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Still under control?

- Stronger guidance than expected by the ECB on both July (25bps) and September (50bps) meetings – it's no longer about whether the ECB is behind the curve or not, it's only about the magnitude at which it lags.
- Ongoing discussions around a potential "anti-fragmentation tool". Italian Govt Bonds continued to underperform generic corporate high yield bonds.

Table 1: Performance overview

	Change						Change				
	10-Jun-22	1 Week	2 Weeks	1 Month	YTD		10-Jun-22	1 Week	2 Weeks	1 Month	YTD
EUR IG Corp spread (bp)	170	7	3	1	75	iTraxx Europe OTR (5 year, bp)*					
BBB	196	7	3	2	88	Main	100	10	13	6	45
IG-ex BBB	61	4	4	2	22	Xover	501	55	70	50	252
EUR HY Corp spread (bp)	484	5	-15	-18	166	Snr Fin	110	12	14	7	48
BB	368	3	-16	-28	126	Sub Fin	210	21	27	12	95
Capital Structure spread (bp)						CDX OTR (5 year, bp)*					
Bank AT1	459	15	-3	-27	137	CDX IG	92	11	13	4	35
Bank Tier 2	248	13	10	0	117	CDX HY	532	66	75	42	231
Corporate Hybrids	311	-1	-25	-33	112						*since index roll
Sub Insurance	278	3	-10	-23	112	Govt. bond yield (bp)					
ETF Total return						10 year US yield	316	25	42	23	165
EUR IG ETF (IEAC)		-2.7%	-3.6%	-3.2%	-11.5%	10 year Bund yield	151	33	55	53	170
EUR HY ETF (IHYG)		-2.6%	-3.5%	-2.6%	-10.8%	10 year Gilt yield	245	29	53	62	148
USD IG ETF (LQD)		-2.6%	-3.9%	-1.3%	-15.8%	10 year BTP yield	376	56	86	86	259
USD HY ETF (HYG)		-4.1%	-5.3%	-1.1%	-11.4%	BTP - Bund spread	224	23	31	33	89
*Cape Fixed Income Fund (EUR B Inst.)		-0.5%	-0.1%	-0.3%	-6.0%						
*Cape Fixed Income Fund (USD B Inst.)		-0.4%	0.0%	-0.2%	-5.6%						

* as of June 9th 2022

Source: iTraxx, CDX, iShares, Bloomberg as of June 10th 2022

Last week was strongly influenced by a harsher-than-expected ECB and another elevated CPI number in the US. Dealing with today's inflation and the corresponding (hawkish) policy response is one thing; another is to change the inflation forecast for the phase beyond the "acute" rate hike cycle (...especially when major Central Banks have been urged to frontload the rate hikes). Hence, the ECB's change in inflation forecast for 2024 from 2.1% to 2.3%, although not a dramatic one, has an "out of control" aspect which requires an additional risk premium. Peripheral Government Bonds, Italian papers in particular, have repriced lower and the only backstop for peripheral sovereign risk in general is the so-called anti fragmentation tool. Depending on its degree of innovation it could play an important role to keep the spreads in check. The lack of detail during last week's ECB meeting has been the driver of weakness in peripheral sovereign bonds. The remaining key question at this stage is where the ECB will become active...and therefore we expect the market to test the level, which means an additional widening in Bund-BTP spreads. The fact that "macro" in form of the Bund-BTP spread has underperformed "micro" in form of Italian corporate spread moves reflects the current environment relatively well. It's not (yet) about corporate credit quality.

The trend to even more extreme rate hike frontloading may accelerate in the US. Last Friday's inflation print of 8.6% on a headline level deserves a look at the breakdown, where permanent elements played a big role. The elevated level of shelter inflation is a good indicator that permanent inflation factors may persist. Hence, there is an increased likelihood that the terminal rate may move towards the 4% area, in case the 75bps-hike are kept off the table.

While these pro-inflationary and anti-growth-related concerns have accelerated last week, parameters which determine corporate credit fundamentals are remaining stable. Credit dispersion, which we expected to move faster, is still very static. Default rates in Europe continue to stay at record lows and the rating upgrade vs. downgrade ratio remains positive at least in Cape's observable investment universe (EU IG Subordinated and Senior). In addition, even though the market is rather weak, there is very little panic which is a consequence of a (globally) defensive average investor positioning.

On company or bond-specific news flow the week has proven to be eventful. We have seen new deals across the capital structure and currencies with Aviva printing a RT1 in GBP, Devoba issuing green AT1 in EUR, SocGen coming with T2 in USD and Vienna Insurance

company tapping the market with an EUR T2. The new Vienna insurance deal was combined with a tender on its 5.5% bond, offering around 0.5pt upside. We expect the primary market bonanza to continue next week if the market conditions ease off. M&A stories came back, with the German Finance Ministry indicating that it is open to selling its 15.6% stake in Commerzbank to another EU bank once the stock has rebounded. CS bonds were especially volatile, as the company had another profit warning which was followed by some speculation about a potential takeover offer (from State Street). Interestingly, there was no new noticeable corporate hybrid bond issue during the last two weeks something expected to change before the summer holiday period.

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