Macroeconomic Scenario

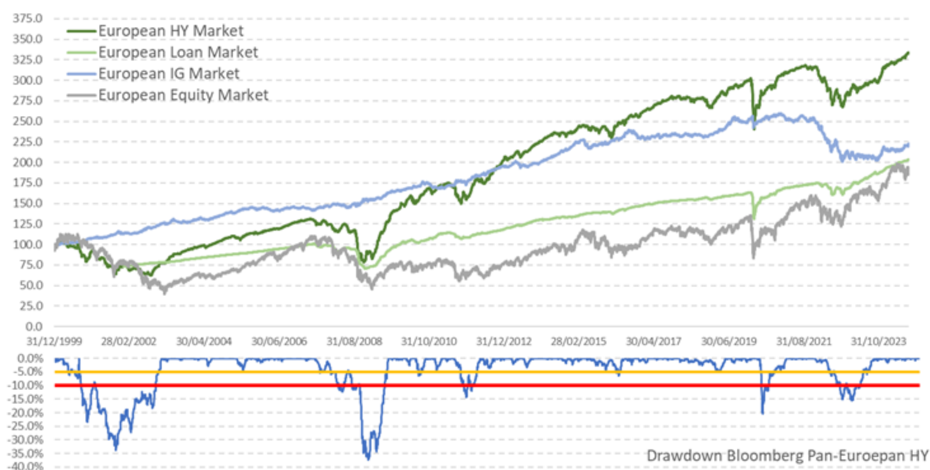
The long-awaited Fed meeting concluded with the institution announcing a 50bps rate cut, which seems like a compensatory move for a cycle of cuts that, according to Powell, could have begun as early as July. The decision, passed by a strong majority (11 to 1), was explained as necessary to recalibrate monetary policy, given the downward adjustment to inflation forecasts and the upward revision of unemployment estimates. However, during the press conference, Governor Powell downplayed expectations by emphasizing that the 50bps cut should not be interpreted as the pace for future cuts, as the labor market remains robust and the economy is in good shape.

A more cautious tone was also reflected in the dot plot, where the median projection of members anticipates another 50bps cut by year-end, followed by an additional 100bps in 2025, totaling 150bps. The market, however, is pricing in 200bps by the end of 2025. Some disappointment is likely. We believe the market will need to adjust its expectations, as we don't foresee significant deterioration in the labor market before the end of the year. In summary, the Fed has opted for a risk management approach to avoid falling "behind the curve" in case of further weakening in the labor market, which remains the key focus.

In the Euro area, we still expect solid real income growth and reduced monetary policy drag to support growth in the coming quarters. Core inflation is projected to slow further, driven by continued declines in services inflation, wage growth returning to normal levels, and fading energy-related impacts. The ECB is expected to deliver 25bp cut in December, followed by additional 25bp cuts until the policy rate reaches 2% by July 2025.

We continue to see the risk of recession as limited, given generally solid economic data, an absence of major financial imbalances, and substantial room for the Fed to act if necessary. Uncertainty remains high around the November US election, with potential policy shifts in trade, immigration, and fiscal matters depending on the outcome. Additionally, heightened geopolitical risks—stemming from ongoing Middle East tensions, the Russia-Ukraine conflict, and strained US-China relations—could significantly impact markets.

European high yield, on an aggregate level, has delivered good and solid returns this year. Rising intermediate rates have compressed spreads on the non-financial index, but yields have stayed within a range around 6%. Year-to-date total returns stand at 5.75%, a notable outperformance compared to higher-rated fixed income (€IG at 3.07%).

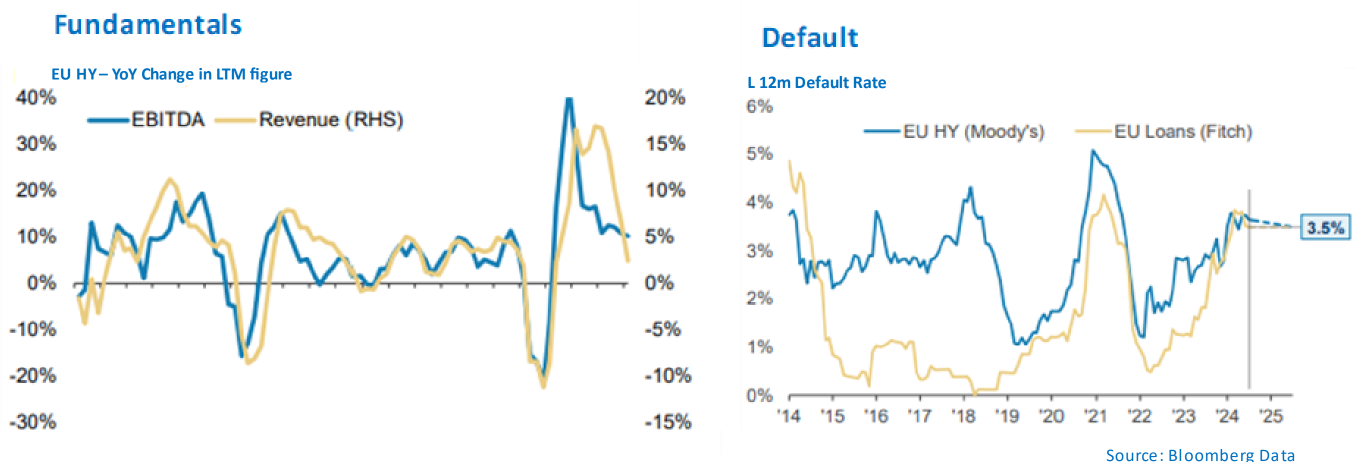


EU HY Credit Market

In the primary market, European leveraged finance supply has continued to stabilize this year, with a broad-based increase in deal volumes across both bonds and loans. Non-financial high-yield bond issuance has reached €79bn through August. We anticipate that refinancing needs will keep high-yield bond and loan issuance elevated throughout the remainder of the year. So far, bond refinancing has accounted for the majority of issuance (63%), though leveraged buyouts (LBOs) have picked up significantly since May, reaching their highest levels in six years (€6.5bn).

The high-yield market has made substantial progress in addressing debt maturing in 2024 and 2025, with many issuers taking a proactive stance on refinancing debt maturing in 2026. Issuers have benefited from a positive backdrop, driven by their ability to manage upcoming maturities through a combination of potential equity injections to support bond refinancings and bondholder-friendly measures such as asset sales and dividend cuts.

In Q2 2024, high-yield issuers have taken steps to improve EBITDA margins, generate additional cash flow, and maintain leverage at median levels, despite a sharper slowdown in revenue growth. This underlying strength has been reflected in net credit upgrades: Rating actions in the high-yield index bottomed out in June and have been trending upwards since then. Over the summer, upgrades outpaced downgrades, with CCC and B-rated issuers contributing less to the overall downgrade pressure compared to earlier in the year. After a sharp increase in default rates over the past two years, we expect these trends to gradually improve as economic growth recovers and financing conditions ease with central bank rate cuts expected in the second half of 2024. Default rates for high-yield issuers (based on Moody's issuer-weighted figures) are projected to decline slightly to 3.5% by Q2 2025.



Source: Bloomberg Data

Historically, rate cuts tended to be accompanied by a rotation out of money market funds into credit, a dynamic that we expect will support credit markets globally over the coming year.

With the average coupon now at 5% on average, the EUR High Yield market should generate a total return of 7,75% in 2024. We expect lower interest rates to generate the bulk of returns for the asset class going forward.

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