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Global Markets Division

Euro Corporate Bonds

Fixed Income

Recommendation: **BUY**

Investment Horizon: 9 Months

Vienna, January 31st

Team Overview

Global Markets Division



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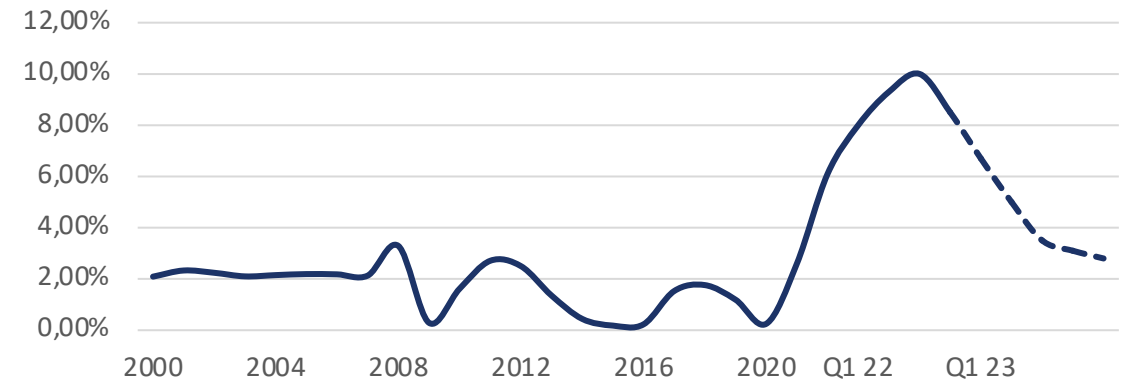
An overview of key economic data

Macroeconomic Analysis

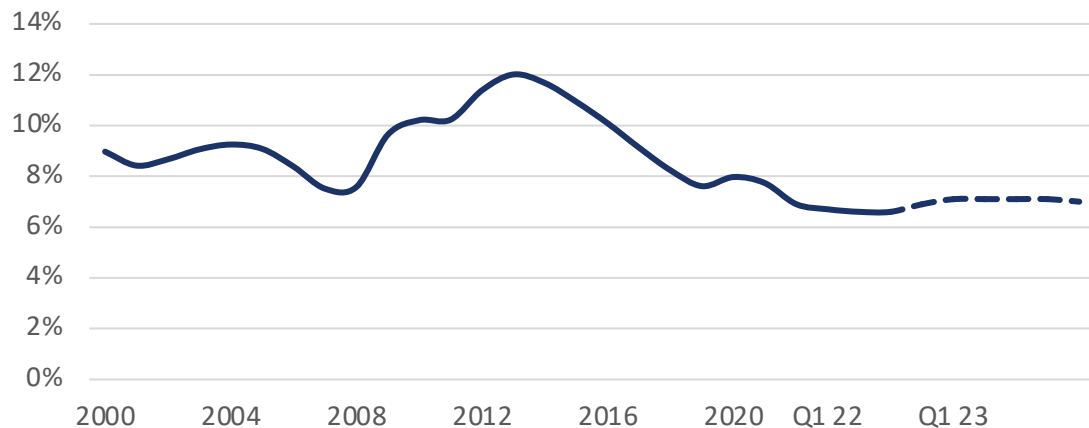
Real GDP Growth



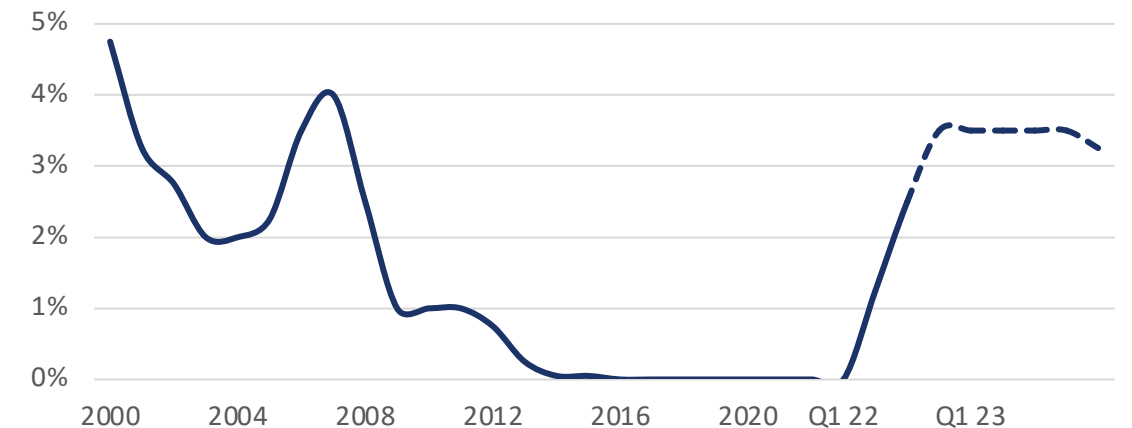
CPI (YoY)



Unemployment



Interest Rate



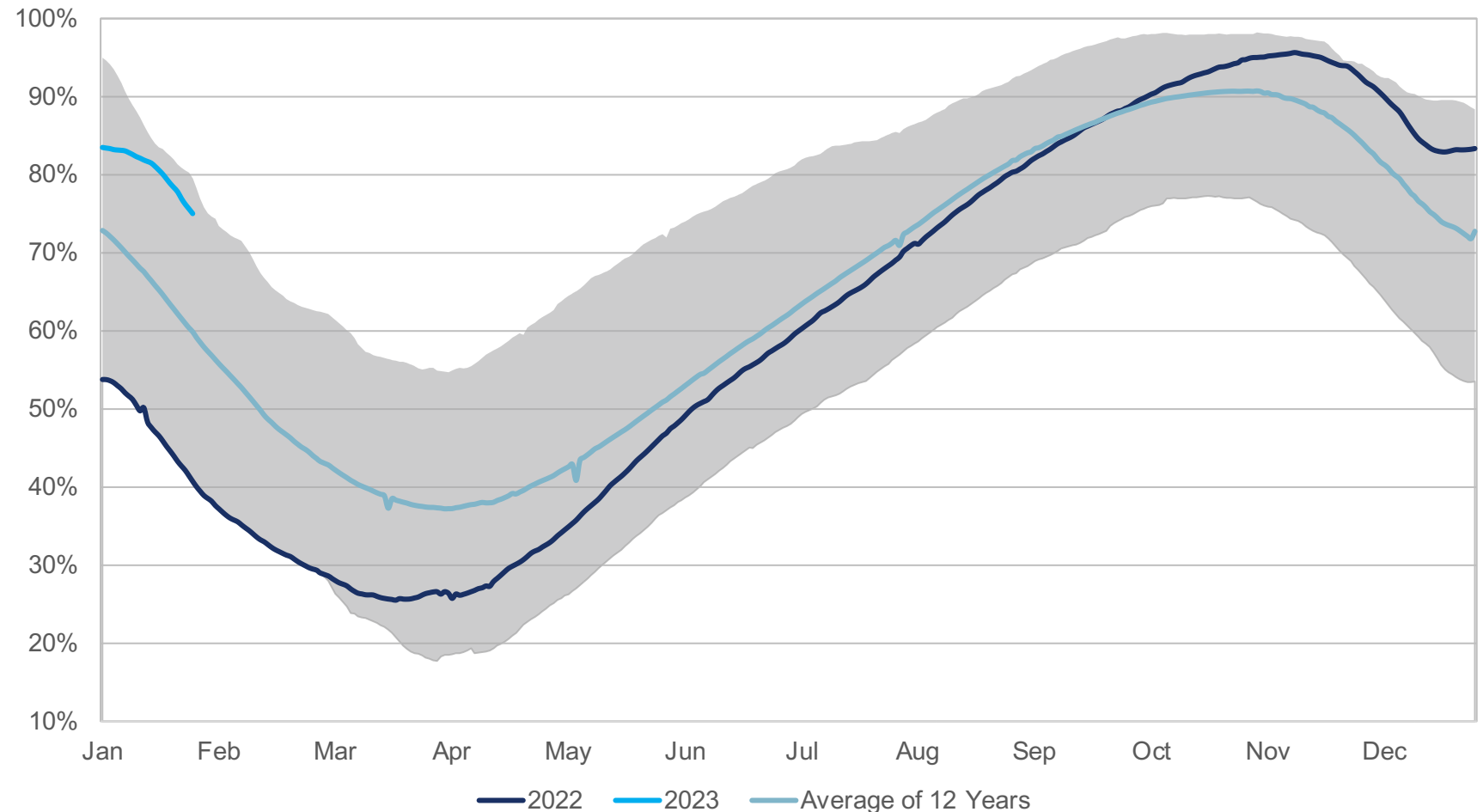
Energy – Europe's major problem

Natural Gas Consumption

Warm Winter proved important

- Recession fears are mainly based on the hit of real income from surging energy prices
- Europe's gas storage facilities are almost full - well above 2022 levels and close to 12-year highs
- Warm winter in Europe
- Goldman Sachs expects storage facilities to remain at least 20% full by the end of March – weather will be crucial

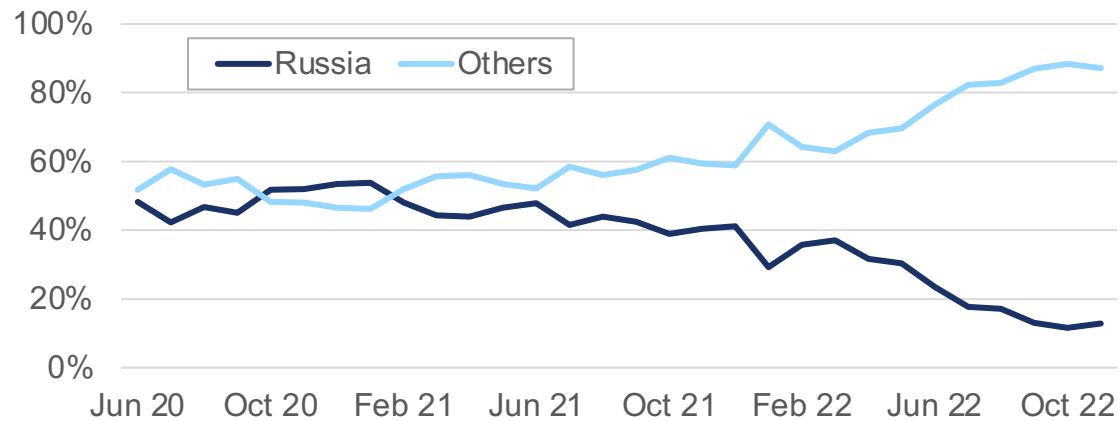
European Gas Storage



Full storages and higher diversification make prices tumble

European Energy Mix

Natural Gas Imports for the EU



- Russian gas imports are already cut by 80% and total gas consumption by 20-25%
- Record LNG imports and higher pipeline gas deliveries from the US, Norway, Algeria, Qatar, and Nigeria
- REPowerEU-Plan: Intensive efforts to build clean energy infrastructure and rapidly reduce dependence on fossil fuels from Russia

Dutch TTF Natural Gas Futures

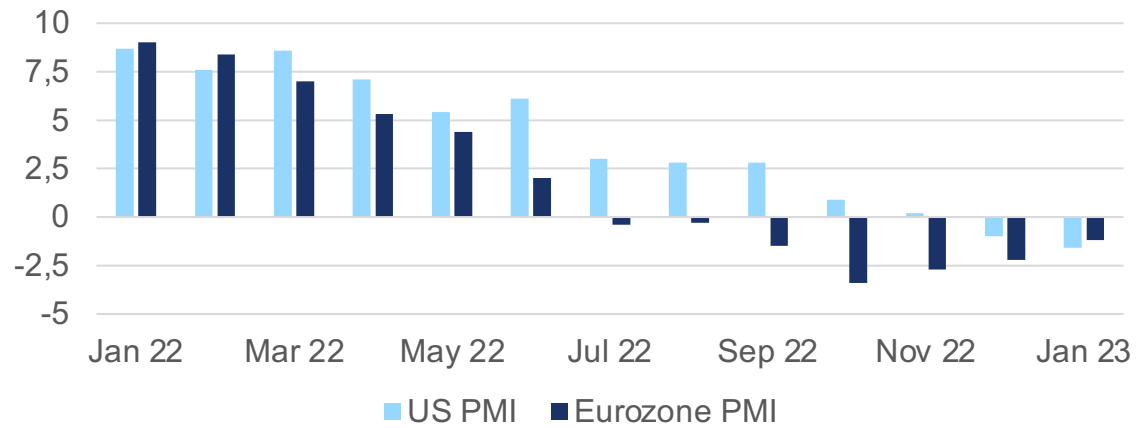


- Mild winter and full storages reduced gas prices by almost 75% from their peak
- Prices have fallen to levels before the war in Ukraine
- The energy crisis is not yet over – next winter may well be harder, depending on the weather, Chinese demand, and LNG availability

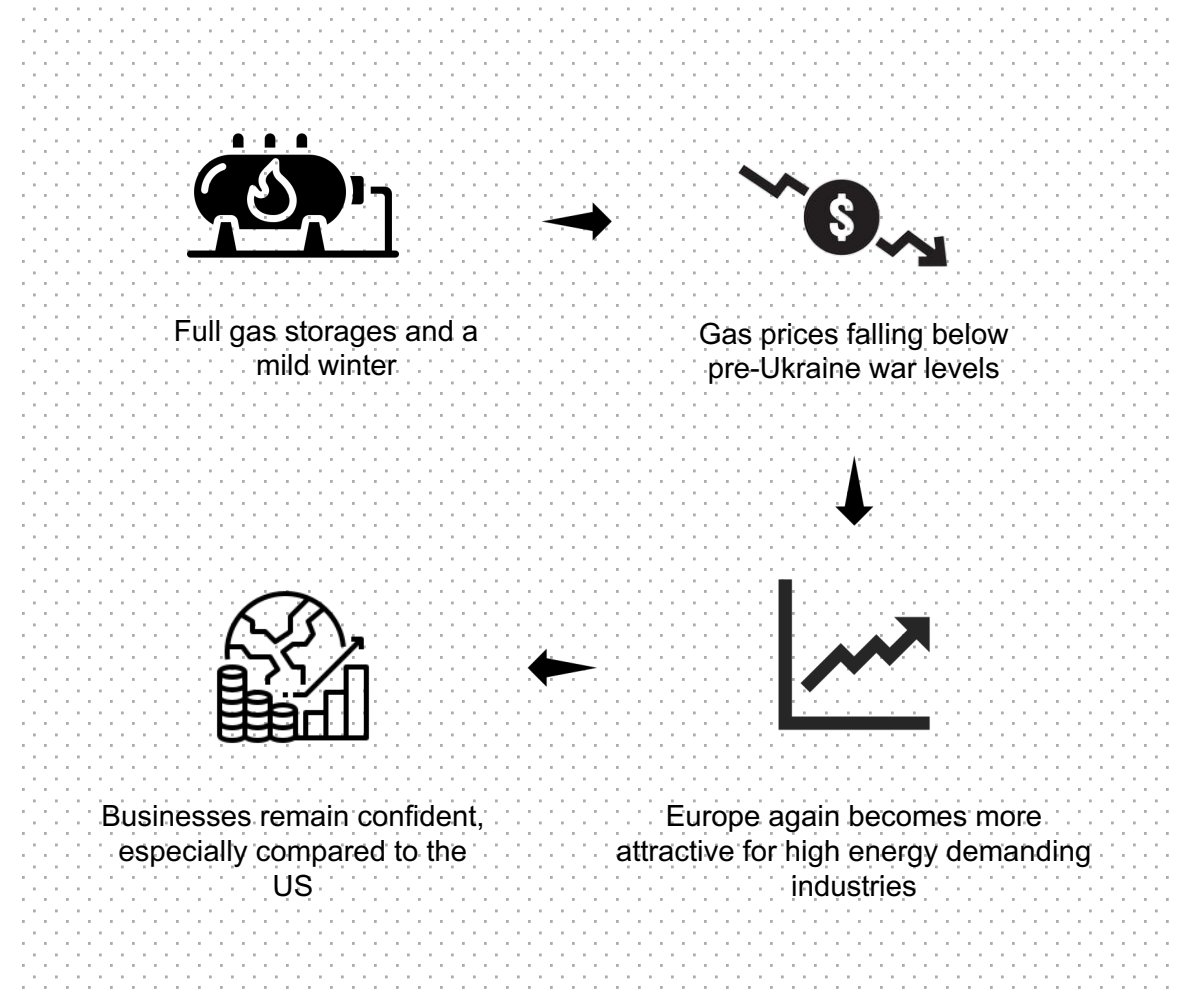
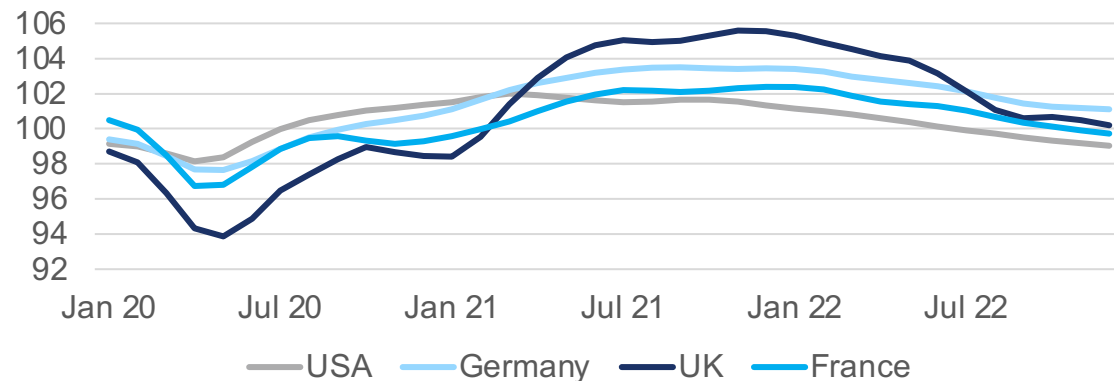
Falling gas prices made costs fall and companies stay confident

Industry Sentiment

Purchasing Managers Index



Business Confidence Index

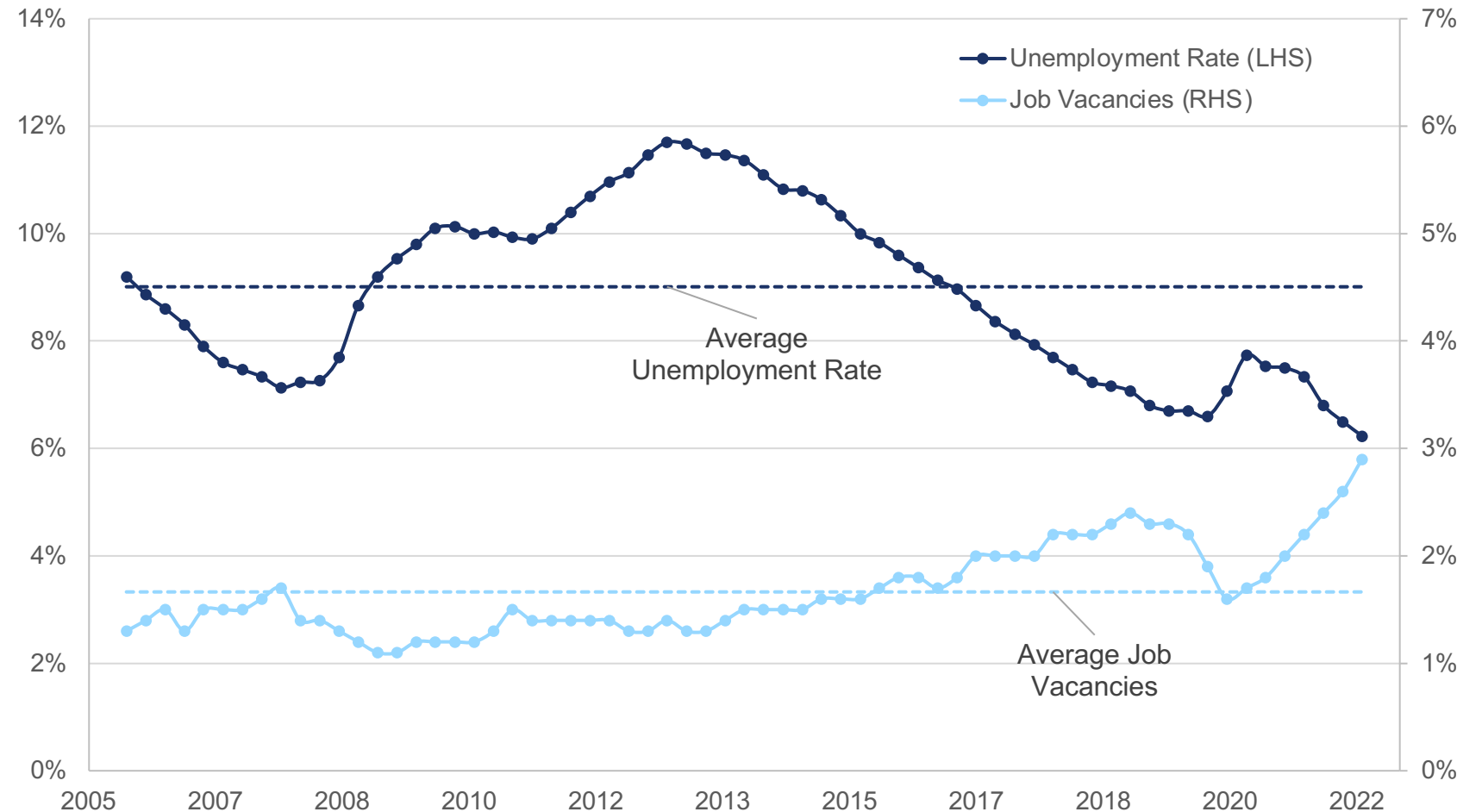


Stable labour market does not point to recession

Unemployment & Labour Market

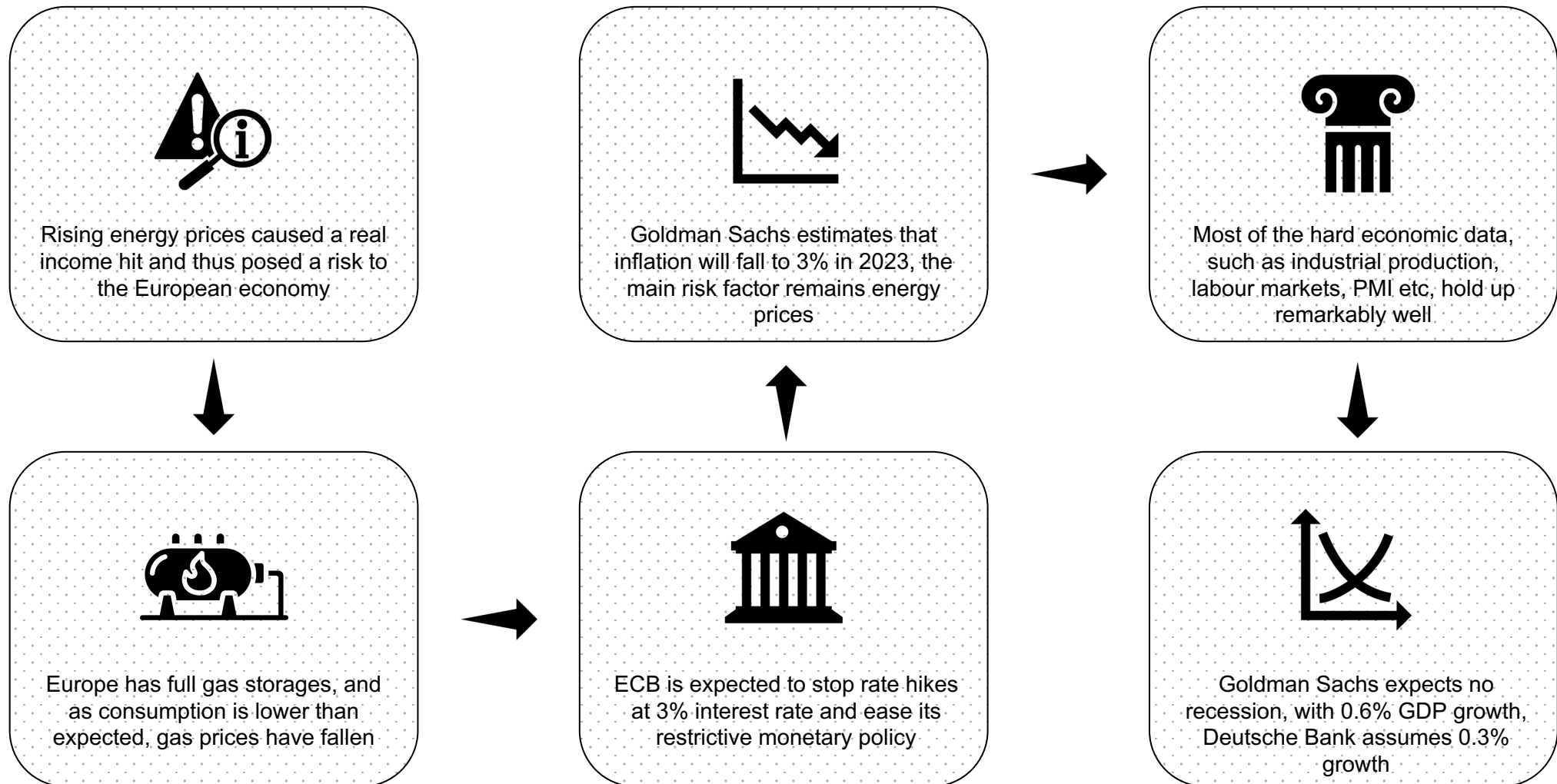


Unemployment Rate vs. Job Vacancies



Major institutions do not believe in a recession

2023 Outlook by Institutions



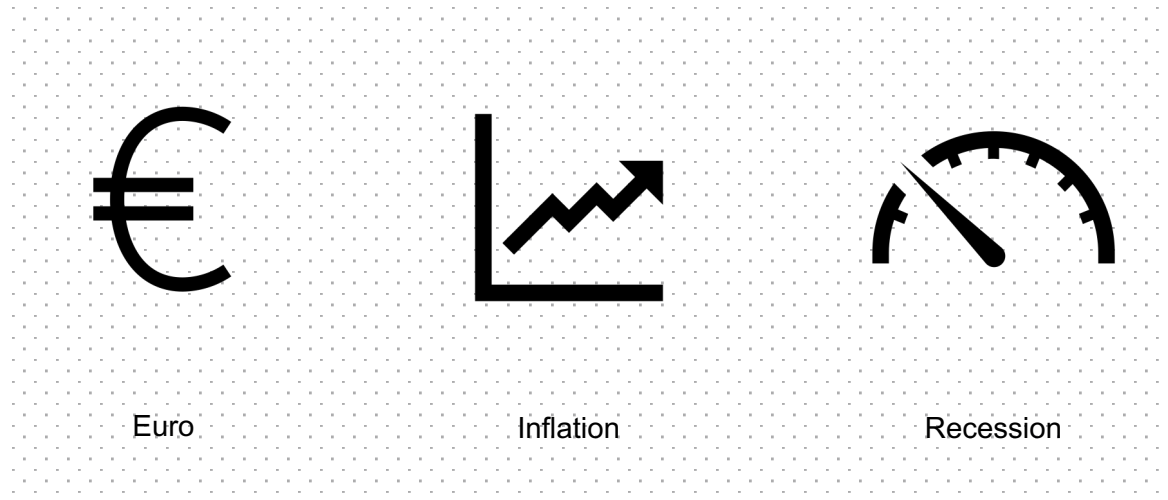
W U T I S

Word Cloud of the last 2100 Tweets



- Eurobond
- Eurozone
- EUCO

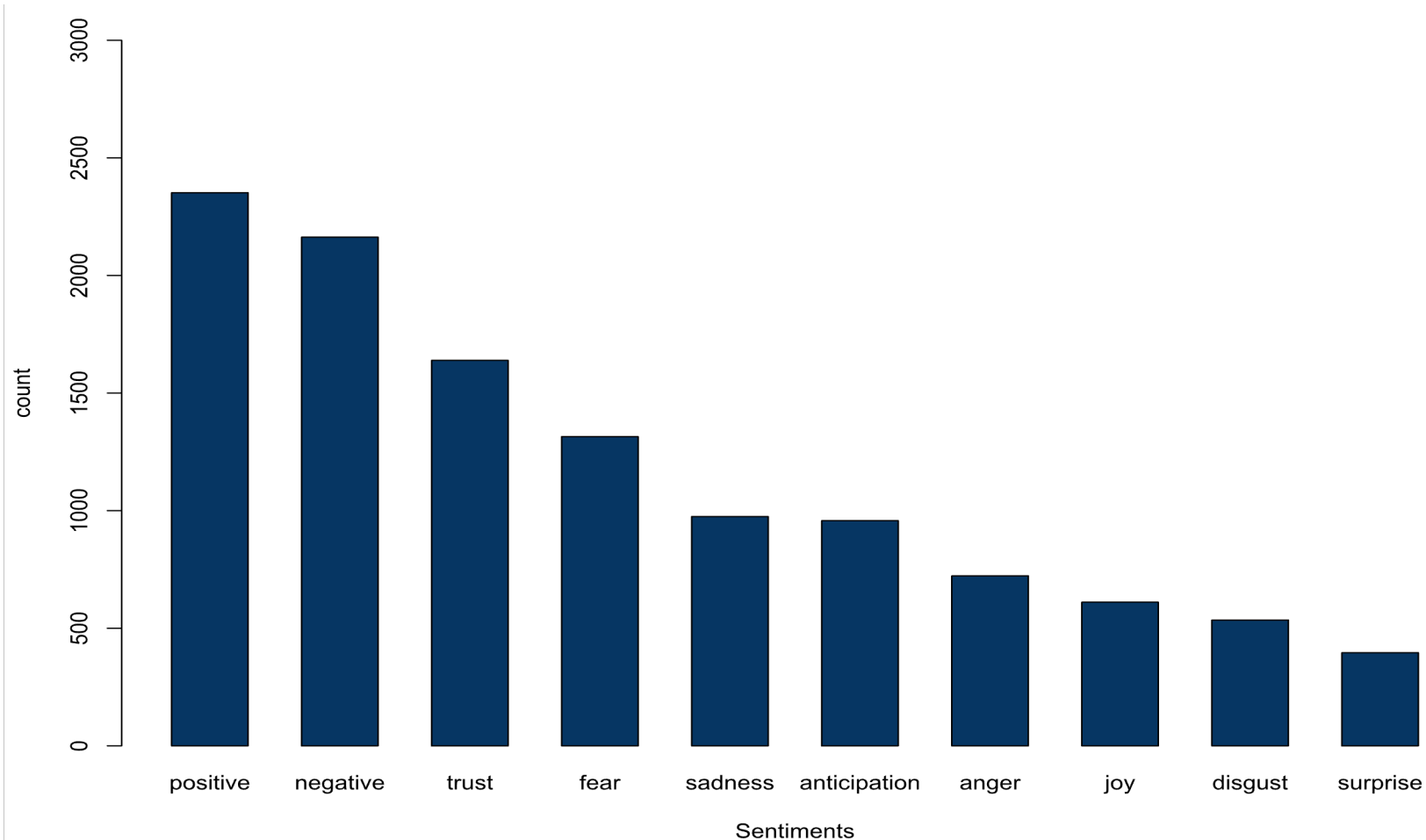
Most common words



There is no defining sentiment, which might signal upside-potential

Twitter Sentiment Analysis

Sentiments



Sentiments with the NRC
sentiment dictionary

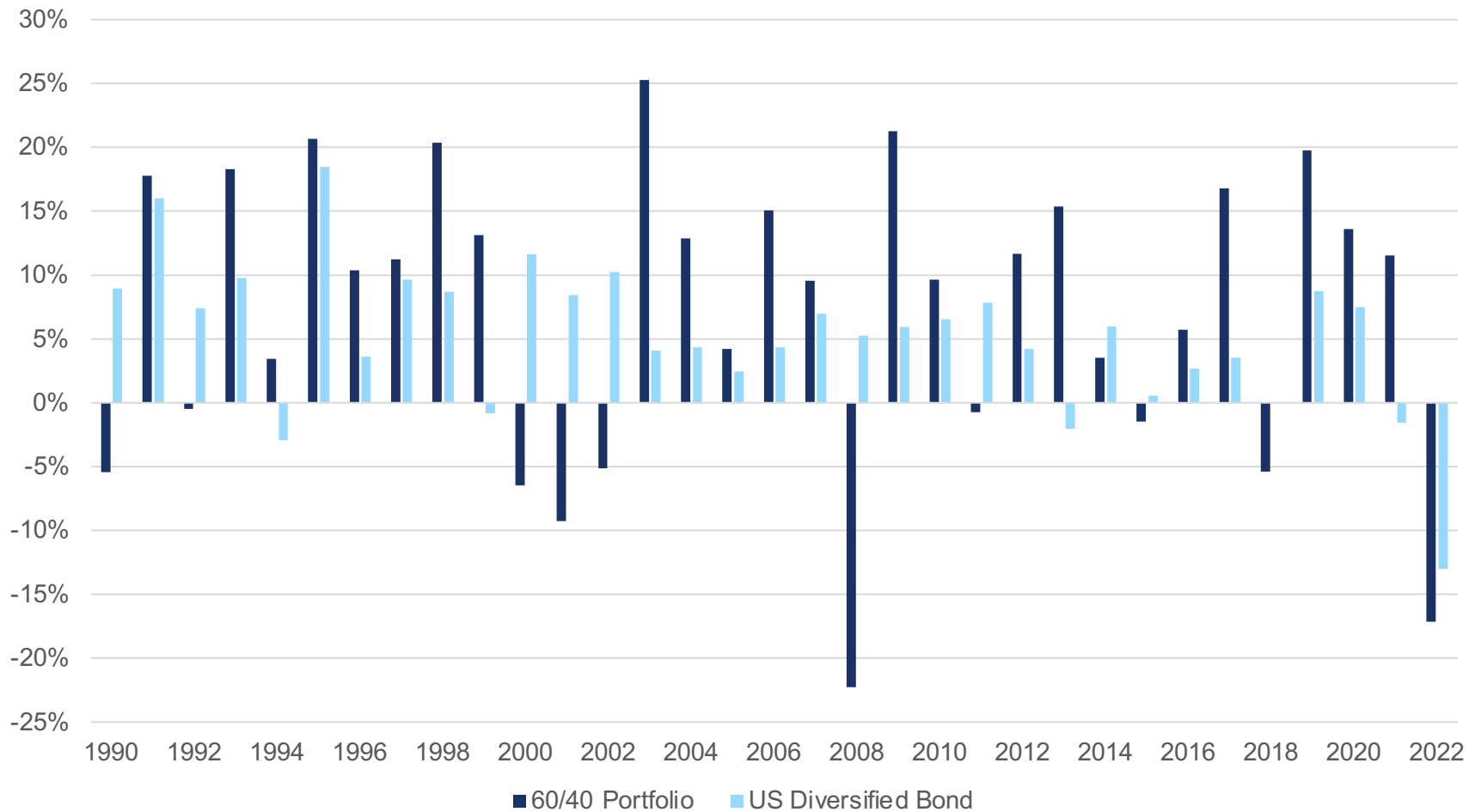


It is not yet clear
if the attitude is positive or
negative

2022 was one of the worst years in history for portfolios

Historical Performance

Annual Returns since 1990



60/40 portfolios have never seen a downturn of both assets in the same year before

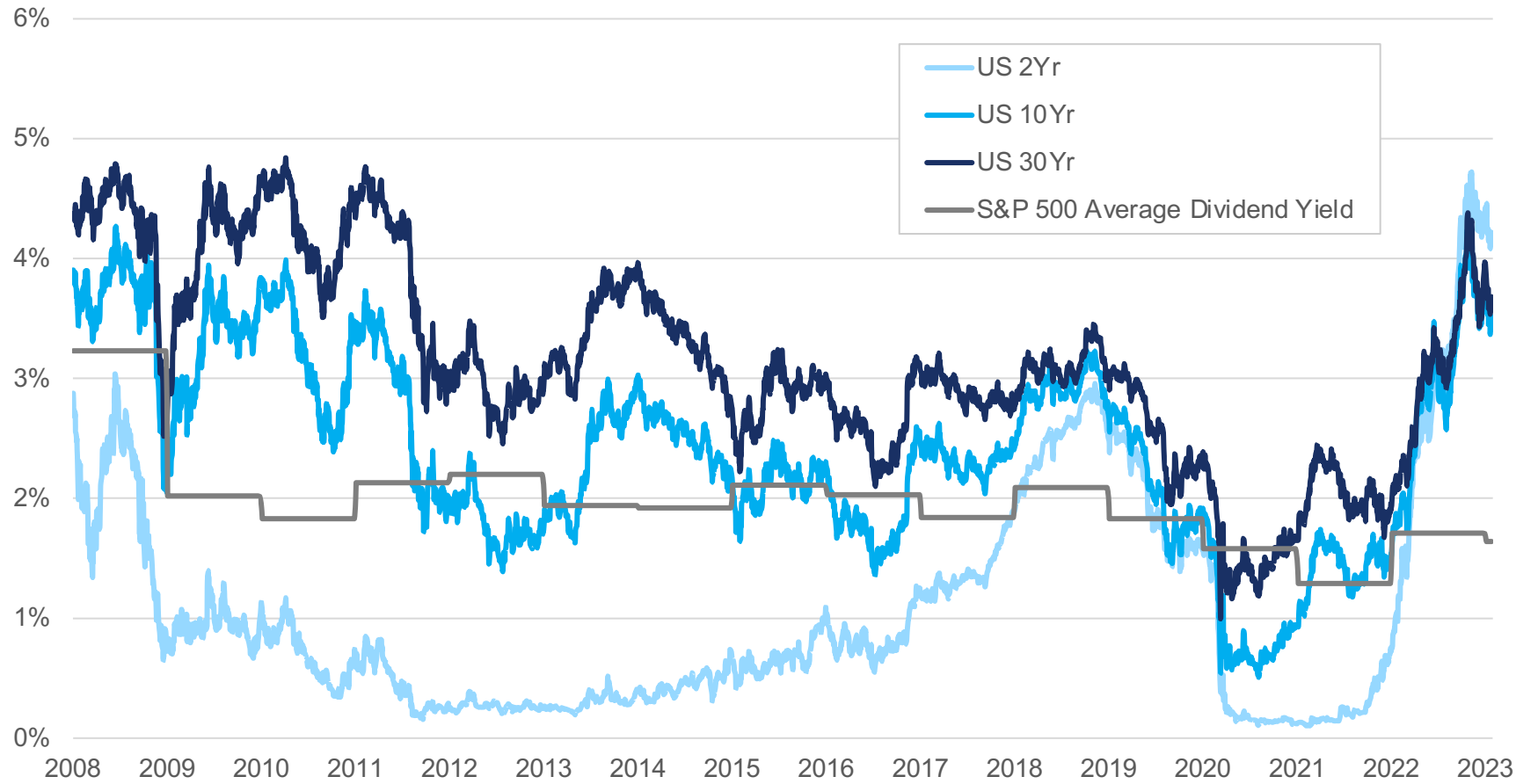


Fastest Fed hike ever has sent all bond categories into decline

Real yields have reached decade highs

Bonds against Stocks

Real Yield against Dividend Yield in the US



Multiple indicators suggest that a pivot could be imminent

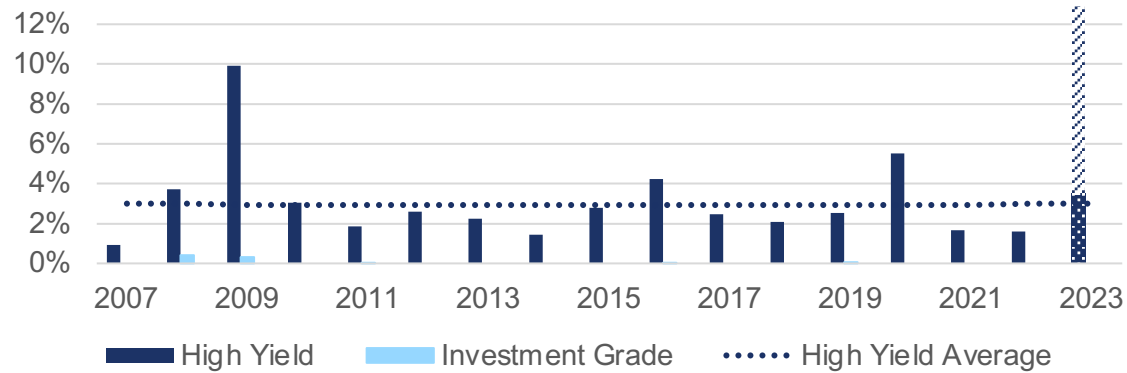


Bonds are more attractive than dividends

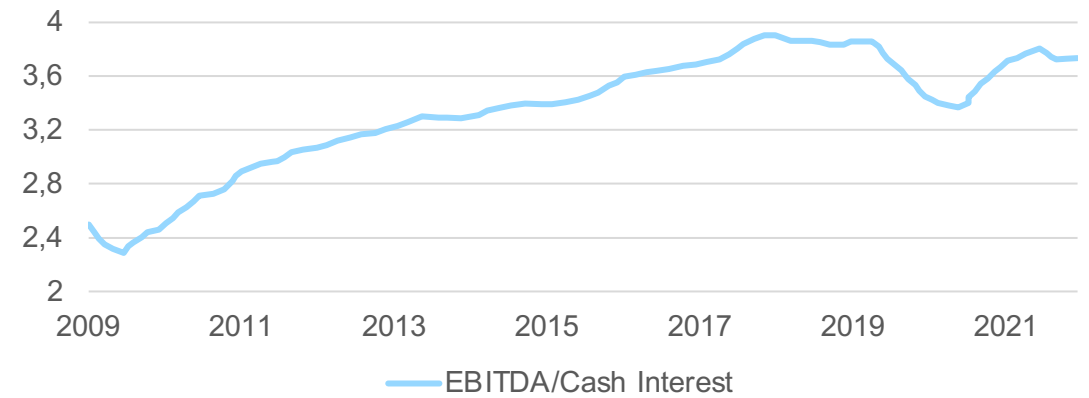
The covid crisis wiped out "bad debt", leaving sound companies back

Risk Assessment

Default Rates



Average European Interest Coverage Rate



Companies look stable and are well positioned for challenging times



Covid 19 "cleaned" high yield from bad bonds



HY default rate below historical average

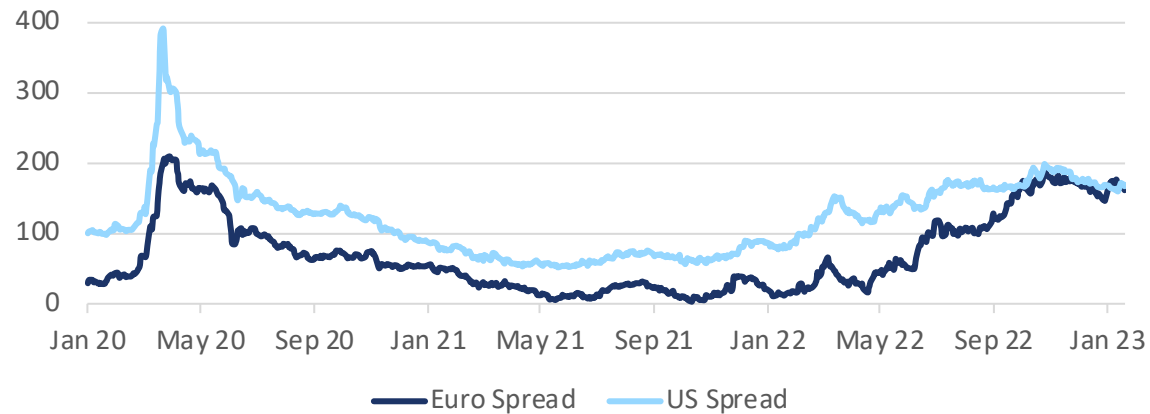


Leverage is significantly lower for IG, but borrowing costs are expected to increase

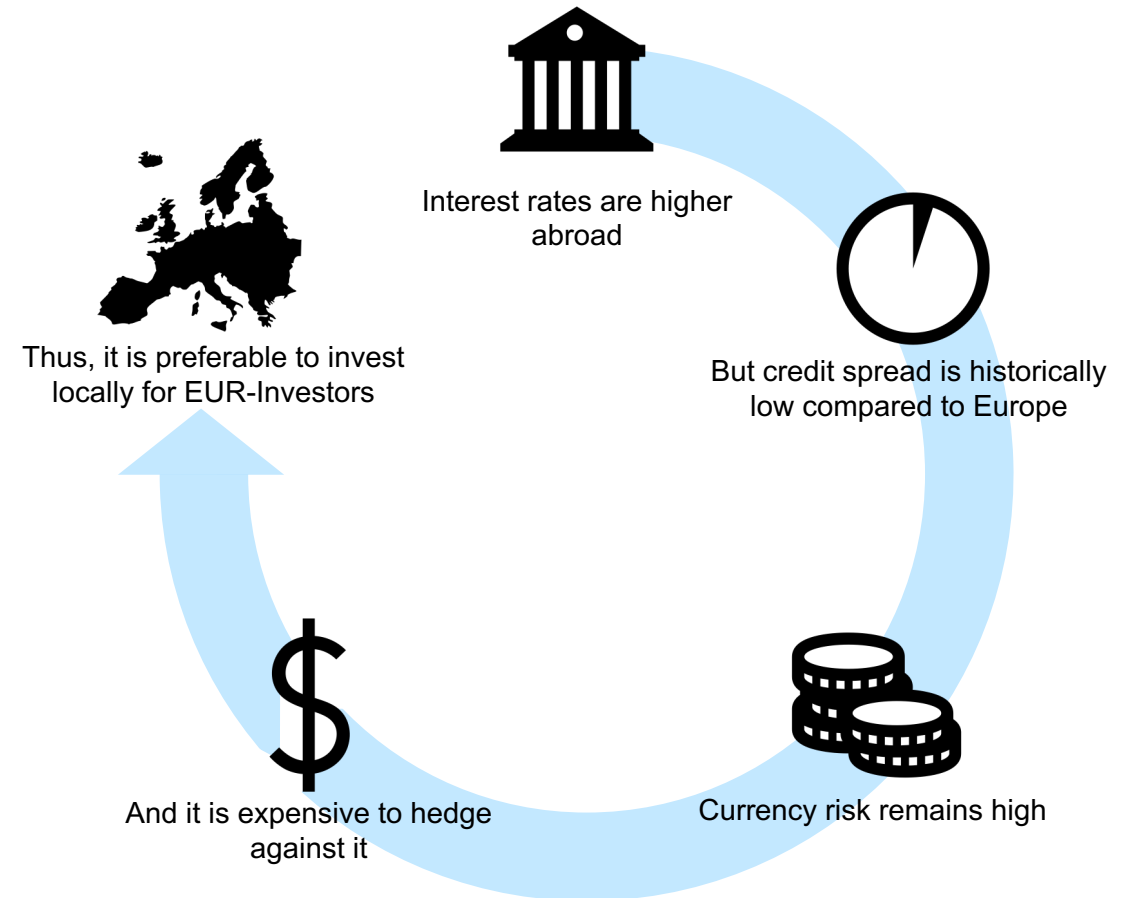
European bonds are better positioned, especially for regional investors

Regional Comparison

Spread Analysis



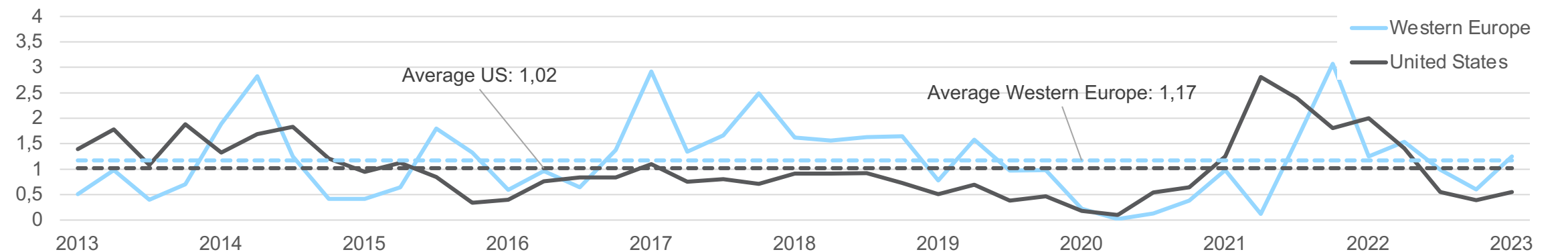
Currency Risk



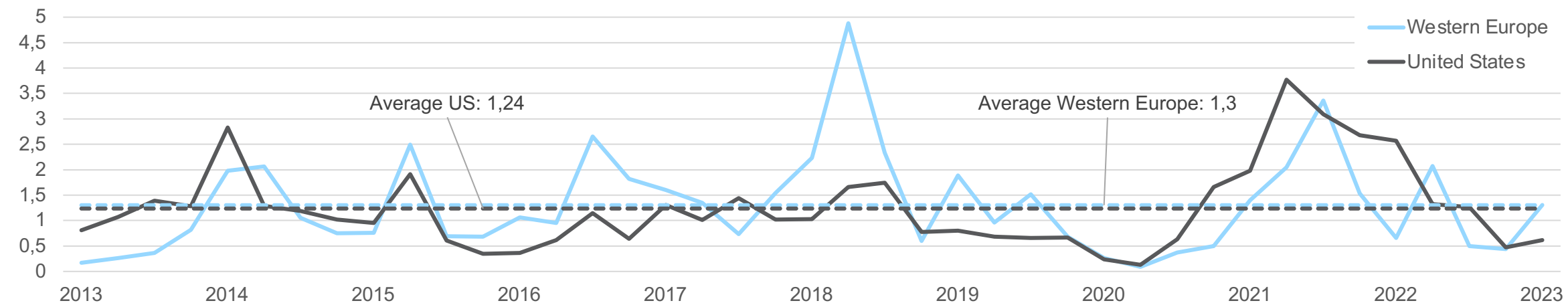
European Fixed Income is consistently better rated than the US

Assessment of Credit Quality

Credit Ratings – S&P



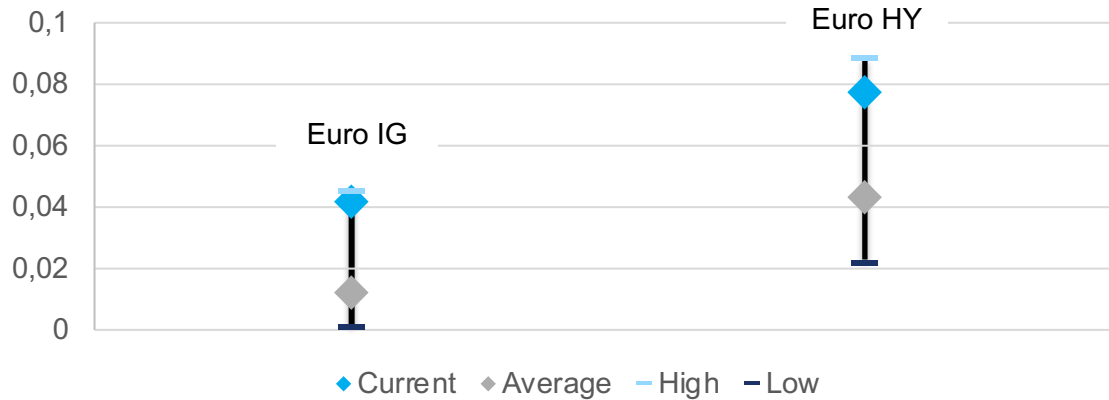
Credit Ratings – Moody's



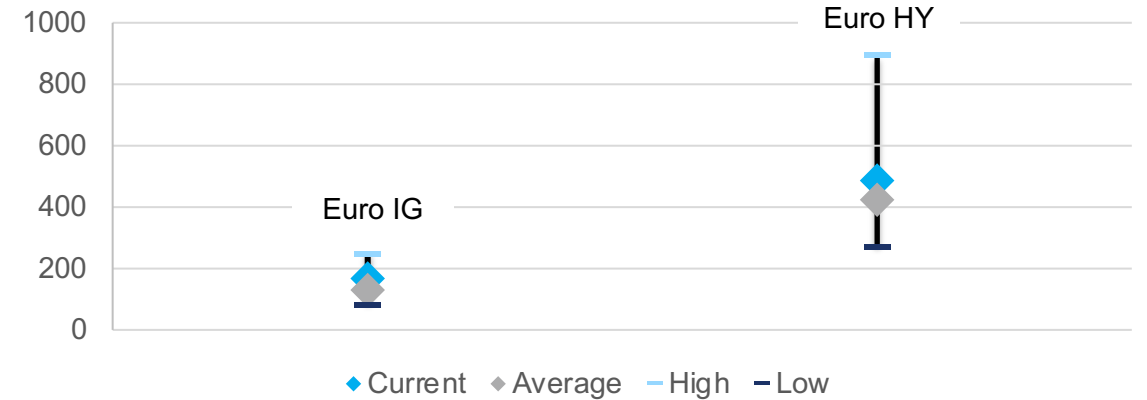
Investment Grade is closer to its historical highs than High Yield

Bond Characteristics

Yield



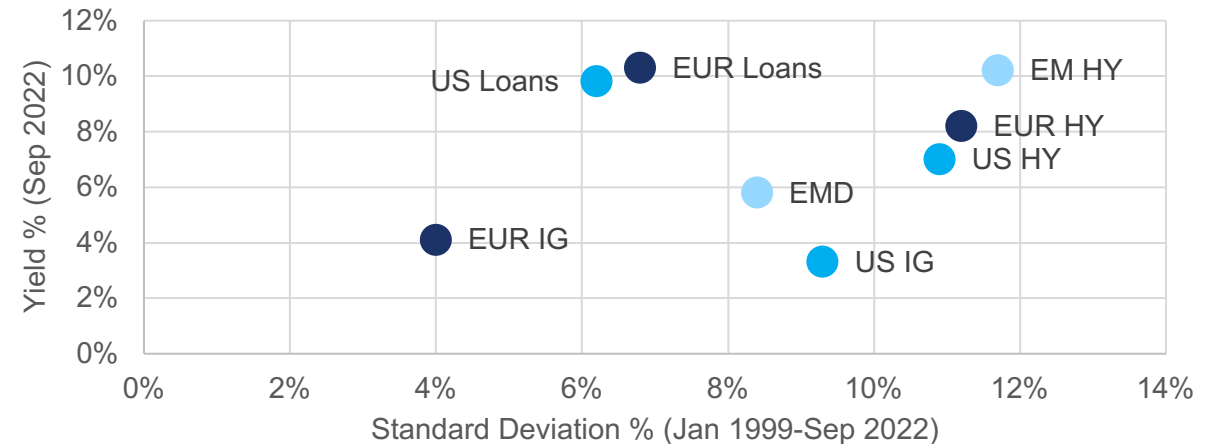
Spread



IG has more favourable Positioning

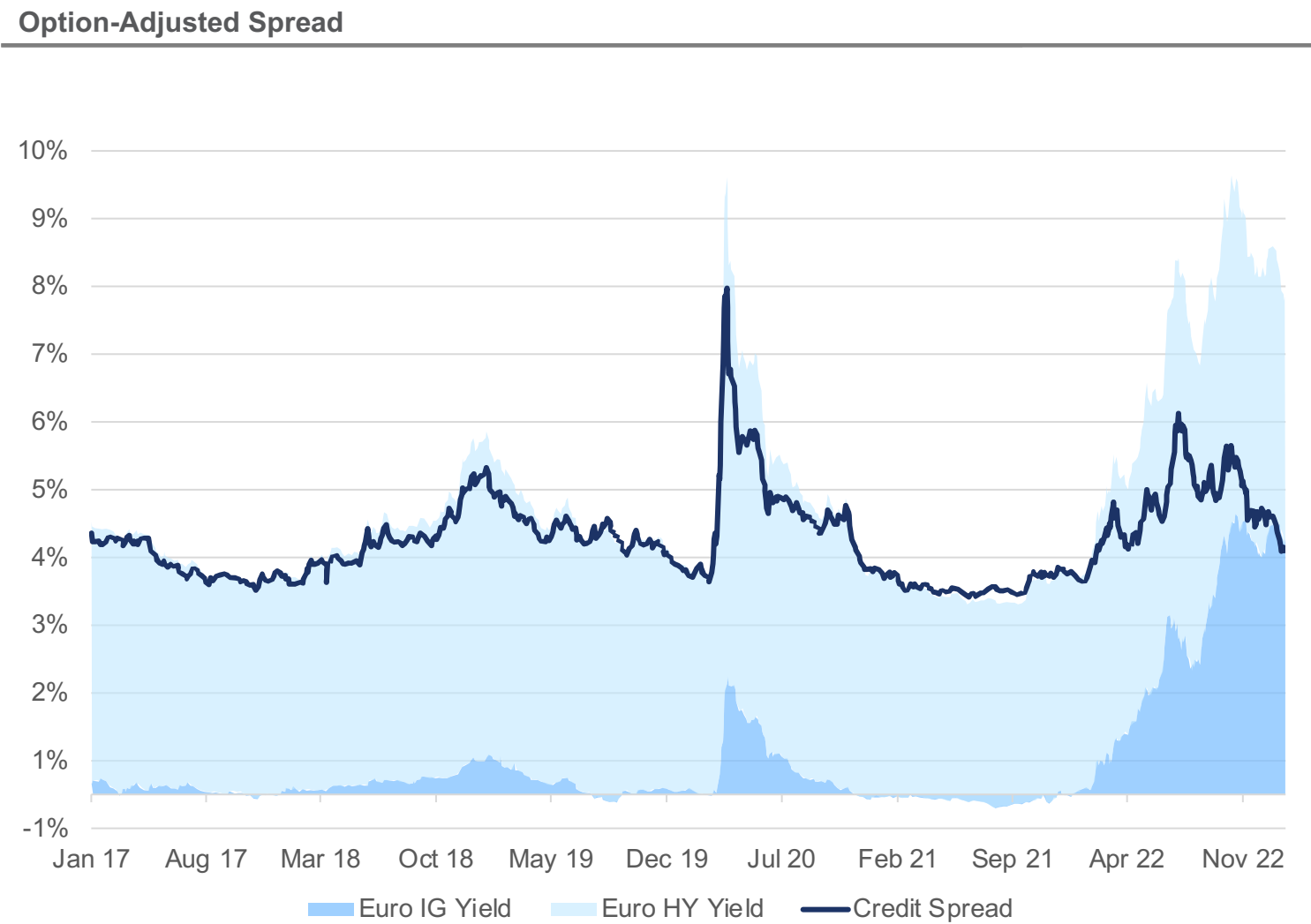
- Yields are reaching historical highs
- Over 25 years, High Yield is below its average spread (574 vs 424)
- Investment Grade bonds, however, are above (129 vs 169)
- Compared against US IG, there is reduced volatility with higher returns
- European Investment Grade bonds are in a unique environment with low risk but possibly double digit returns

Risk Return by Asset Class



Narrowing spreads suggest small upside for increased risk

Yield comparison



Yields for HY have fallen.



Spreads have narrowed

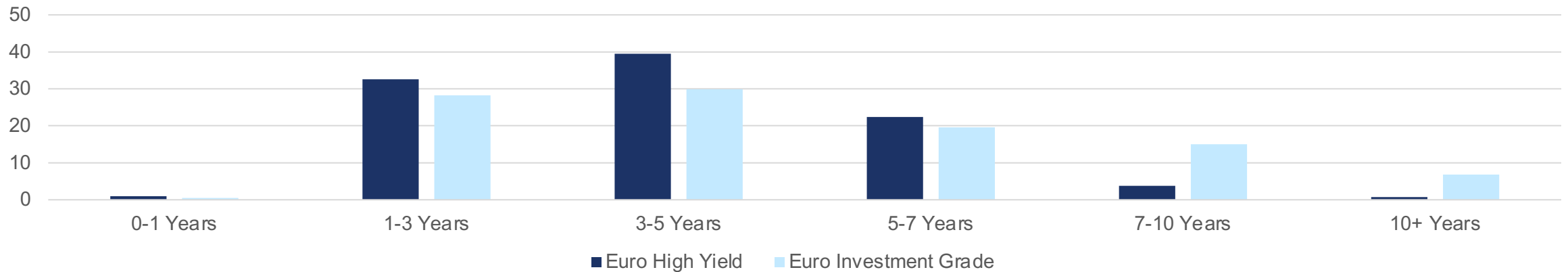


Reduced risk makes IG more attractive

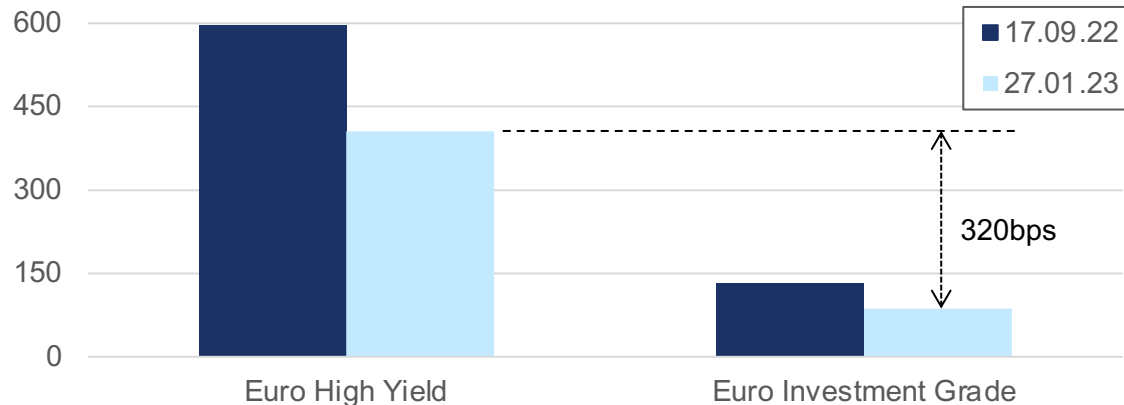
IG has advantages, as hedge against HY defaults is expensive

Composition & Risk Assessment

Maturity Ladder



Credit Default Swaps



Conclusion

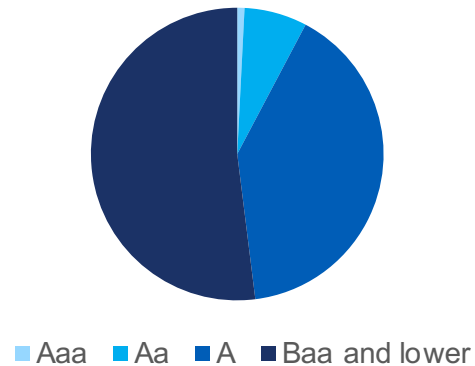
- IG has higher average maturity (5,00Y vs 3,82Y)
- Convexity is also higher (0,31% vs 0,09%)
- CDS are significantly higher for HY, making hedges more expensive
- A more solid bond composition is the reason for the lower swap prices

An overview of the traded security

SPDR Bloomberg Euro Corporate Bond UCITS ETF

Key facts

- Ticker: EUCO
- TER: 12bp
- Average Maturity: 5,00Y
- Effective Duration: 4,55Y
- YTM: 4,27%
- Distribution Yield: 0,97%



Breakdown

- Low costs
- Close resemblance of the index
- Comfortable fund size
- Long track-history
- High diversification over countries and bonds

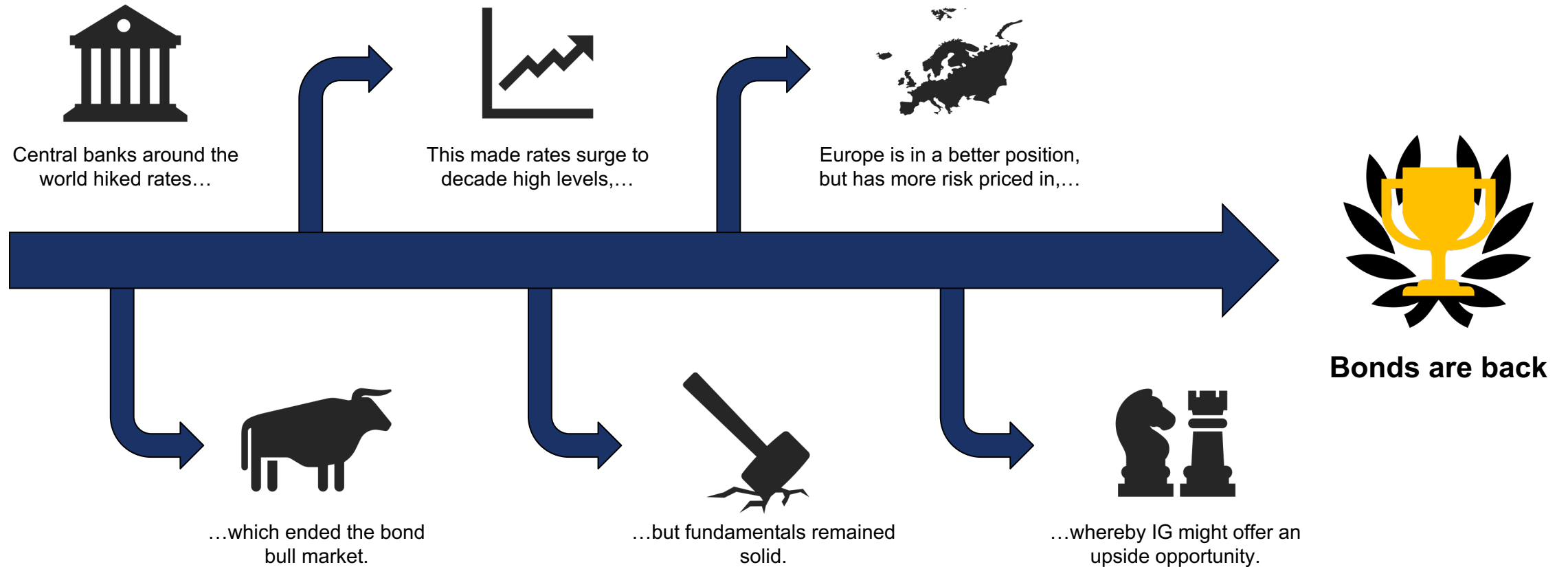
Performance



Performance (annualized)				
1Y	3Y	5Y	10Y	Since Inception
-14,11%	-4,51%	-1,85%	0,66%	1,66%
2018	2019	2020	2021	2022
-1,39%	6,10%	2,58%	-1,19%	-14,11%

Times of "TINA" are over

Conclusion



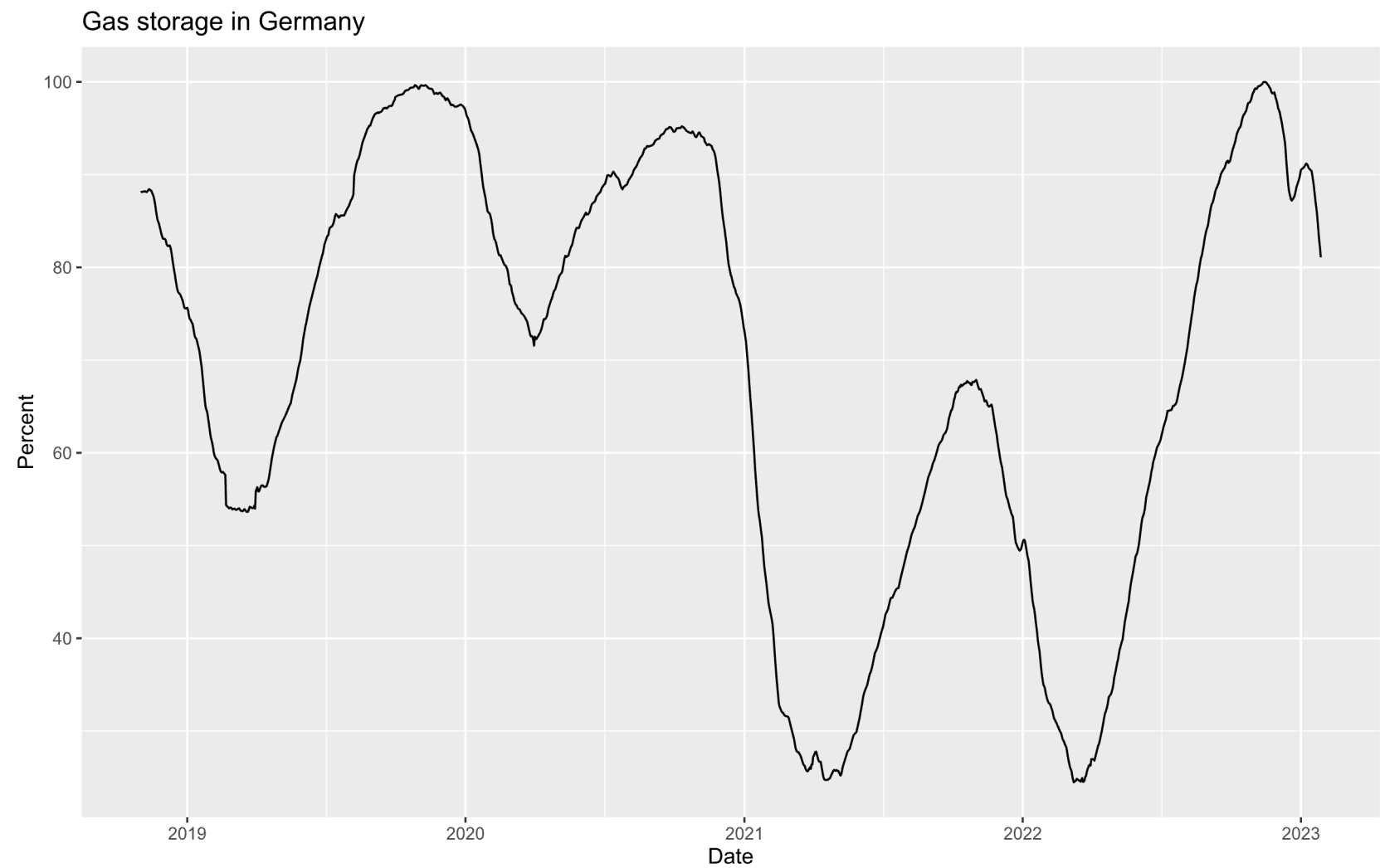
Appendix

Sources

Source Name	Link	Date of Retrieval	Used for
FitchRatings	https://www.fitchratings.com/research/corporate-finance/us-ll-hy-default-rates-to-rise-slightly-in-2023-exceed-2-by-2024-13-06-2022	06.12.2022	Default rates
Bloomberg	-	05.12.2022	Macroeconomic Data
State Street Global Advisers	https://www.ssga.com/library-content/products/factsheets/etfs/emea/factsheet-emea-en_gb-sybj-gy.pdf	04.12.2022	ETF Information
Organisation for Economic Co-operation and Development (OECD)	https://www.oecd.org/sdd/oecdmaineconomicsindicatorsmei.htm	07.12.2022	Statistical part, estimations, plots
S&P Global Rating	https://www.maalot.co.il/Publications/TS20220424121828.PDF	08.12.2022	General information on High-Yield Bonds
FTSE	https://research.ftserussell.com/Analytics/FactSheets/Home/DownloadSingleIssue?issueName=EUROHYM&isManual=True	06.12.2022	Bond Index Breakdown
European Central Bank	https://www.ecb.europa.eu/stats/financial_markets_and_interest_rates/euro_area_yield_curves/html/index.en.html	08.12.2022	Yield Curve
Interest Coverage Ratio AM	https://www.icgam.com/wp-content/uploads/2022/10/europe_economic_update-where_to_from_here-NOV2022.pdf	08.12.2022	Interest Coverage Ratio

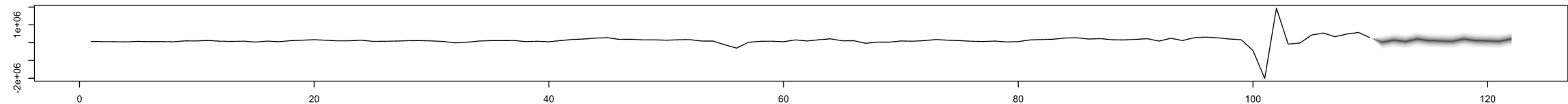
Sources

Source Name	Link	Date of Retrieval	Used for
Multpl	https://www.multpl.com/s-p-500-dividend-yield/table/by-year	28.01.2023	S&P500 Dividend Yield
Investing.com	https://www.investing.com/economic-calendar/services-pmi-272	29.01.2023	PMI
OECD	https://data.oecd.org/leadind/business-confidence-index-bci.htm#indicator-chart	29.01.2023	Consumer Confidence
Alliance Bernstein	https://www.alliancebernstein.com/corporate/en/insights/investment-insights/european-fixed-income-outlook-stay-high-quality-in-2023.html	29.01.2023	Yields & Spreads
European Commission	https://ec.europa.eu/commission/presscorner/detail/de/ip_22_3131	20.01.2023	REPowerEU-Plan
Goldman Sachs	https://www.goldmansachs.com/insights/pages/gs-research/macro-outlook-2023-this-cycle-is-different/report.pdf	29.01.2023	Macro Outlook 2023
Aggregated gas storage inventory (agsi+)	https://alsi.gie.eu/	29.01.2023	Appendix

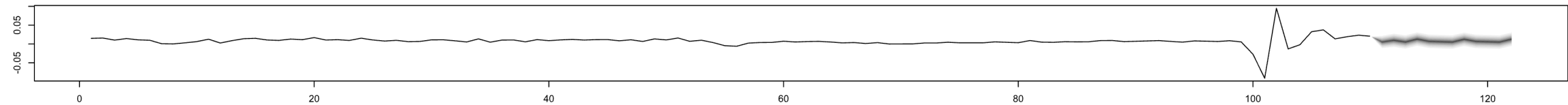


- To not rely completely on external forecasts we tried to estimate a VAR model.
- Estimated a VAR model with change in GDP growth, change in consumption, population size, and investment in the EU 19 countries.
- We do not find any highly significant estimates, therefore we do not use or present them in the main pitch.
- The forecast mimics the report we use on slide 4.
- We do not find granger causality.
- We do not check for cointegration and do not show the impulse response functions (since it is not significant anyway).

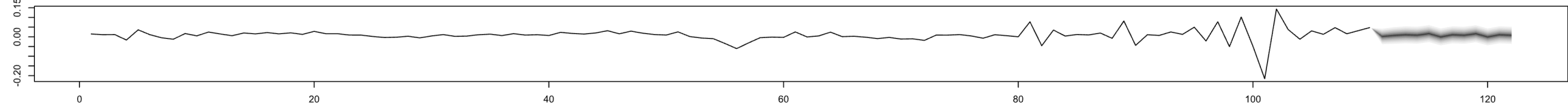
Fanchart for variable dGDP



Fanchart for variable dC



Fanchart for variable dI



Fanchart for variable dPop

