# Cape Fixed Income Weekly

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## Fair levels – but «Capitulation Risks» remain

- Lagarde in the July-hike camp causing some volatility – but should not shock markets. This follows the trend that Central Banks front-load rate hikes as long as long-term inflation expectations are still anchored at "relatively low" levels. If front-loading is the price for credibility, which is difficult to negotiate at this stage, lower rated and growth-sensitive credit segments may underperform while IG may be at an inflection point.

### Table 1: Performance overview

| | | Change | | | |
|---|---|---|---|---|---|
| | 13-May-22 | 1 Week | 2 Weeks | 1 Month | YTD |
| EUR IG Corp spread (bp) | 168 | 7 | 17 | 35 | 73 |
| BBB | 193 | 9 | 20 | 39 | 85 |
| IG-ex BBB | 57 | -1 | 2 | 6 | 18 |
| EUR HY Corp spread (bp) | 504 | 16 | 57 | 94 | 186 |
| BB | 396 | 15 | 43 | 75 | 155 |
| Capital Structure spread (bp) | | | | | |
| Bank AT1 | 490 | 24 | 43 | 77 | 169 |
| Bank Tier 2 | 242 | 2 | 19 | 49 | 111 |
| Corporate Hybrids | 349 | 32 | 44 | 67 | 149 |
| Sub Insurance | 305 | 26 | 37 | 69 | 139 |
| ETF Total return | | | | | |
| EUR IG ETF (IEAC) | | 1.2% | -0.5% | -1.9% | -8.2% |
| EUR HY ETF (IHYG) | | 1.5% | -0.5% | -2.1% | -8.0% |
| USD IG ETF (LQD) | | 0.8% | -1.7% | -4.1% | -15.2% |
| USD HY ETF (HYG) | | -1.0% | -3.0% | -4.5% | -10.4% |
| *Cape Fixed Income Fund (EUR B Inst.) | | -0.9% | -1.2% | -2.1% | -5.8% |
| *Cape Fixed Income Fund (USD B Inst.) | | -0.9% | -1.1% | -2.0% | -5.4% |

* as of May 12th 2022

| | | Change | | | |
|---|---|---|---|---|---|
| | 13-May-22 | 1 Week | 2 Weeks | 1 Month | YTD |
| iTraxx Europe OTR (5 year, bp)* | | | | | |
| Main | 92 | -4 | 3 | 13 | 37 |
| Xover | 446 | -16 | 28 | 68 | 197 |
| Snr Fin | 103 | -4 | 3 | 14 | 40 |
| Sub Fin | 196 | -9 | 4 | 29 | 81 |
| CDX OTR (5 year, bp)* | | | | | |
| CDX IG | 85 | -1 | 4 | 14 | 28 |
| CDX HY | 484 | 4 | 38 | 82 | 184 |
| | | | | | *since index roll |
| Govt. bond yield (bp) | | | | | |
| 10 year US yield | 292 | -21 | -2 | 22 | 141 |
| 10 year Bund yield | 94 | -19 | 1 | 18 | 113 |
| 10 year Gilt yield | 174 | -25 | -16 | -6 | 77 |
| 10 year BTP yield | 285 | -28 | 8 | 48 | 168 |
| BTP - Bund spread | 191 | -10 | 7 | 30 | 55 |

Source: iTraxx, CDX, iShares, Bloomberg as of May 13th 2022

It has been a volatile week with crypto news (maybe/really?) and more importantly the ECB adding to the weakness as President Lagarde suggested that they could start raising rates as soon as July. Stagflationary pressures continue to build, well visible in the decline of the US personal savings as a % of disposable income, which is now at the lowest levels since 2013 (~ 6%). U.S. 30y fixed rate mortgage hitting the highest level since 2009 (5.6%) probably doesn't help.
So, it seems like the consumer wallet buffer which everyone is talking about is finally declining. Hence, with Energy prices staying stubbornly high, the contribution of the US consumer to growth seems capped and will eventually move the needle from inflation to growth. At least, short to medium term inflation expectation has taken all the pain while the longer end remained relatively anchored, a sign that the Fed is credible - so far. While "macro" continues to be a rather hostile space, "micro" looks somewhat better from a credit perspective. The earnings season has brought more clarity on how corporates and financials deal with the severe supply-related challenges and the bleak macro-outlook. We still think that the median corporate balance sheet in Europe and the U.S. starts the economic slowdown with a strong liquidity and balance sheet. Earnings indicate that dispersion is clearly on the rise and we expect this to accelerate in the credit space, especially as the focus slowly moves from inflation towards growth-deceleration. This ultimately leads to a phase of de-compression where growth-sensitive segments (HY, Loans) should underperform inflation-sensitive segments (IG). This leads to an up-in-quality bias in the Cape Fixed Income Fund while similarly our risk tolerance for extending the credit duration by a moderate amount has increased. However, to reflect our (still) cautious overall positioning and the continued volatility we stick to a comfortable overall liquidity profile and we do not intend to net-deploy cash for the time being.

Looking at the Financial sector, the earnings reports showed a broad-based resilience and the market continues to see the direct Russian or Eastern European exposure to be manageable for the vast majority of the banks. In addition, the ECB's balance sheet reduction has a less direct impact on the « Technicals » for financials versus corporates, as only certain EUR insurance seniors were included in the bond buying programme. While a higher interest rates environment should be net-positive for banks, the benefit is not linear as some loan exposure might become vulnerable, especially in the periphery. It is worth to look at BTP-Bund spreads again (see below chart). Hence, while banks are definitely not the epicentre of the current market weakness, we prefer to stay selective. Within the insurance space, we prefer bonds from direct insurers over reinsurers considering the Q1 22 results and the potential future cat losses with the hurricane season coming up. In both financials and corporates, the sell-off during the last few months has

led to a re-pricing back to «fair» valuations and we start to see value in selected bonds with positive catalysts (such as upgrade, M&A upside) but recommend remaining side-lined when it comes to generic market beta.

BTP-Bund still a good credit risk proxy

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