CANDRIAM
A NEW YORK LIFE INVESTMENTS COMPANY

Discover the potential of short-term bonds and a specific sustainable approach

60 seconds with the fund manager

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This marketing communication is aimed at non-professional customers.

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Philippe Dehoux, Head of Global Bonds at Candriam and lead manager of our Sustainable Euro Short Term Fixed Income strategy, Sylvain de Bus, Deputy Head of Global Bonds and co-manager, and Pierre Boyer, Head of Money Markets & Short Term and co-manager, discuss how short-term bonds combined with ESG selection criteria[1] can help make the most of the opportunities offered by the European bond market in today's volatile environment.

Can you give us an update on European bond markets?

After many years of very low or even negative yields, European short-term bond markets are finally offering attractive valuations, with yields on the rise following the tightening of monetary policies since June 2022 in the face of rising inflation.

Core markets such as France and Germany are showing positive rates across the curve, creating opportunities, particularly in Investment Grade credit[2]. The short end of the[3] curves has benefited greatly from this rise, and should continue to offer high yields in the medium term, as inflation should also remain above central bank targets. Note that we expect dispersion to increase, due to reduced support from central banks, as fundamental and specific risks take center stage. What's more, faced with markets impacted by secular trends such as deglobalization, digital transition and decarbonization, corporate business models are likely to be disrupted, creating winners and losers. We believe that greater selectivity, based on fundamental analysis and incorporating ESG factors, is essential to extract value from these markets. Furthermore, in an environment of reduced liquidity and increased volatility, active duration management[4] and flexible allocation are, in our view, important pillars.

Why should investors consider an allocation to short-term European sustainable bonds?

Faced with expectations of a normalization of ECB policy (reduction of its asset purchase program, end of the rate hike cycle), and the increased supply of issues, bond markets are likely to remain volatile. Against this backdrop, short-term bonds may be ideally placed to offer a potentially higher risk/return profile than the market as a whole.

Finally, by selecting these bonds according to ESG criteria, investors benefit from a strategy that takes sustainability risks into account, with a view to sustainable investment.

The euro-denominated corporate bond market is diversified in terms of region, sector and quality. For most of the last few years[5], it has provided higher yields than government bonds, with an attractive level of liquidity and volatility, particularly for short-term bonds. We expect this yield trend to continue, which is why we prefer to invest in corporate bonds as part of this short-term strategy.

60 SECONDS WITH THE FUND MANAGER

(1) Environmental, social & governance.
(2) Investment grade bonds are those with a high credit rating (low probability of default, rating above BBB-) awarded by a rating agency (such as Standard and Poor's).
(3) The yield curve represents the borrower's bond rates over several maturities. The y-axis therefore represents the rates, while the x-axis indicates the term to maturity.
(4) The duration of a bond is a measure of time (in years) that expresses: the weighted average maturity of all discounted bond cash flows (Macaulay duration), the sensitivity of bond prices to rate fluctuations (modified duration). Duration is widely used to measure the risks of bond portfolios linked to changes in the credit spread or risk-free rate.
(5) Comparing Euro IG Corporate Index and Euro Govt Indexas over 10 years, source: ICE, Bloomberg at 11/12/2023.

How do you approach your strategy?

This benchmarked strategy[6] invests mainly in Investment Grade corporate bonds and European government bonds. Our active management approach makes this a diversified, flexible strategy with a broad investment universe of sovereign, sub-sovereign, financial and non-financial bonds.

To define our investment universe, in addition to our exclusion policy[7], our in-house team of extra-financial analysts establishes ESG scores using an exclusive method designed to determine the quality of issuers from an extra-financial point of view. The aim is to include only issuers with the highest ESG profile, using a best-in-universe approach[8].

In addition, we aim to select the most attractive securities via our fundamental analysis, combined with our top-down process which helps define our interest rate strategy and credit allocation. This strategy may represent an interesting alternative in the current market conditions, with a focus on portability, risk/return and sustainability.

How do you create added value compared with the benchmark index?

Our added value lies in the rigor of our investment process, which combines ESG and financial analysis, enabling us to select stocks based on strong convictions. Allocation decisions between government and corporate bonds are primarily based on analysis of our positioning in the credit cycle, but we also take into account valuation and technical factors. In our government bond portfolio, we use active duration and yield curve strategies based on analytical frameworks developed in-house (based on macroeconomic, technical and valuation indicators). We combine these with a robust country selection process that incorporates ESG criteria to assess the credit risk of each country. Our selection of corporate bonds is based on an in-depth analysis of the quality of each issuer, paying particular attention to the risk of downgrading to speculative grade. We analyze their economic and financial profiles, also taking ESG criteria into account, which leads to the attribution of an internal credit rating independent of rating agencies.

Finally, we construct the portfolio according to the relative value of the different issues and a rigorous risk budgeting approach to ensure that the portfolio accurately reflects our view of the markets and that risks are appropriately spread. This process has contributed significantly to minimizing portfolio volatility, as well as meeting the strategy's sustainable objectives of reducing greenhouse gas emissions and having a positive long-term impact on environmental and social goals.

In order to contribute to and reinforce the sustainable aspect of the strategy, we also take care to include more Green Bonds[9] than the index, also selected through a combination of our fundamental and ESG analyses.

What are Candriam's strengths in managing this type of strategy?

Our strengths in managing this strategy lie primarily in combining our in-depth, long-standing bond market expertise in both government and corporate bonds with our recognized ESG expertise. Our team consists of seven sovereign analysts and eight[10] investment grade corporate debt analysts.

(6) Benchmark: reference index
(7) We only consider issuers that are not excluded by the Candriam Exclusion Policy. This document can be viewed at https://www.candriam.fr/fr/professional/market-insights/sri-publications/.
(8) The "best-in-universe" approach to ESG corporate selection favors companies with the best extra-financial ratings, regardless of their sector of activity.
(9) Any type of bond instrument whose proceeds will be used exclusively to finance or refinance projects with clear environmental benefits.
(10) Data subject to change over time.

In addition, instead of relying on financial ratings from external agencies, we use an in-house rating system based on our own fundamental analysis incorporating ESG factors. This has enabled us to experience no «fallen angels[11]» and no issuer defaults on this strategy since its launch in 2016. Another major strength lies in our risk management capabilities.

In addition to our rigorous valuation, we also apply strict internal rules on diversification and risk. In fact, a daily check is carried out by the risk department to ensure that the constraints in the strategy are being properly applied.

(11) A fallen angel is a security which, after having been classified as an investment-grade asset, shows a very significant drop in value, leading it to rapidly obtain a "junk bond" rating (below BBB-).

The main risks of the strategy are:

• Risk of capital loss:
There is no guarantee for investors relating to the capital invested in the sub-fund in question, and investors may not receive back the full amount invested.

• ESG Investment Risk:
The non-financial objectives presented in this document are based upon the realization of assumptions made by Candriam. These assumptions are made according to Candriam's ESG rating models, the implementation of which necessitates access to various quantitative as well as qualitative data, depending on the sector and the exact activities of a given company. The availability, the quality and the reliability of these data can vary, and therefore can affect Candriam's ESG ratings. For more information on ESG investment risk, please refer to the regulatory documents.

The risks listed are not exhaustive, and further details on risks are available in regulatory documents.