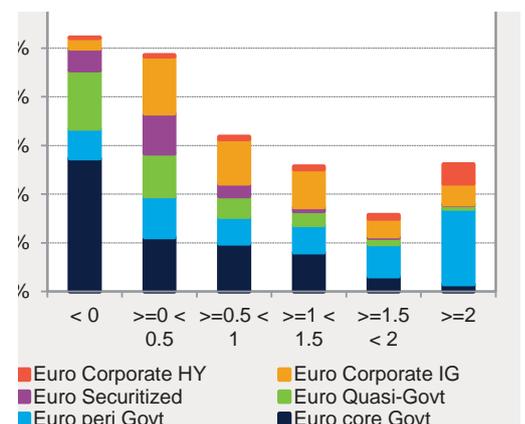
- The technical factors are supportive.
- Issuers' fundamentals remain favourable to bond investors. The default rate in the high-yield segment has fallen back in recent years to a historic low of 2%. We're at the centre of a virtuous circle: 1) strong demand for credit is helping issuers easily refinance their debt and extend their debt's average maturity, 2) historically low borrowing rates are also substantially reducing borrowing costs.
- In a low-rate environment, HY Euro offers attractive carry strategies.



Monetary policy will remain accommodating in the eurozone and contribute to keeping interest rates low



1 Eur fixed income market Yield distribution as of 03/23/2017



Source: Bloomberg, Amundi Research

