ECB more hawkish than expected

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- Lagarde says inflation “a unanimous concern” for the governing council and a March recalibration is underway; market has priced in 1 rate hike for 2022; risky asset correlation spiked with indiscriminative selling
- While short dated callable bonds were also impacted by the spill over of correlation, we remain firm in our thesis of short-dated Bank AT1s with high resets due to meaningful dislocation vs. SX7E performance
- Floating Rate structures (i.e. CLOs) so far more shielded from the vol seen in the rest of the credit market. We continue to see value as default rates should screen low and the elevated supply should abate

Table 1: Weekly performance overview

		Change			
	04-Feb-22	1 Week	2 Weeks	1 Month	YTD
EUR IG Corp spread (bp)	113	7	13	19	18
BBB	128	8	15	22	20
IG-ex BBB	43	2	4	6	5
EUR HY Corp spread (bp)	368	15	40	62	50
BB	279	9	29	44	37
Capital Structure spread (bp)					
Bank AT1	368	15	31	57	47
Bank Tier 2	164	12	24	36	34
Corporate Hybrids	261	17	30	46	62
Sub Insurance	199	7	18	36	33
ETF Total return					
EUR IG ETF (IEAC)		-2.1%	-2.5%	-3.1%	-3.4%
EUR HY ETF (IHYG)		-1.2%	-2.7%	-3.5%	-3.4%
USD IG ETF (LQD)		-1.6%	-1.9%	-3.7%	-5.3%
USD HY ETF (HYG)		-0.7%	-1.6%	-2.3%	-3.4%
***Cape Fixed Income Fund (EUR B Inst.)**		-0.2%	-0.6%	-1.0%	-1.0%
***Cape Fixed Income Fund (USD B Inst.)**		-0.2%	-0.5%	-1.0%	-0.9%

* as of Feb 3rd 2022

		Change			
	04-Feb-22	1 Week	2 Weeks	1 Month	YTD
iTraxx Europe OTR (5 year, bp)*					
Main	65	5	9	17	9
Xover	315	29	45	72	41
Snr Fin	73	5	9	17	11
Sub Fin	138	10	18	31	17
CDX OTR (5 year, bp)*					
CDX IG	64	3	5	12	8
CDX HY	356	13	26	51	63

*since index roll

Govt. bond yield (bp)					
10 year US yield	191	14	15	20	40
10 year Bund yield	20	25	27	29	39
10 year Gilt yield	141	17	24	32	44
10 year BTP yield	174	46	46	51	57
BTP - Bund spread	154	21	19	22	19

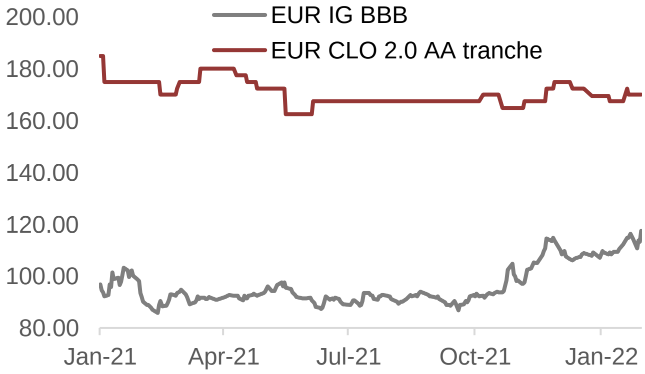
Source: Bloomberg, Bloomberg Barclays, Markit as of February 4th 2022

Hawkish Central Banks have stirred up the market selloff again, but this time it was the ECB (and the BOE). The meeting turned out to be more hawkish than what the market has expected with Lagarde mentioning that inflation is a key concern for the governing council (as a reminder, Jan-22 headline inflation printed at 5.1% yoy vs. 4.3% est.). A recalibration in March is also announced, which the market has interpreted as a higher probability to hike rates post the end of the asset purchasing program. One rate hike has been priced into front-end rates following the meeting. Volatility and correlation within Euro IG credit shot up with indiscriminative selling across the board. Credit curves continued to steepen as investors have run away from duration risks. To give some magnitude, EUR IG ETF (ticker: IEAC LN) which runs at a duration of 5.5y has lost 2.1% WoW and its USD counterpart with a duration north of 9-year tumbled 1.6% for the week.

In the U.S., apart from rising yields, the sentiment was further dampened due to the disappointing earnings from some large tech (Meta, Paypal) which spilled over to the rest of the equity market and had a secondary impact on credit spreads of relatively more equity-like-/earnings-linked instruments like high yield and subordinated structures such as Bank AT1s and Corporate Hybrids. We'd highlight that for EUR Bank AT1s which is asset class that sits right below equity on the capital structure, have significantly underperformed in terms of total return vs. the Euro banking index (SX7E) even when taking into consideration the differential between shareholder returns (dividend and share buybacks) and AT1 coupon payment. Despite that the rates movement accounts for a large part of the loss, the market has marked down the valuation in an indiscriminative manner to the extent that short-dated callable investments are treated the same as long-dated papers with a much lower reset (and hence higher extension risk and prone to rates vol). We therefore remain firm in our thesis of short-dated callable AT1s and wouldn't shy away from buying into the weakness.

The one area where we have seen less impact so far was the leveraged loan / CLO space (both in EUR and USD) where the floating rate structure essentially means zero interest rate duration risk and higher coupons for investors. Default risk remains low thanks to high liquidity on the average corporate balance sheet and the momentum of re-opening and economic growth continues. While the elevated supply may suppress the valuation in the short term, we are convinced that this is not only the harbor to hide from rising rates but also a sweet spot to capture floating carry and eventually valuation appreciation.

Chart 1: CLO AA vs. EUR BBB cash bond spread
Spread, in bps



Source: Bloomberg as of February 3rd 2022

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