

AMUNDI FUNDS TARGET COUPON

Monthly
Portfolio
Update

28/02/2023

The Central Banks have continued their monetary tightening with a 50bp hike for the ECB to 2.50% and a 25bp hike for the Fed to 4.75%. The ECB has confirmed the reduction in reinvestment as from March 1 and announced another 50bp hike for mid-March. Nonetheless, in their interpretation of the statements by Christine Lagarde and Jerome Powell, investors also saw signs that the end of the cycle was drawing near.

However, the economic data rapidly invalidated this interpretation: growth is for the moment withstanding the monetary tightening and the blow dealt to household income by inflation. Price inflation is slowing but not as rapidly as expected with inflation at 8.5% year on year in February in the Eurozone after 8.6% in January and 9.2% in December. In the United States, the PCE deflator even rose again slightly, to 5.4% in January after 5.3% in December and 5.6% in November. Labor tensions continued with historically low unemployment rates in both Europe and the United States. Job creations have remained very vigorous in the United States with 588,000 jobs created in January and an upward revision of 291,000 jobs for the two previous months, which should shore up consumer demand despite rising prices. The PMI leading indicators have recovered in the Eurozone, rising to 52.3, and in the United States at 50.2, with 50 marking the line between growth and stagnation. The services sector is particularly vigorous at 53 in the Eurozone in February (up from 50.8 in January) and 50.5 in the United States. Lower energy prices (oil and gas) and the reopening of the Chinese economy may explain the improvement in business confidence.

In these conditions, bond yields have risen: US 10-year yield ended the month at 3.97% (13bp higher than at the end of January) while French 10-year yield ended the month at 2.74% (+15bp) and the German Bund ended at 2.67% (+17bp). The rise in the projected terminal rate of the monetary cycle has penalized the short end of the curve and the curve has inverted further by another 12bp, 5bp between the 2-year and 5-year rates and 7bp between the 5-year and 10-year rates. Risky assets did not suffer from this rise in interest rates: country and swap spreads remained stable against Germany over the month.

The rise in inflation expectations, of 38bp for the 5-year and of 28bp for the 10-year, has accelerated with the theme of more persistent inflation, despite expectations of even stiffer monetary tightening. In France, the substantial inflows into Livret A deposit accounts (€9.27 billion in January) automatically led to buyer flows.

In this environment, Investment Grade Credit suffered from the rise in yields, but nonetheless managed to perform thanks to the improvement in the growth outlook and companies' solid fundamentals. Consequently, the IG credit spread tightened by 4bp (to 148bp) over the month, outperforming government bonds with same maturities by 27bp, corresponding to a cumulative outperformance of 124bp for the year. High-beta asset classes posted the strongest performances for the month: High Yield (1.23% of excess return relative to government bonds) and corporate hybrids (0.64%) substantially outperformed the safer credit segments. By sector, Real Estate and Energy were the best performers while the Pharmaceutical and Food sectors lagged the rest of the market.

The different equity markets responded differently to this rise in interest rates: while Europe continued its catching, posting positive performance with +1.8% for the FTSE 100 and +1.6% for the MSCI EMU index, the US markets felt the blow, with the S&P 500 and Nasdaq 100 indices down by respectively -2.6% and -0.5%. The MSCI China index, down by 10.2% over the month, corrected part of the very strong rebound recorded these past few months driven by the reopening of the economy. At sector level, European financials once again benefited greatly from a more positive view of the Eurozone economy and posted a rise of 6.7% for the month. The portfolio has managed to make the most of these diverging market trends: sensitivity has been kept very low, at 0.56 at the end of February, which prevented it from being significantly affected by the rise in yields; in contrast, its credit component has been increased, particularly high-beta subordinated debt, with the weight of contingent convertibles (Cocos) up from 24.1% to 26.2% of the assets over the month, and the weight of all subordinated debt rising to 67%, with this increase achieved mainly via the primary market. Although the fund has maintained a very low exposure to currencies, the equities component via spreads gain performed well, particularly via the long position on Eurozone banks versus Nasdaq. All in all, the fund managed to post a significantly positive monthly performance despite the rise in interest rates.

With regard to the ESG profile of the fund, which is classified as an SFRD 8 fund, its ESG score was 0.71 at the end of February, still well above that of its benchmark universe.

With an ECB terminal rate of nearly 4% already factored in at the short end of the yield curves, will the ECB push interest rates even higher? The alternative would be to keep them at or close to this level for longer to ensure that core inflation comes down to its target level. This would be compatible with a soft landing for growth and adapted to a European economy that is increasingly financed at fixed rates. Also, maintaining corporate margins in this context of inflation linked to energy prices could eventually considerably dampen household consumption as their purchasing power has been amputated by the rise in prices. The ECB will undoubtedly take this aspect into account in its future decisions.

AMUNDI FUNDS TARGET COUPON

Monthly
Portfolio
Update

28/02/2023

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AMUNDI FUNDS TARGET COUPON

Monthly
Portfolio
Update

28/02/2023

Important information

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AMUNDI FUNDS TARGET COUPON

Monthly
Portfolio
Update

28/02/2023

Important information

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