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2023 Global Credit Outlook

Our 10 most burning questions

Fixed Income Boutique

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Christian Hantel
Executive Director
Asset Management

Marc van Heems
Director
Asset Management

Pam Gelles
Director
Asset Management

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Our 10 most burning questions into 2023

Macroeconomics

1. Are we heading into a global recession?
2. Will we see inflation ease further?
3. Will central banks get less hawkish?

Microeconomics

4. How healthy are credit fundamentals?
5. Is the benign rating trend ending soon?

Technical factors

6. What to expect from bond issuance?
7. Who is likely to buy corporate bonds in 2023?

Valuation

8. What about yields and low cash price bonds?
9. Where can investors find value?
10. How to benefit from this environment?

Our monthly scorecard evaluates the four main driving factors for global credit: Macroeconomics (economic trend and monetary policy), Microeconomics (corporate fundamentals), Technical factors (flows, new issues, etc.) and Valuation. Our market outlook follows this structure.

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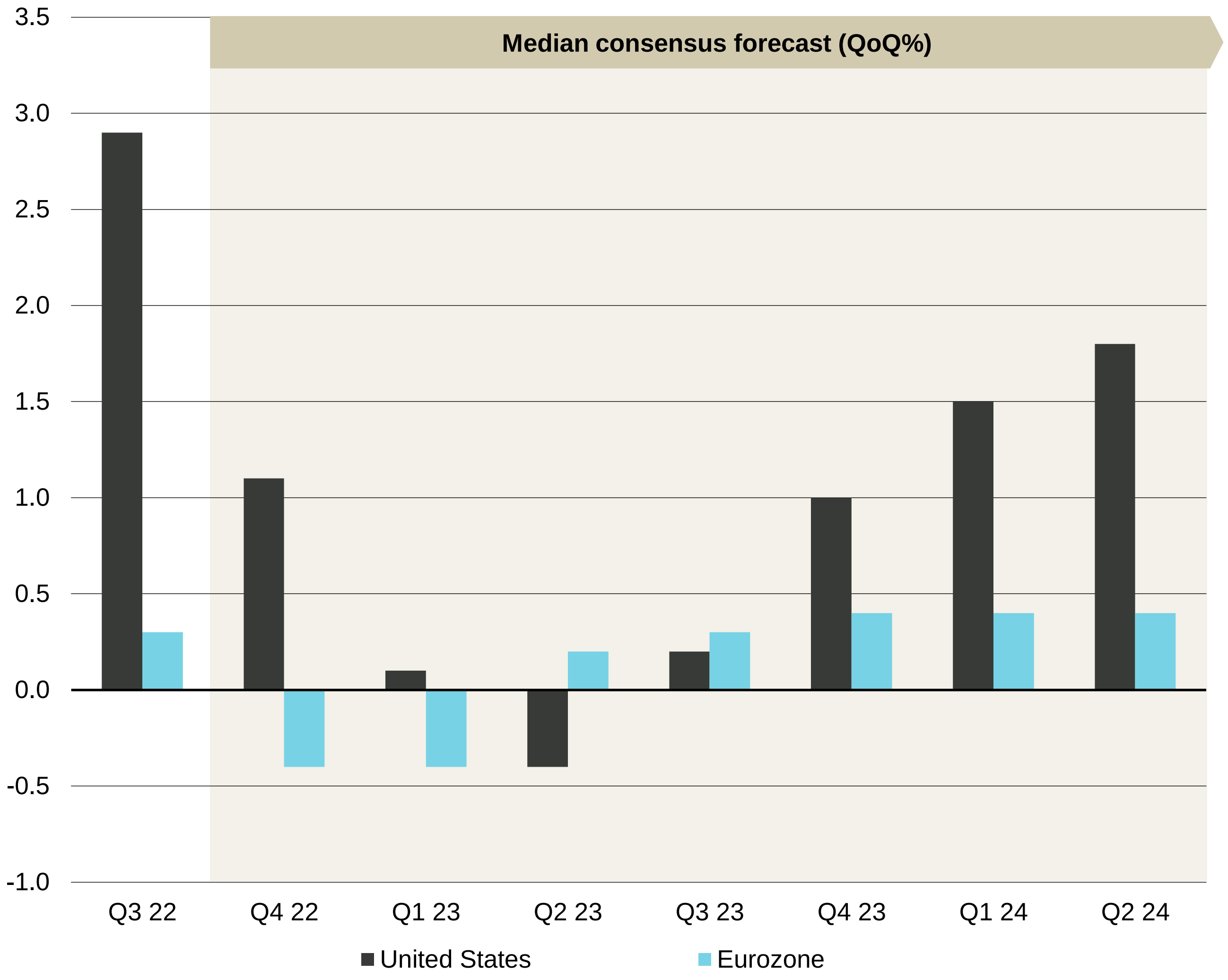
#1. Leading indicators pointing towards a recession…

Macro

Global leading indicators trending lower

GDP expected to slow down further



*Proportion of central banks increasing rates minus proportion of central banks decreasing rates (for each of the last six months).
Forecasts based on internal / external analysis; not guaranteed; and actual outcomes may differ materially.
Source: Refinitiv Datastream, Bloomberg, Vontobel, as of 12.2022.

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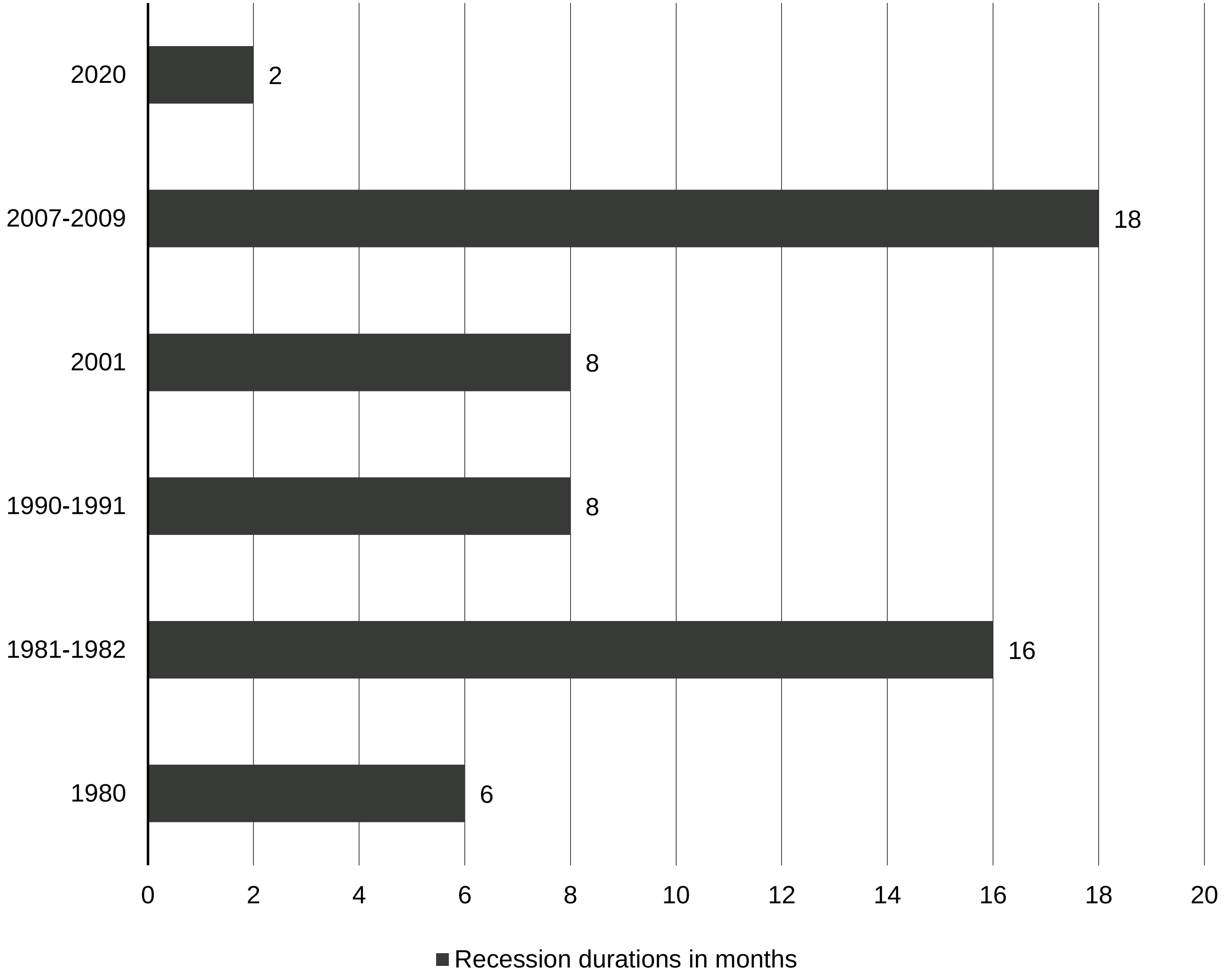
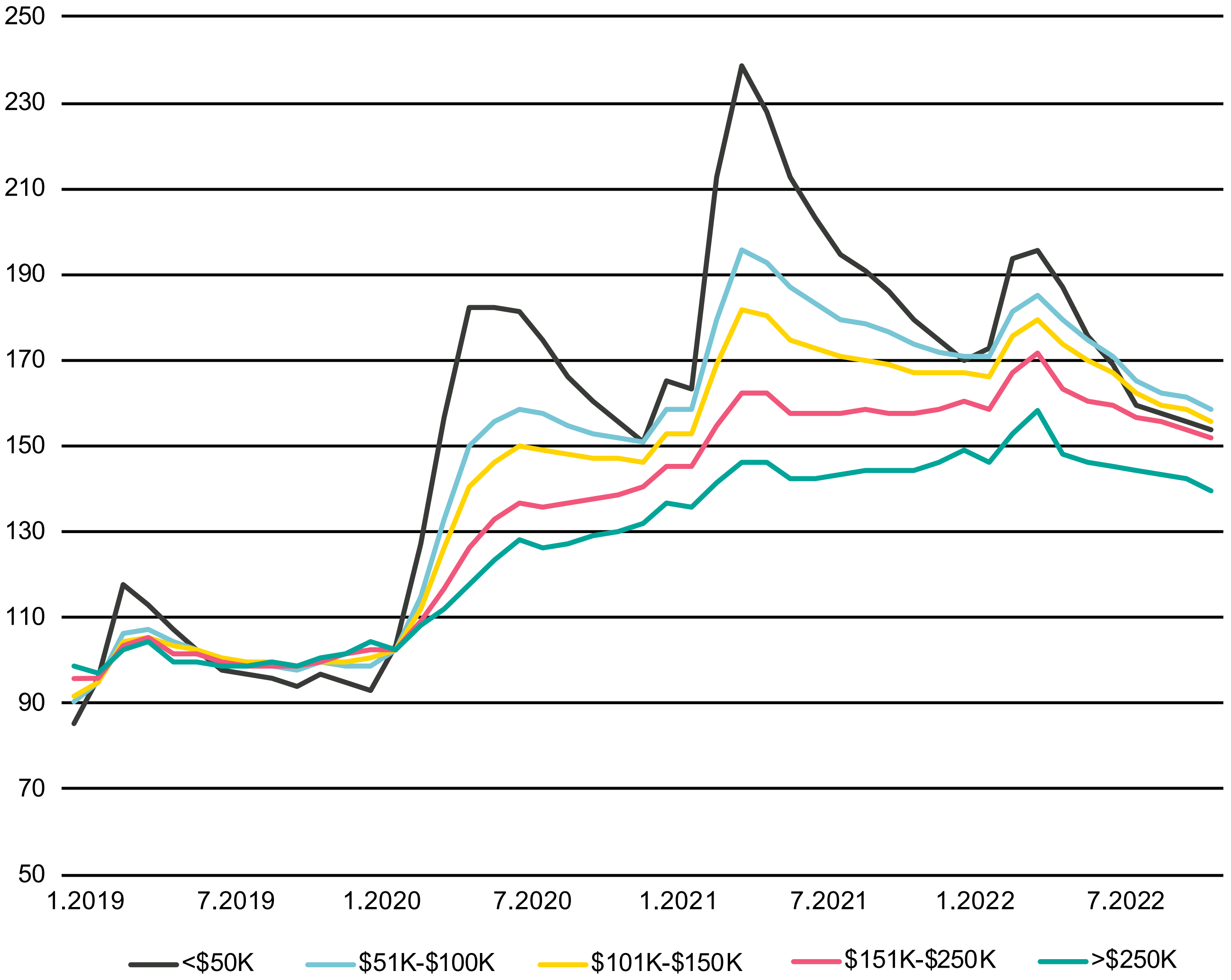
…which could be shorter this time as the consumer shows resilience.

Macro

Recession durations in the US



Deposit balances remain above 2019 levels*



*Monthly median household savings and checking balances by income (index, 2019 average =100) for a fixed group of households.
Source: National Bureau of Economic Research, Wells Fargo, Bloomberg, Bank of America, Vontobel, as of 12.2022.

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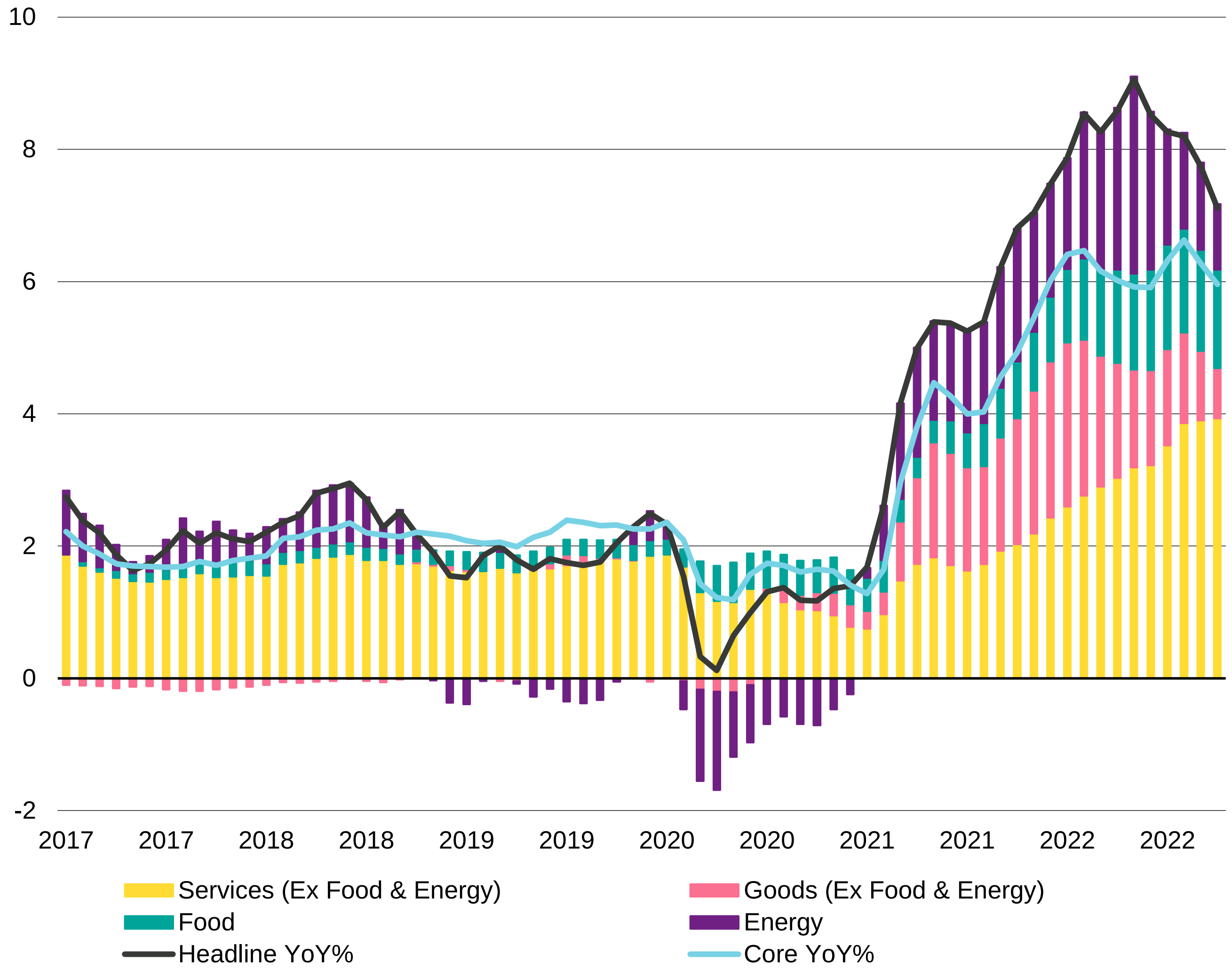
#2. We have likely seen the pivot in inflation…

Macro

Energy and Goods driving inflation lower



Freight costs almost back to pre-COVID levels

Source: New York Fed, Bloomberg, Vontobel, as of 12.2022.

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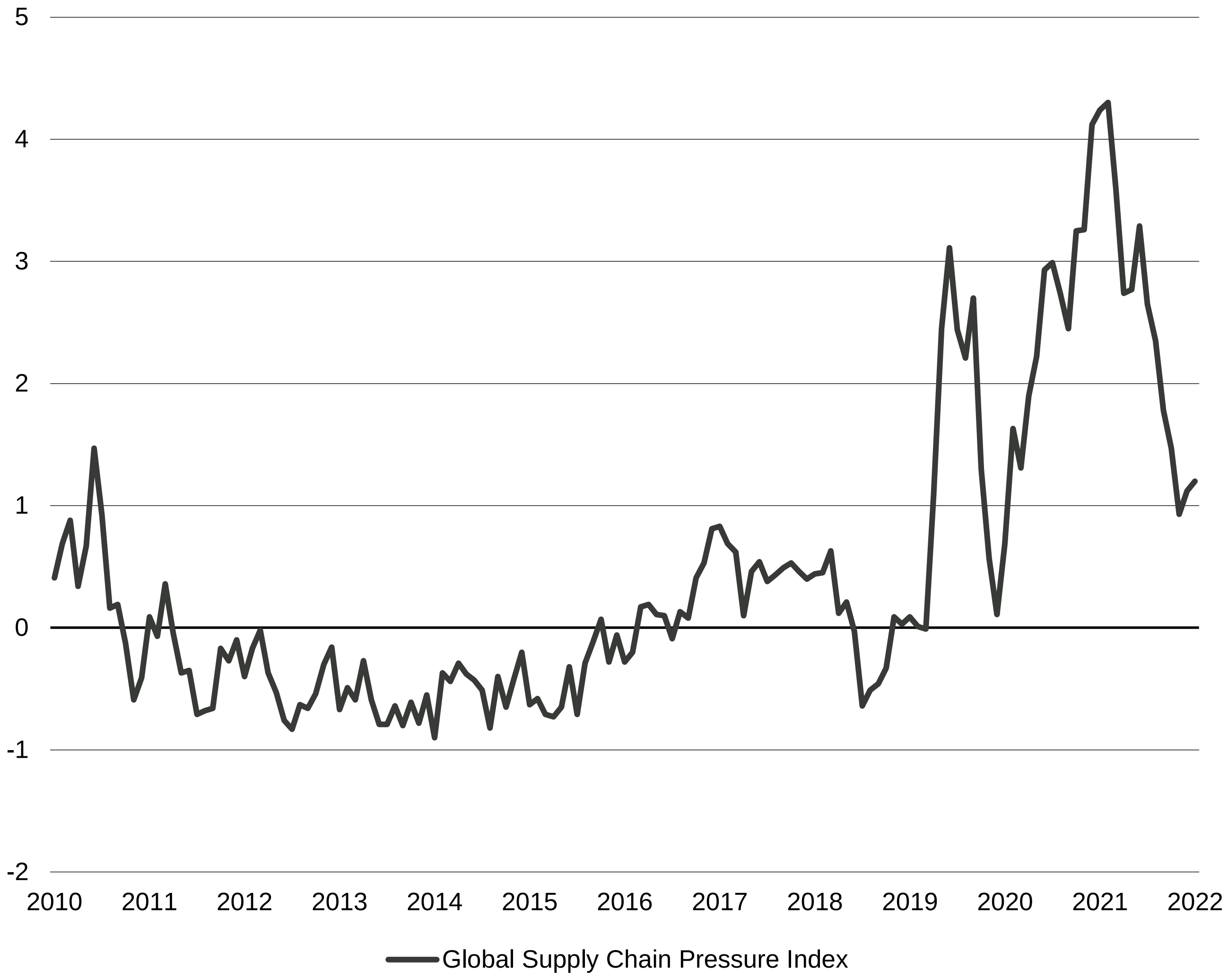
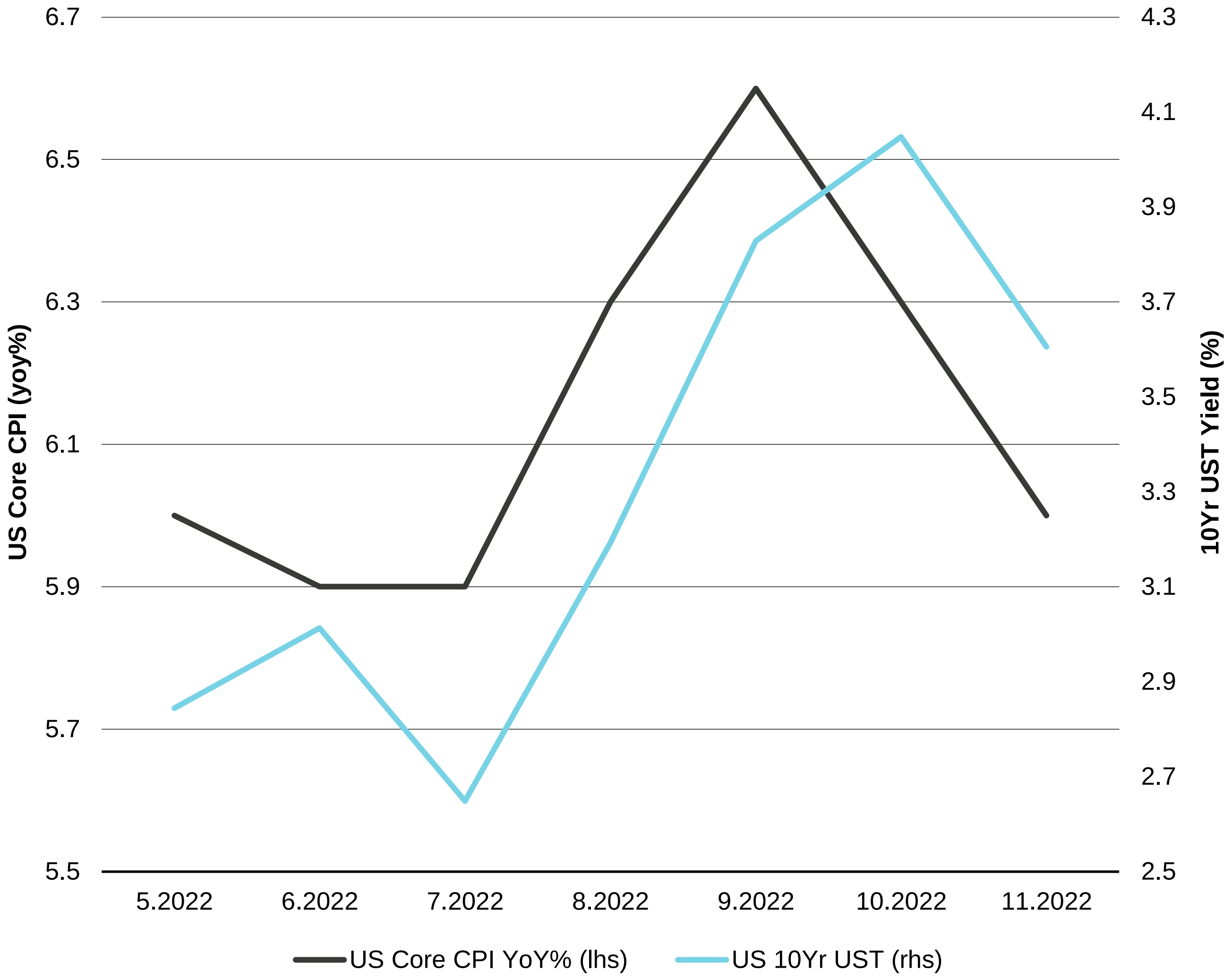
Macro

…as leading indicators point towards further decline.

Supply chain pressures are easing



US Yields tend to follow US CPI recently

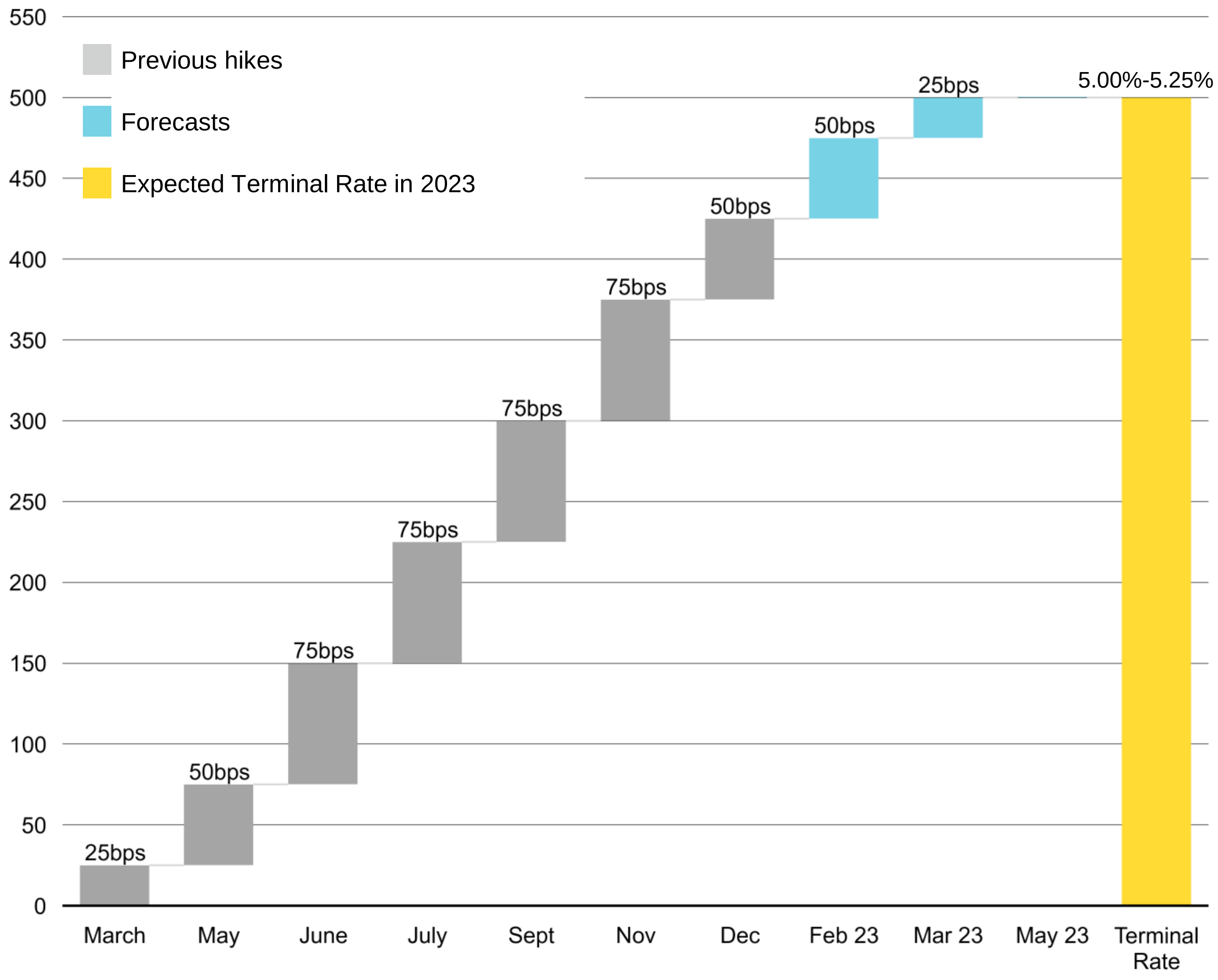


Source: New York Fed, Bloomberg, UBS, Vontobel, as of 12.2022.

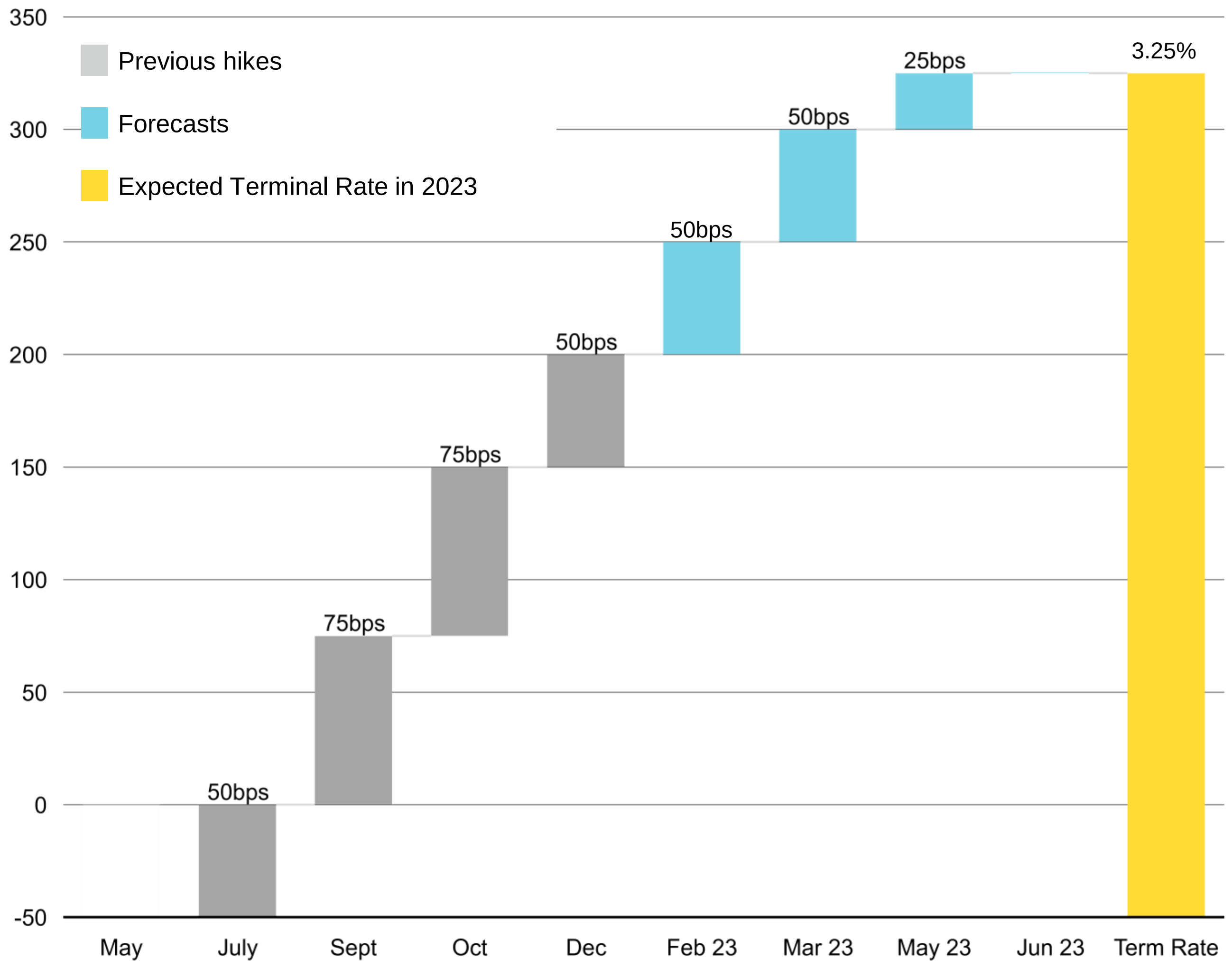
#3. Central banks slowing down their path of rate hikes...

Macro

Fed: rate hikes slowing down already



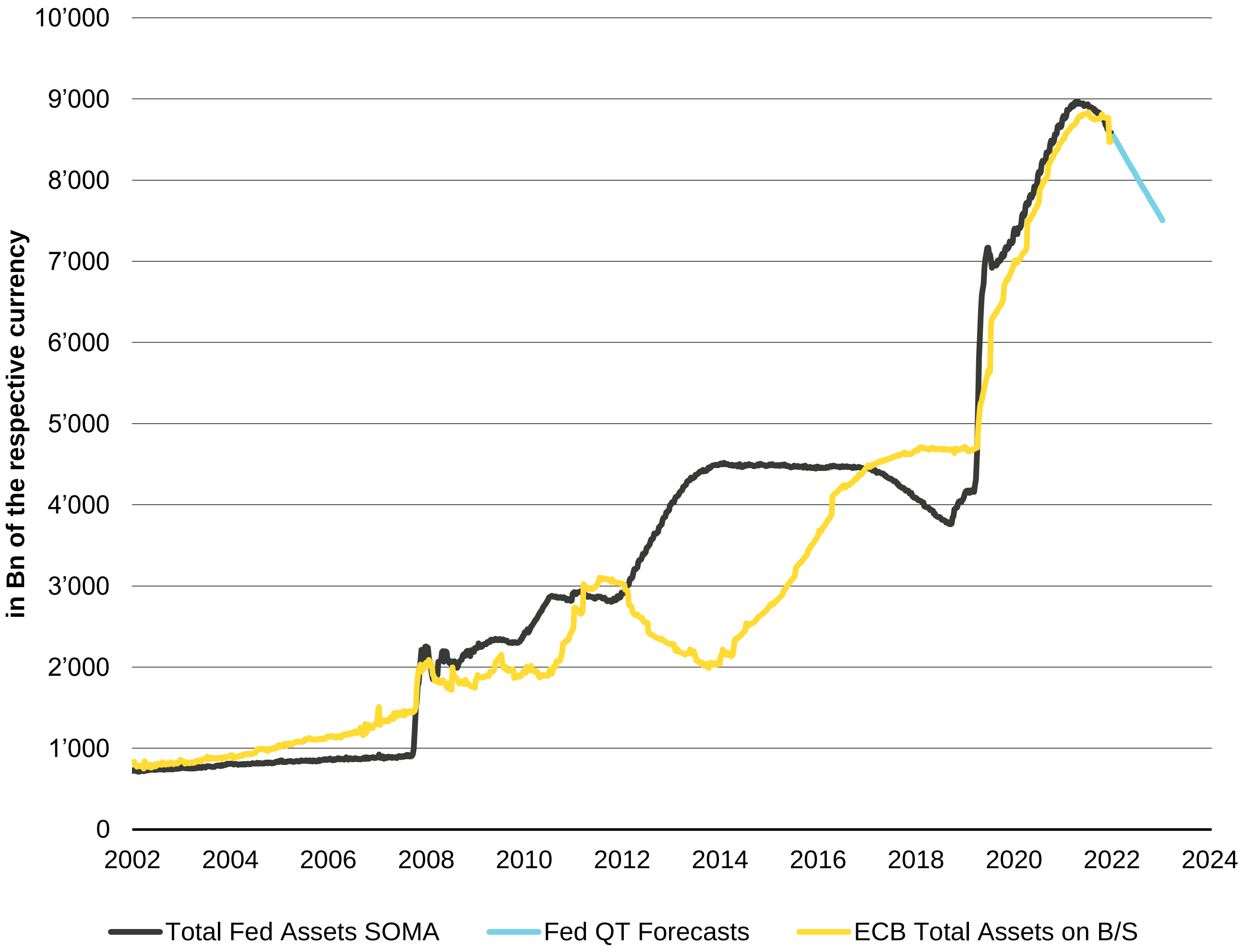
ECB: some more rate hikes to come



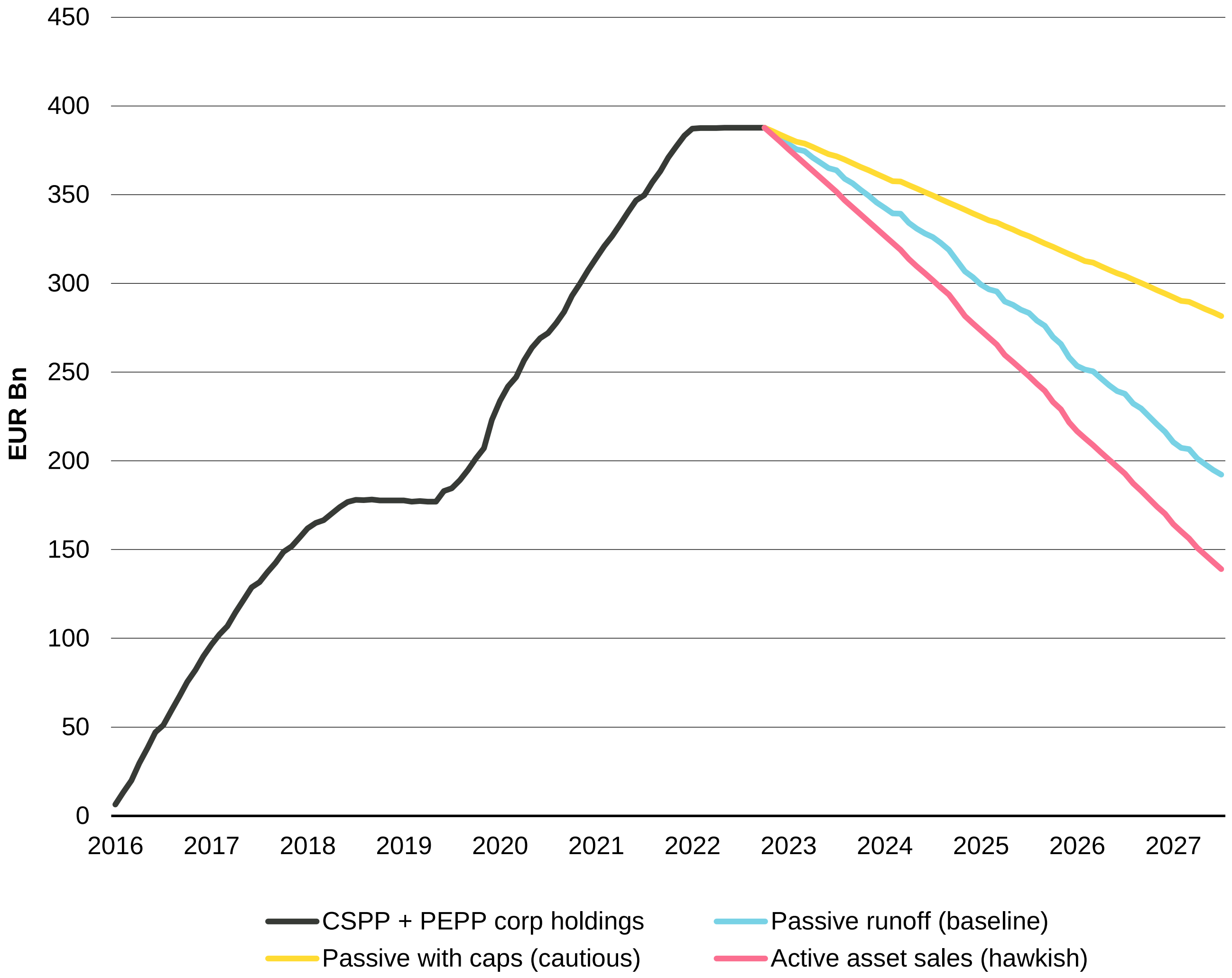
Source: Fed: Median hike forecast of the Fed fund rate from Goldman Sachs, BAML, JP Morgan, Citi and Barclays. ECB: Median hike forecast of the ECB deposit rate from Goldman Sachs, JP Morgan, Citi, Deutsche Bank and Barclays, as of 12.2022.

…which should allow for a smooth runoff of their QT programs.

Central Banks’ total assets trending lower



ECB CSPP/PEPP holdings set to decline

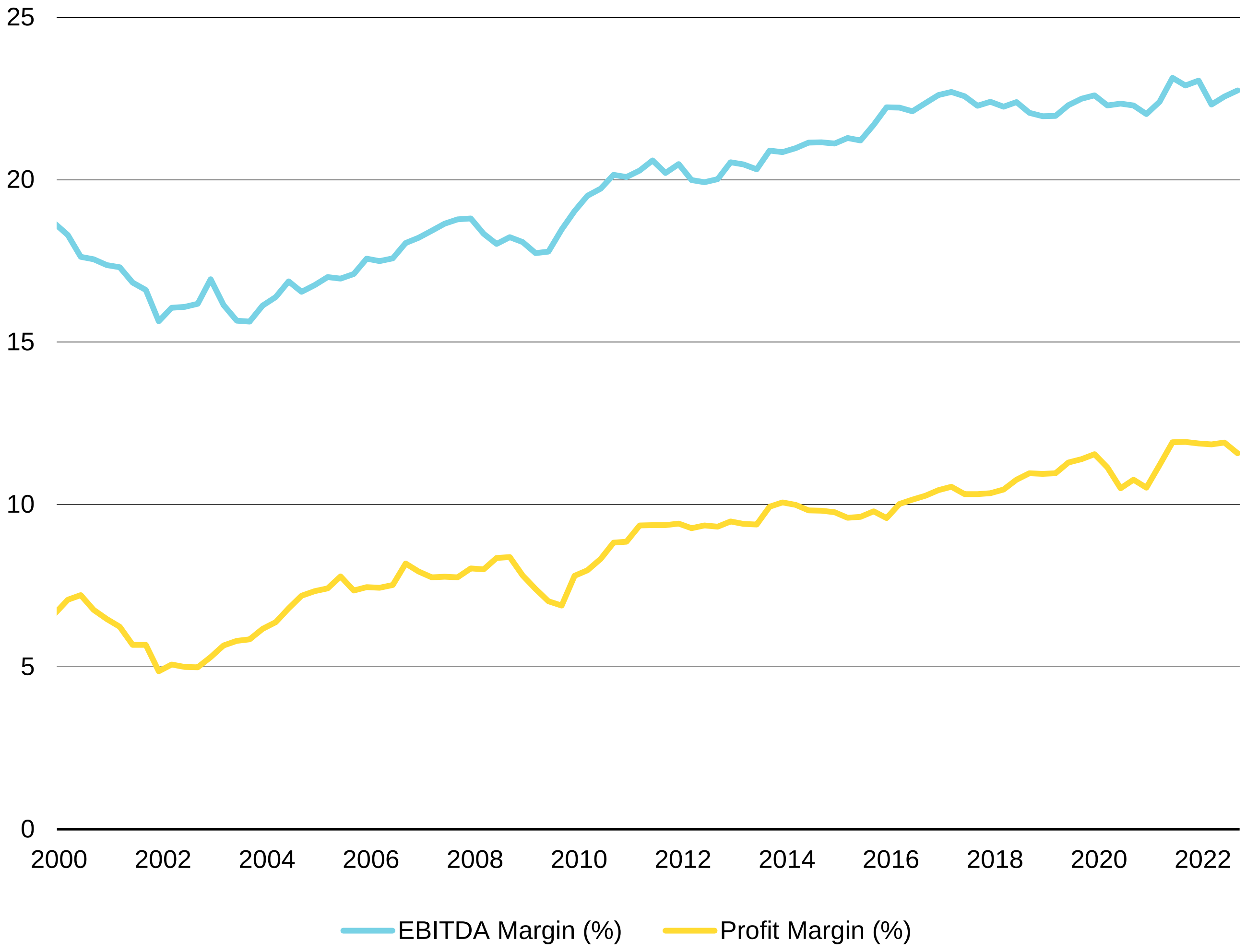


Source: St. Louis Fed, Bloomberg, BNP, Goldman Sachs, as of 12.2022.
Forecasts based on internal / external analysis; not guaranteed; and actual outcomes may differ materially.

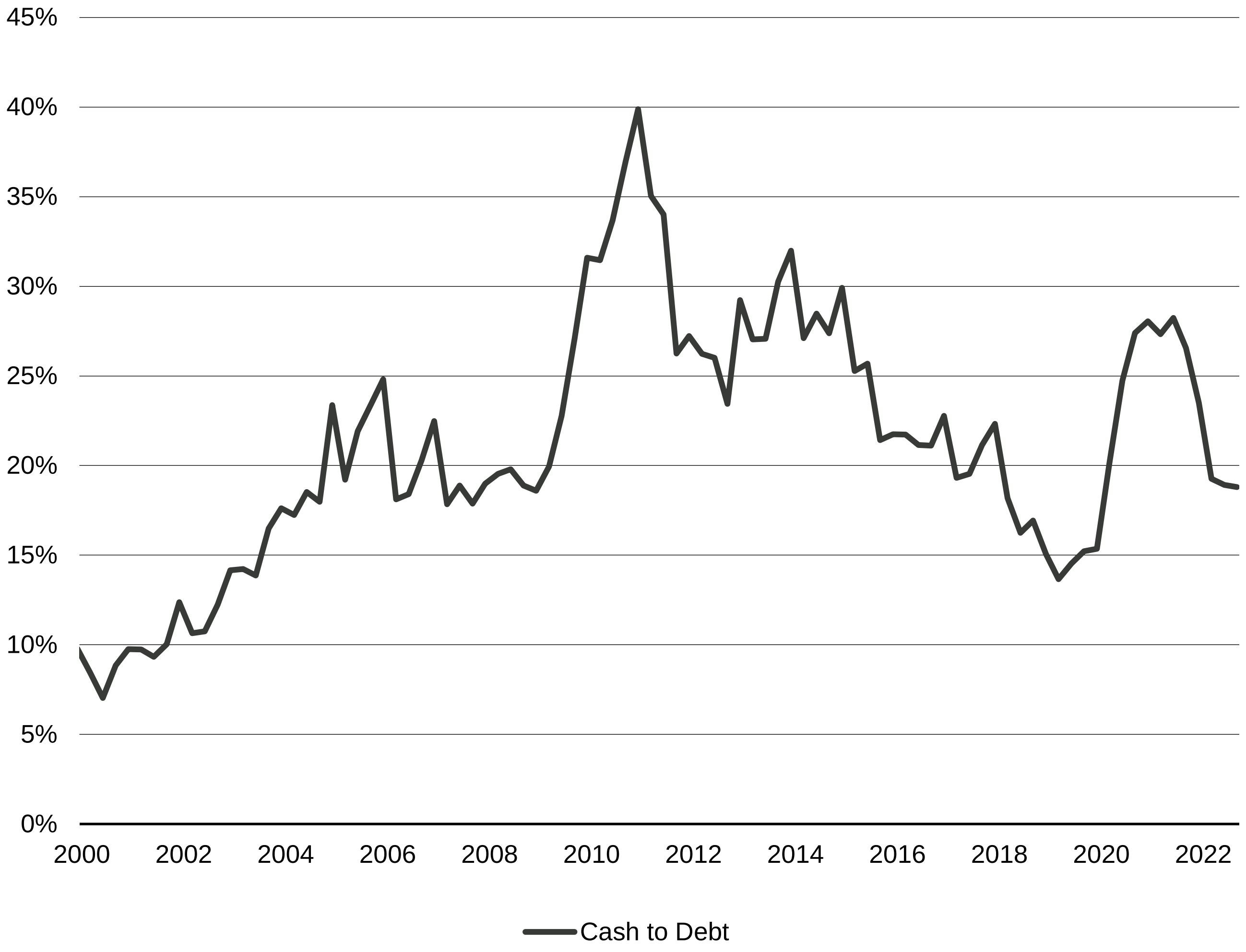
#4. Margins holding up well, while cash spend increased...

Micro

Margins at very high levels



Companies started to spend some cash



Including Q3 2022 results of US Investment Grade Non-Financial issuers. Source: Morgan Stanley, Vontobel, as of 12.2022.

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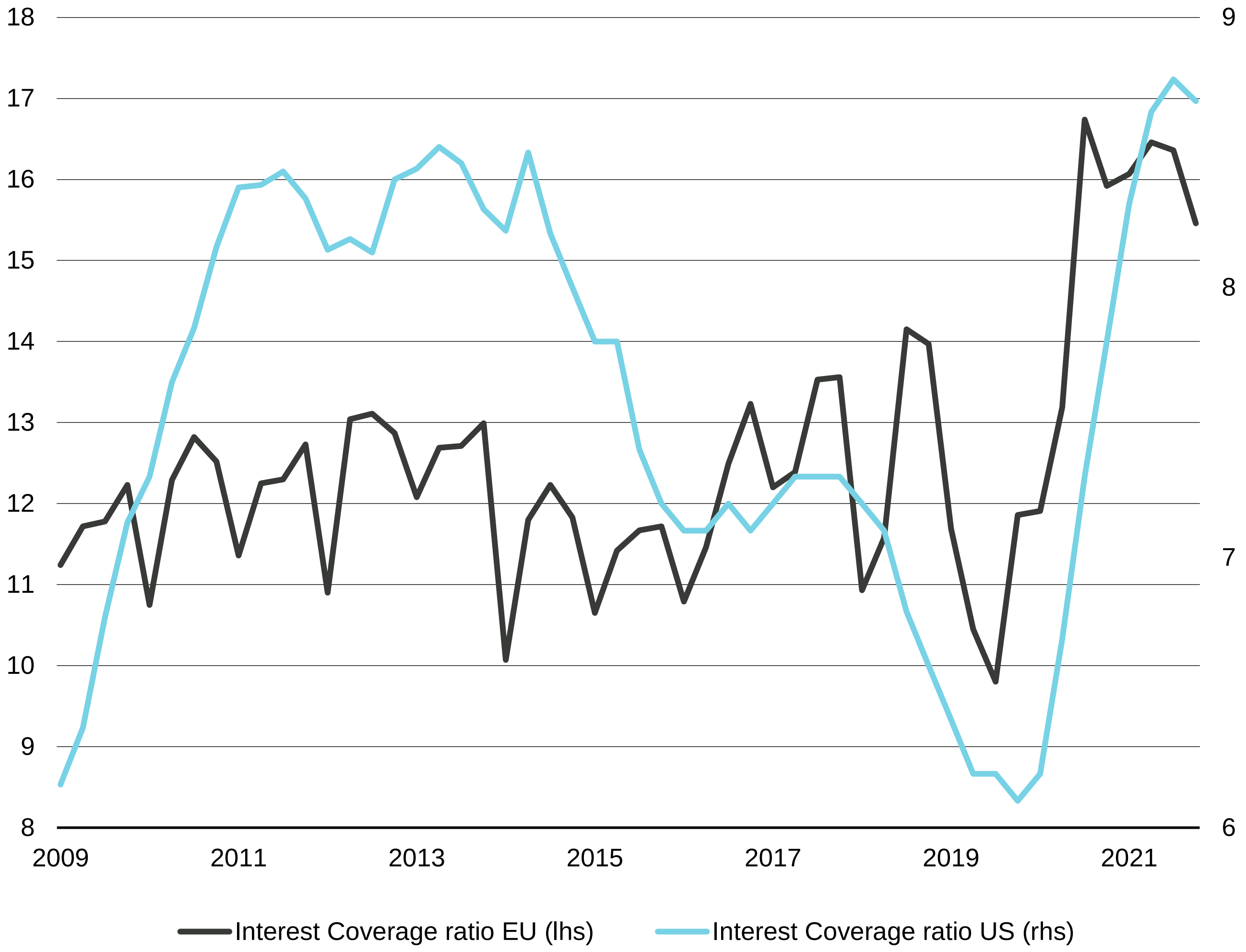
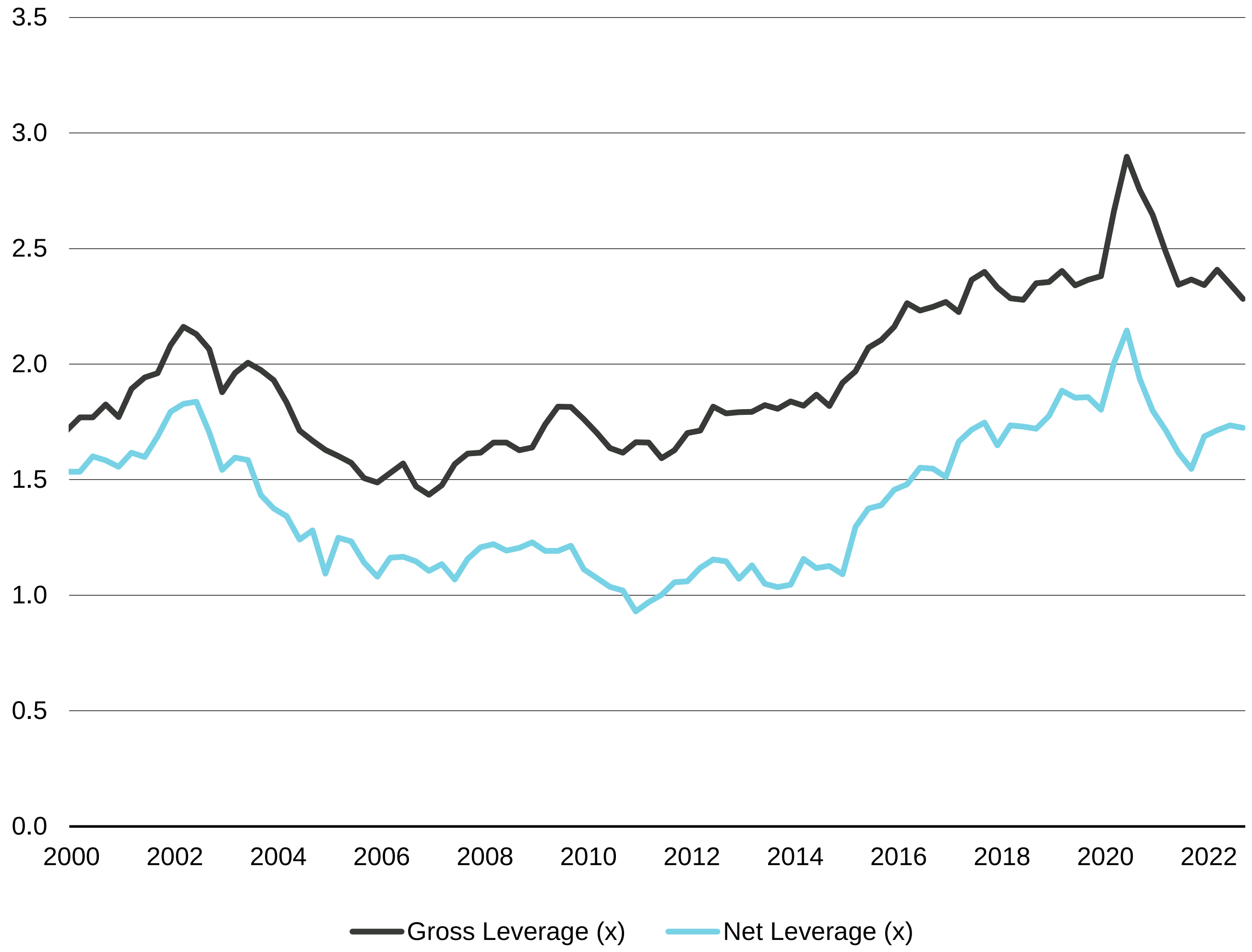
Micro

…while credit metrics remain at strong levels.

Interest coverage near record levels



Gross leverage down, net leverage flat



Including Q3 2022 results of US and EU Investment Grade Non-Financial issuers (left); results of US Investment Grade Non-Financial issuers (right). Net Leverage = Net Debt / LTM EBITDA. Net debt is gross debt minus cash and marketable securities.
Source: Morgan Stanley, Bloomberg, Vontobel, as of 12.2022.

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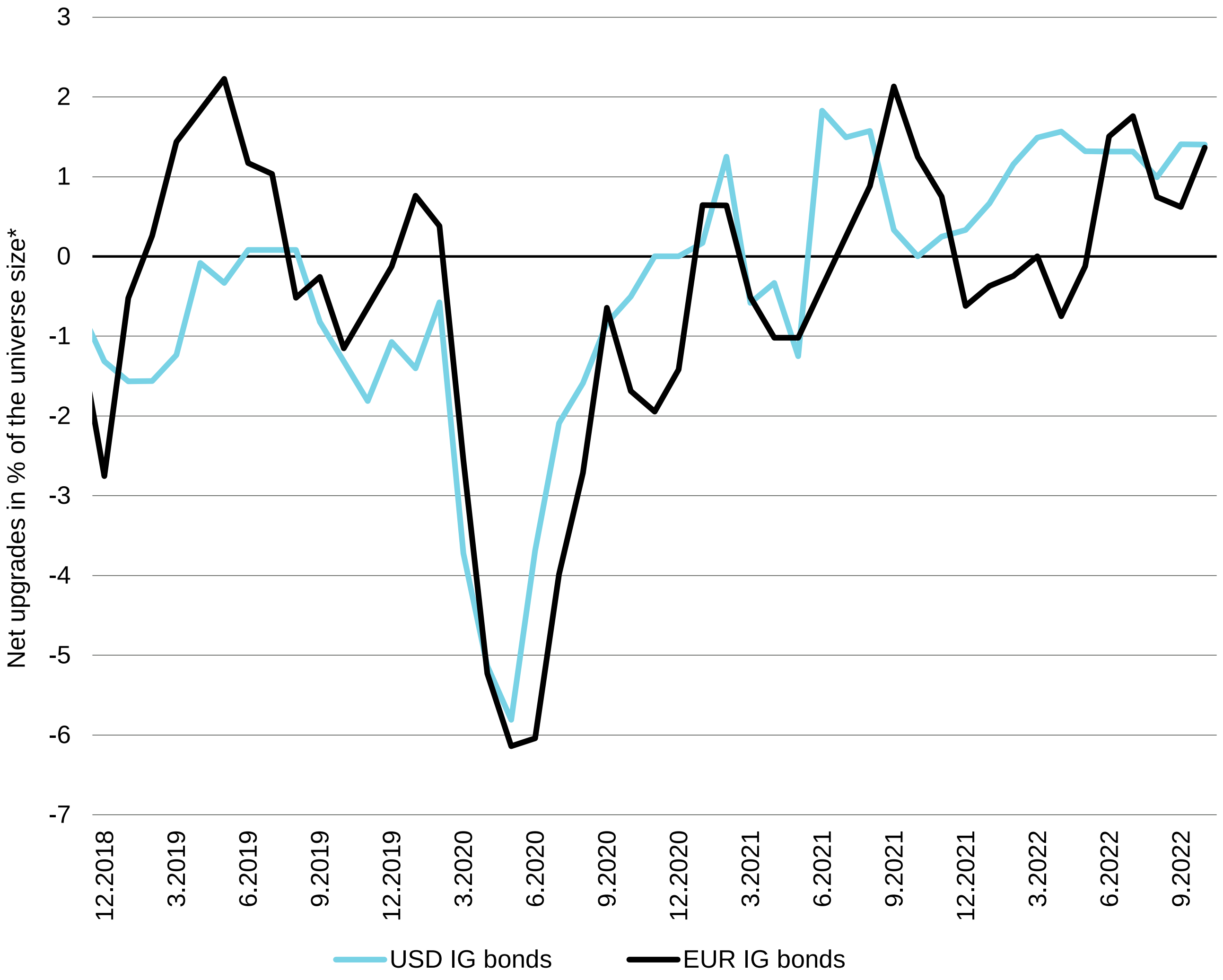
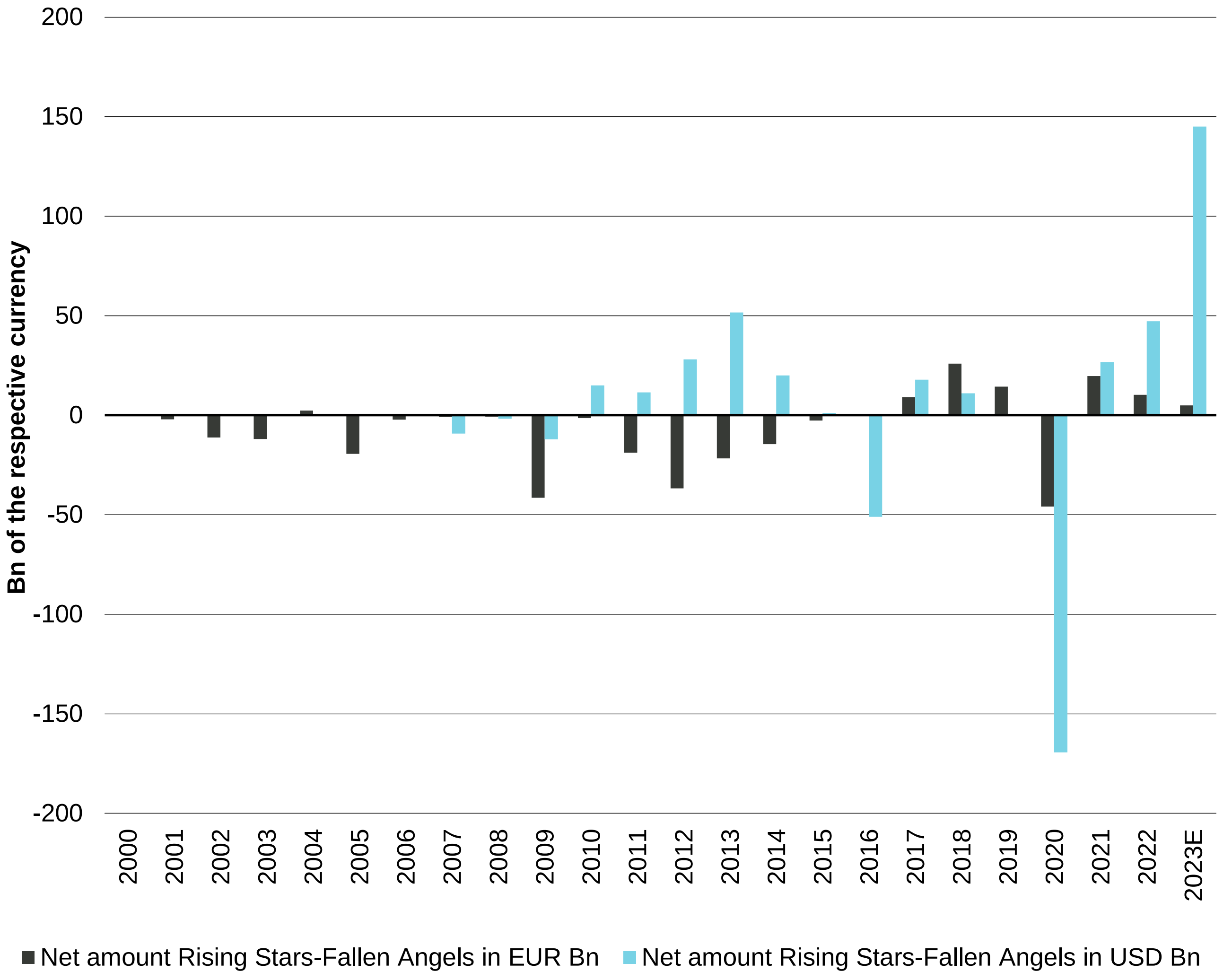
#5. The rating trend remains intact with a positive outlook for 2023.

Micro

More upgrades than downgrades within IG



Fallen Angels/Rising Stars

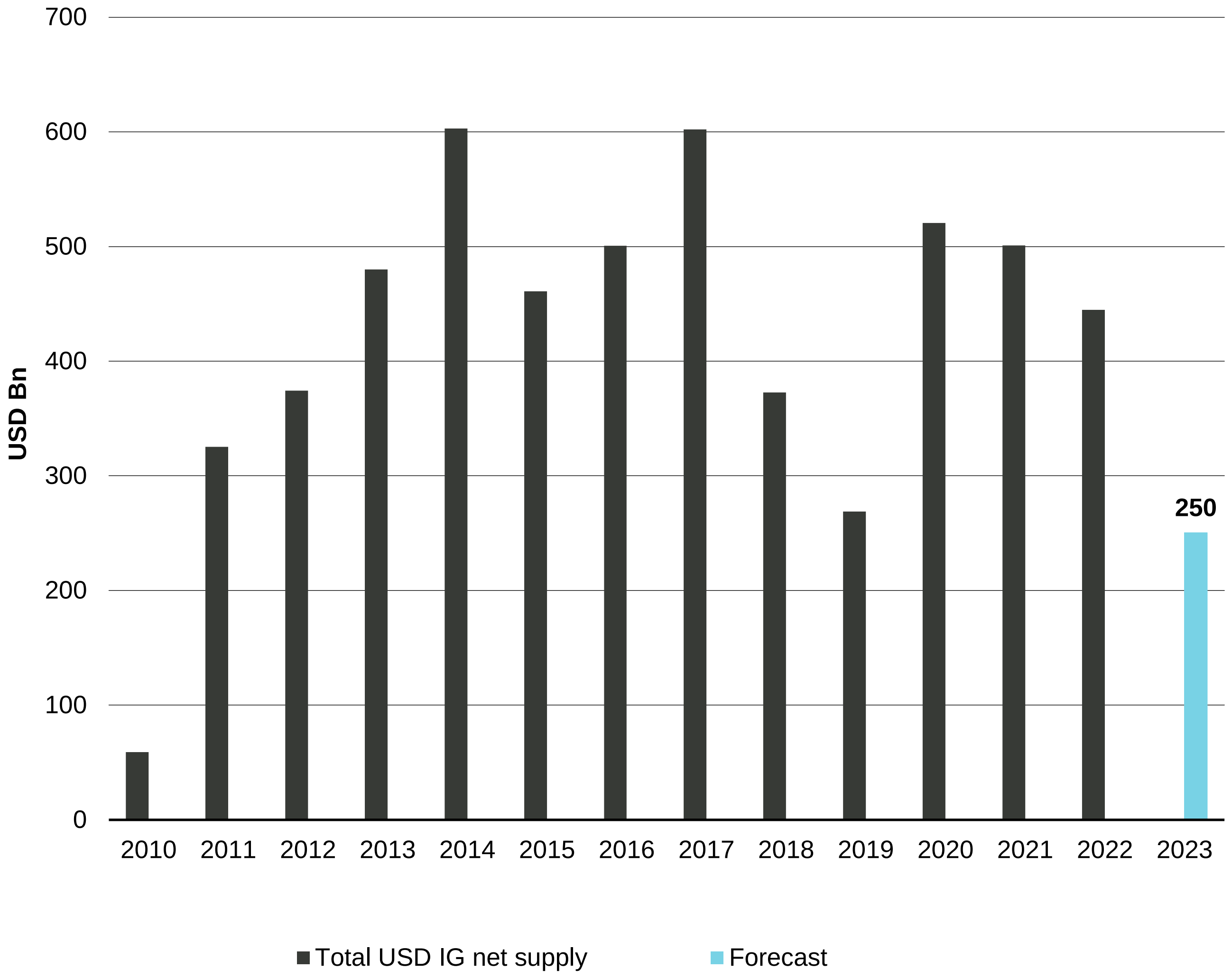


*Notches of upgrades minus notches of downgrades, divided by the total universe of rated firms over a rolling 3-month period.
Source: Goldman Sachs, JP Morgan, Vontobel, as of 12.2022.

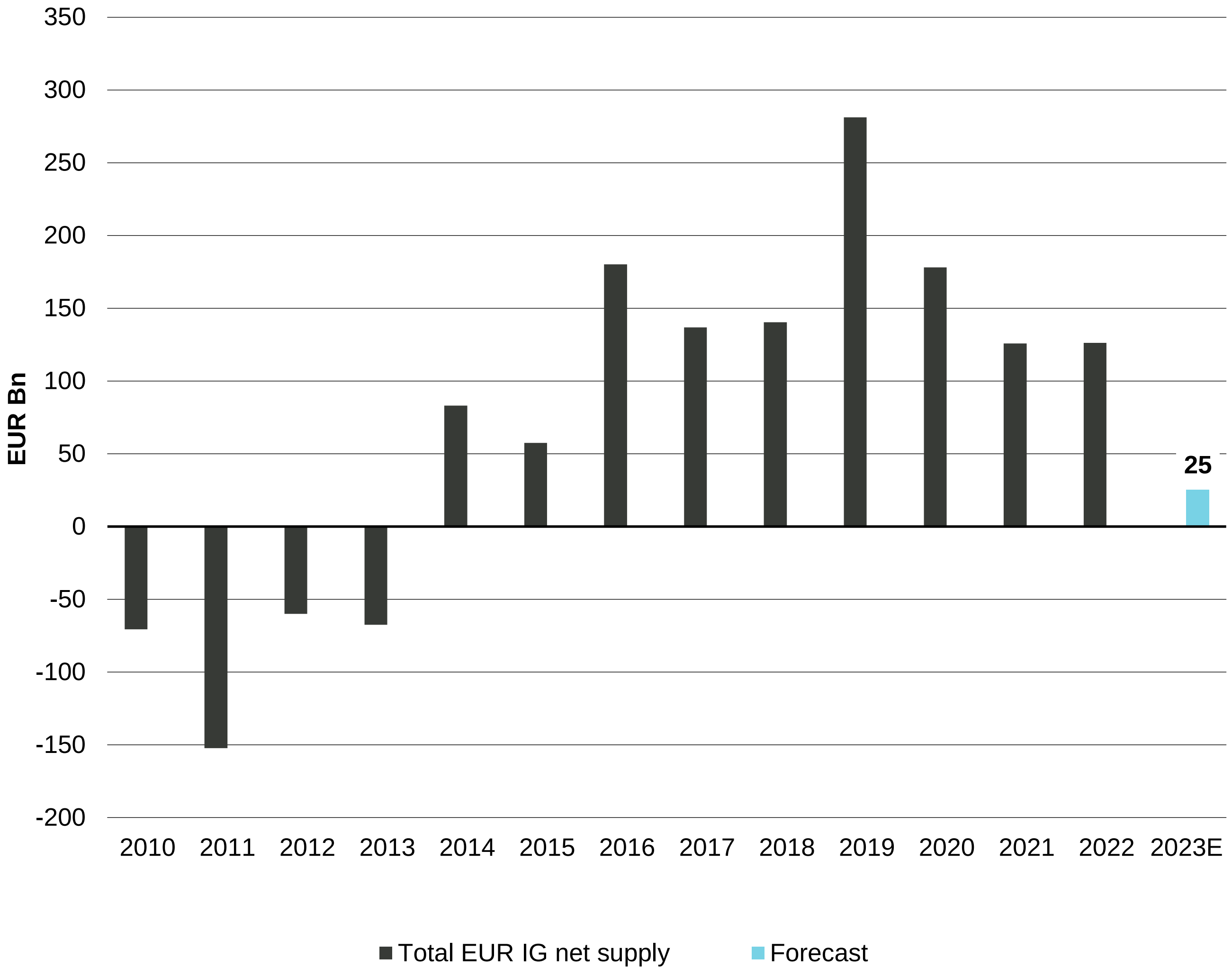
#6. Bond issuance is expected to decline to 10-year record lows.

Technicals

USD IG corporate bond net issuance



EUR IG corporate bond net issuance



Source: Goldman Sachs, Vontobel, as of 12.2022.

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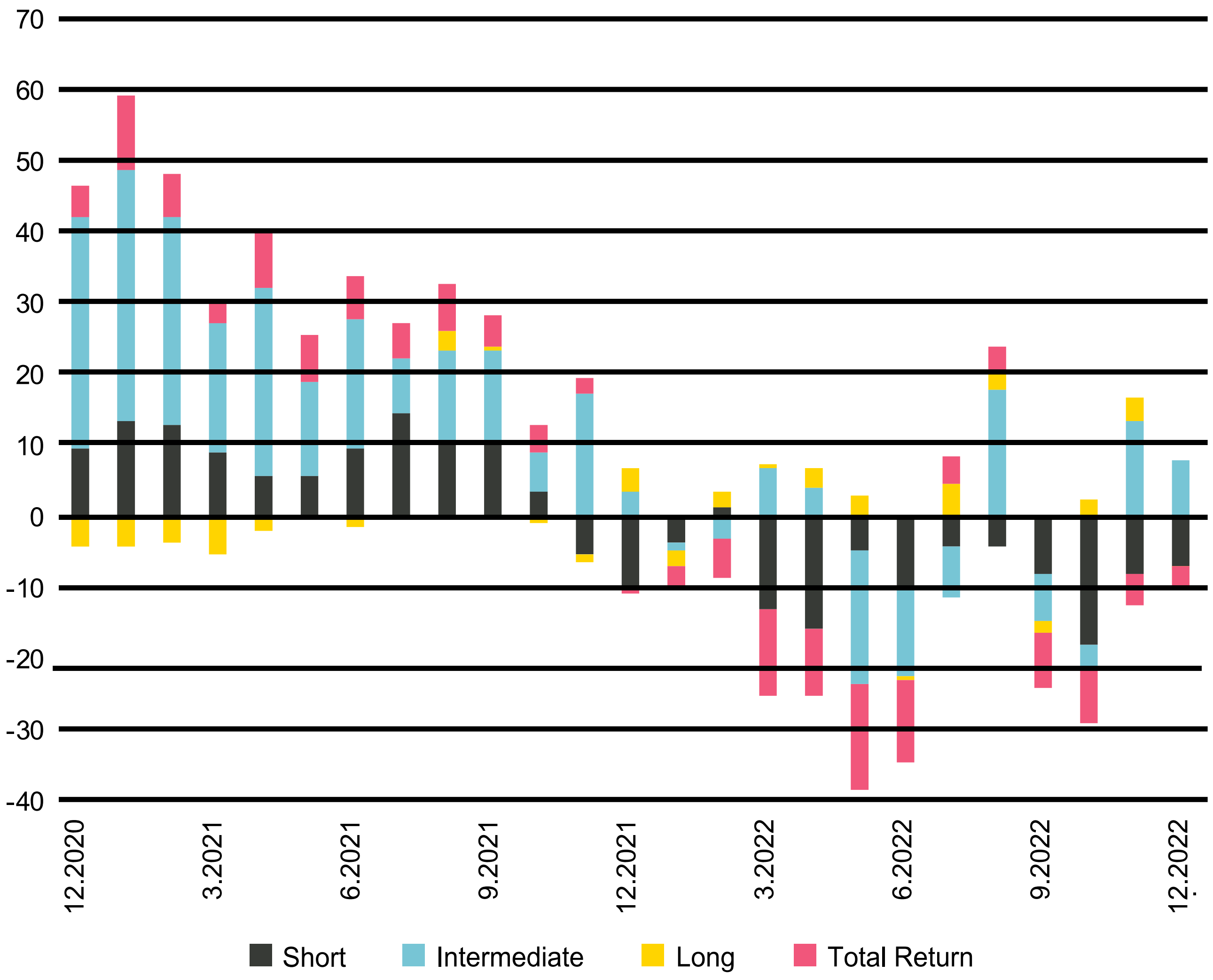
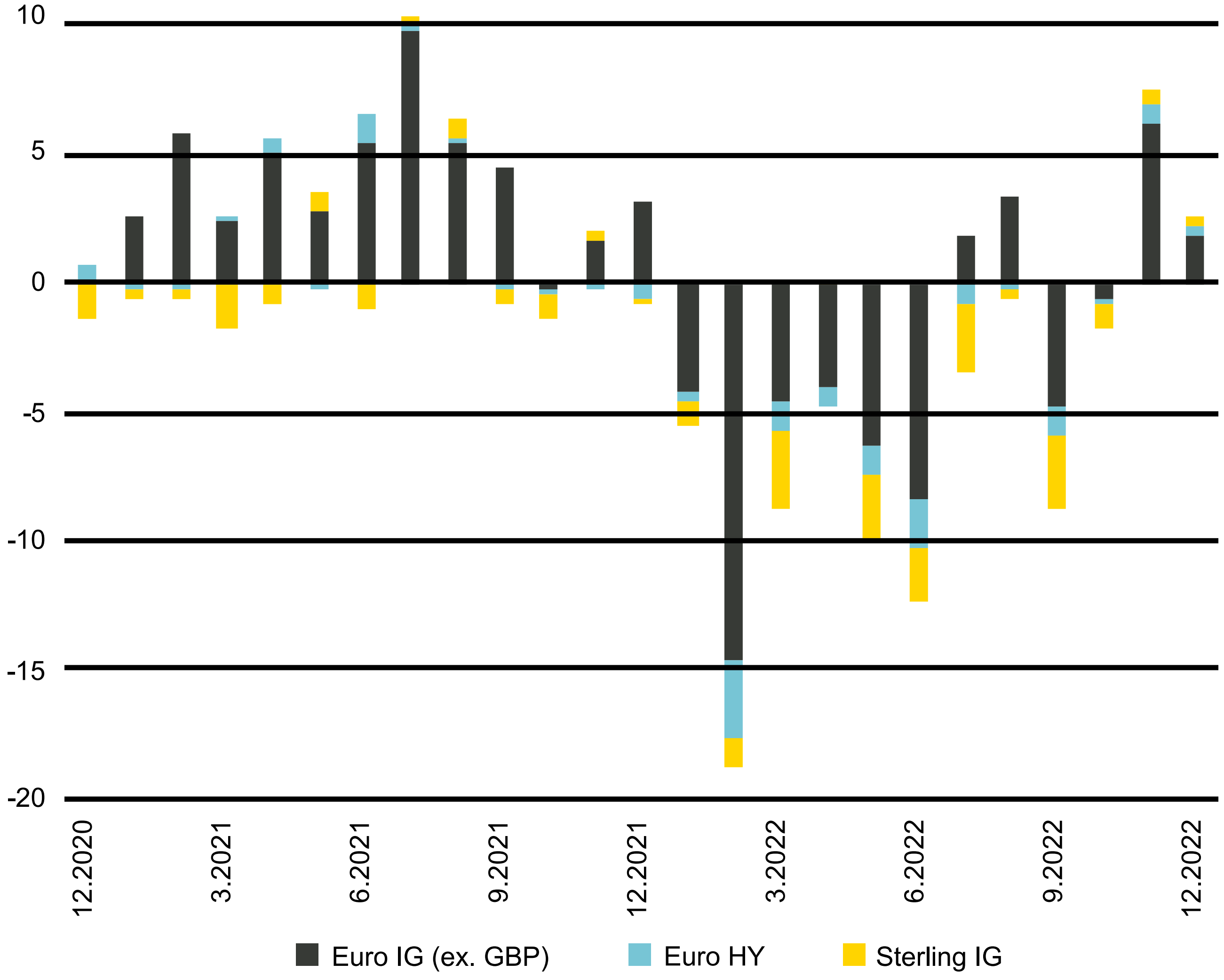
#7. Following a very negative 2022, fund flows turned positive recently…

Technicals

USD IG corporate bond flows



EUR IG corporate bond flows



Source: Wells Fargo, Vontobel, as of 12.2022.

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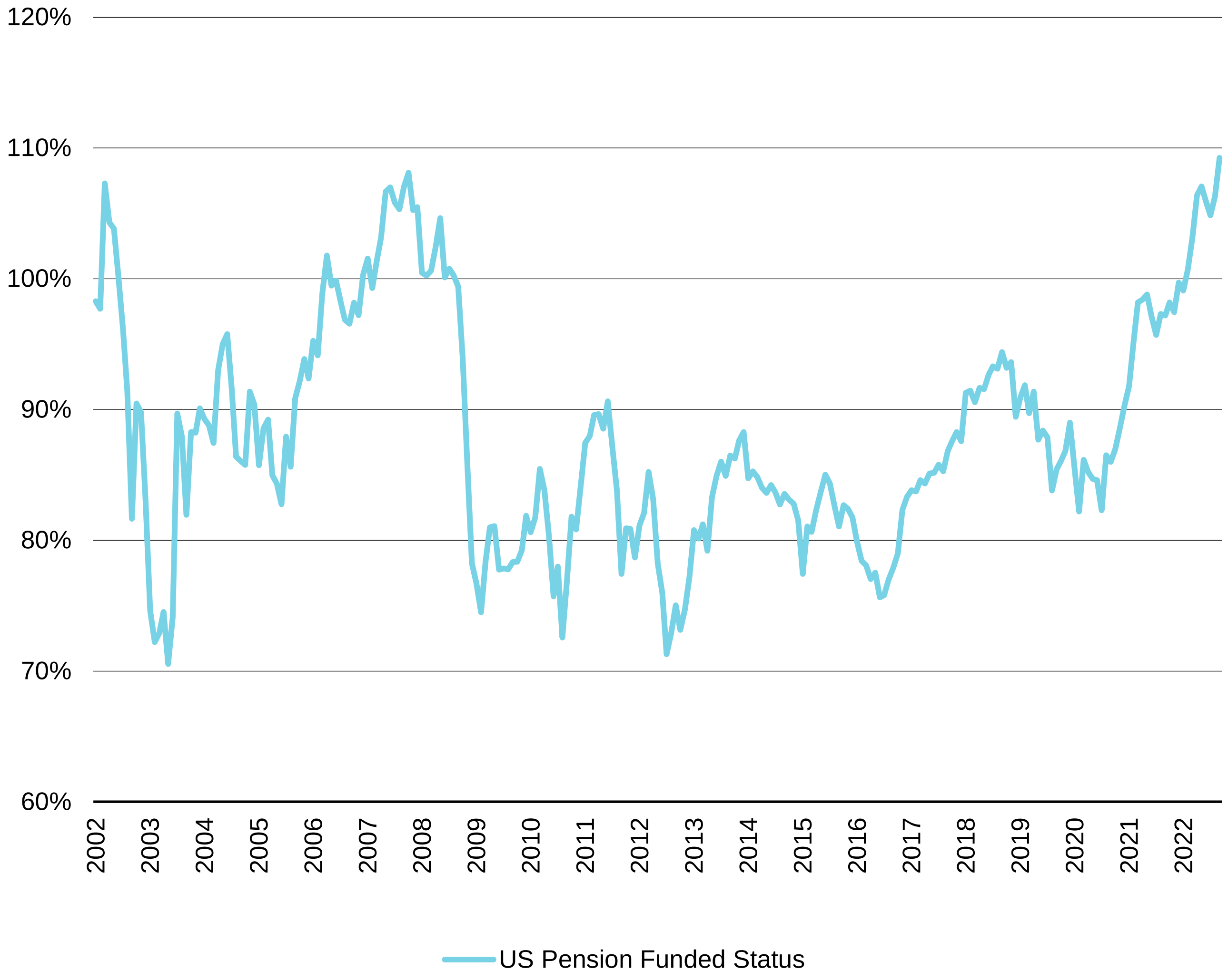
… and pension funds are likely to be a key buyer of corporate bonds going forward.

Technicals

Funding ratio of US Pension plans improved



Funding ratio of EU Pension plans also improved

Source: Milliman, JP Morgan, De Nederlandsche Bank, Vontobel, as of 12.2022.

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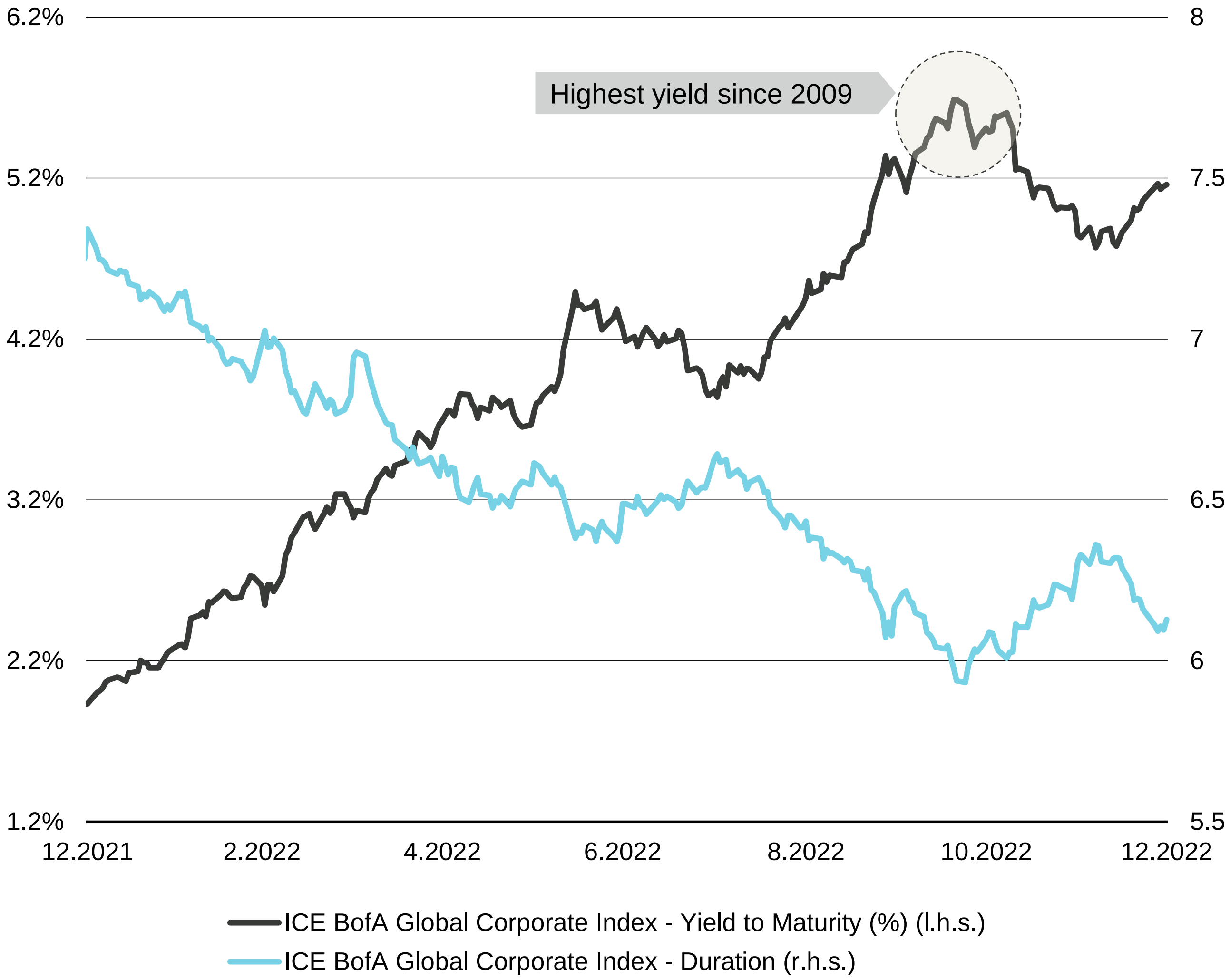
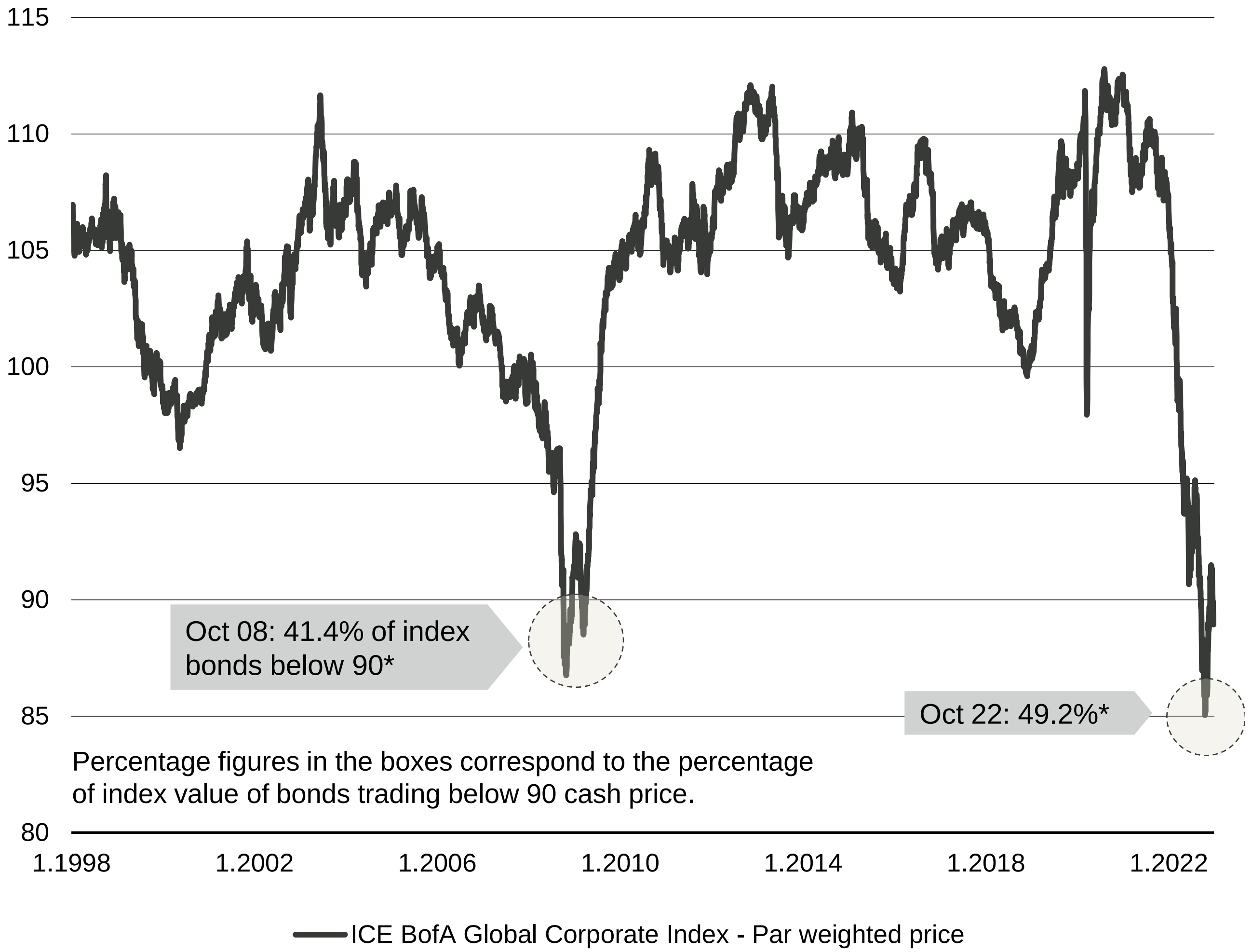
#8. Yields up significantly and bond prices down…

Valuation

Yields up, duration down since the start of 2022



Record amount of low cash price bonds



Source: Vontobel, ICE BofA Global Corporate Index, as of 12.2022.

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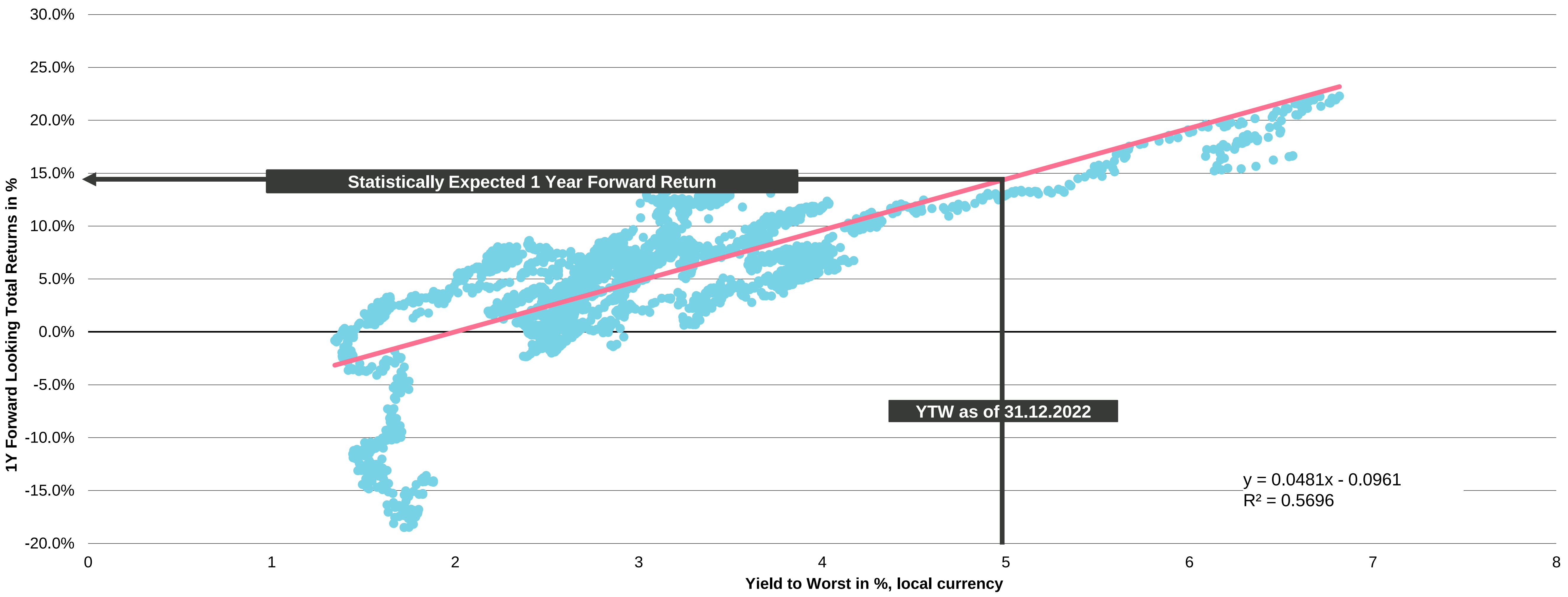
…and historically forward-looking returns looked attractive when the starting yield was at 5%.

Valuation

Regression of 1-year forward-looking total returns on yield (G0BC Index)



Past performance is not a reliable indicator of current or future performance.

Source: ICE BofA Global Corporate Index (G0BC Index). Daily data range from 01.01.2009 to 30.11.2022. The current (December 31, 2022) yield to worst of the before mentioned reference index is at 5.1% in local currency terms.

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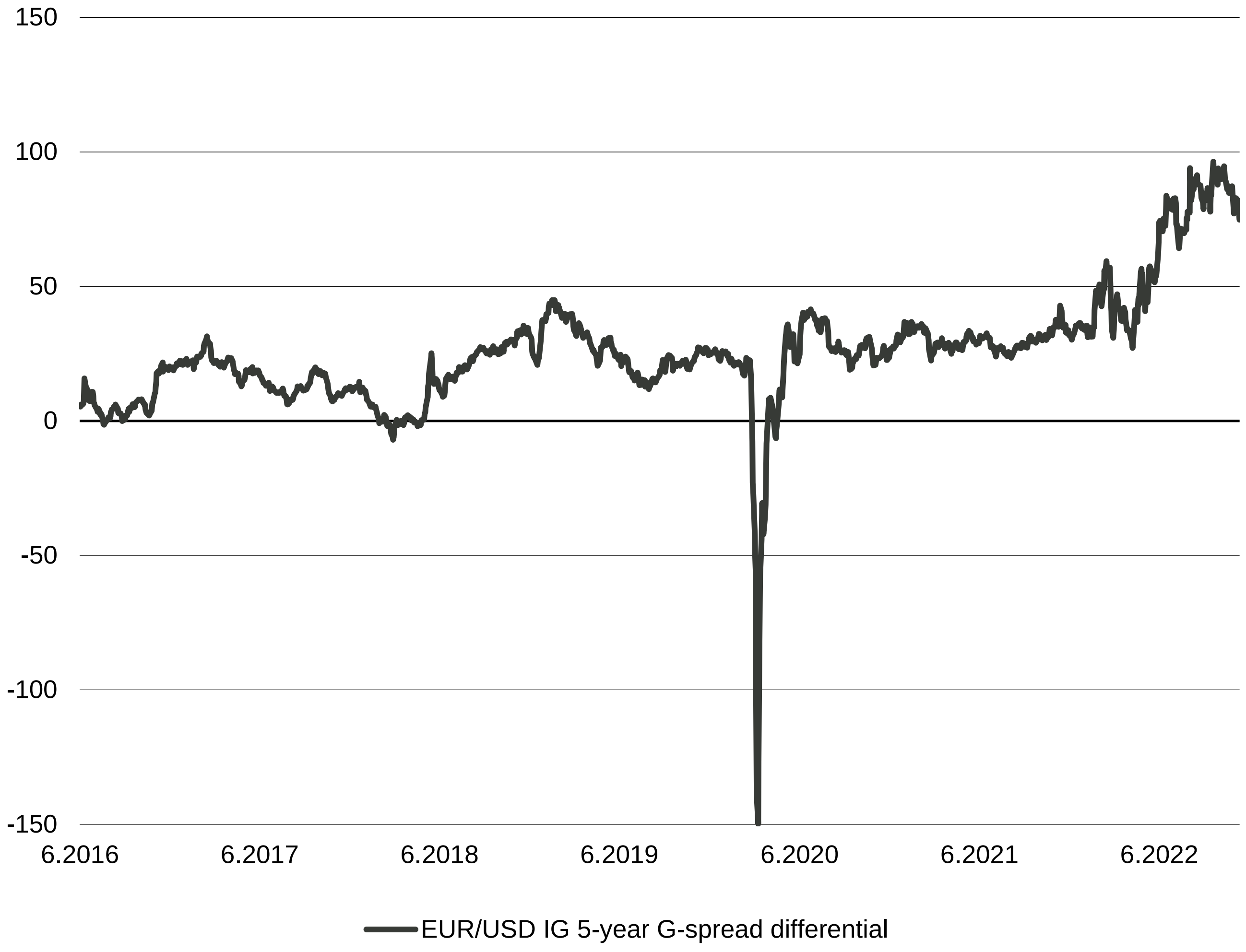
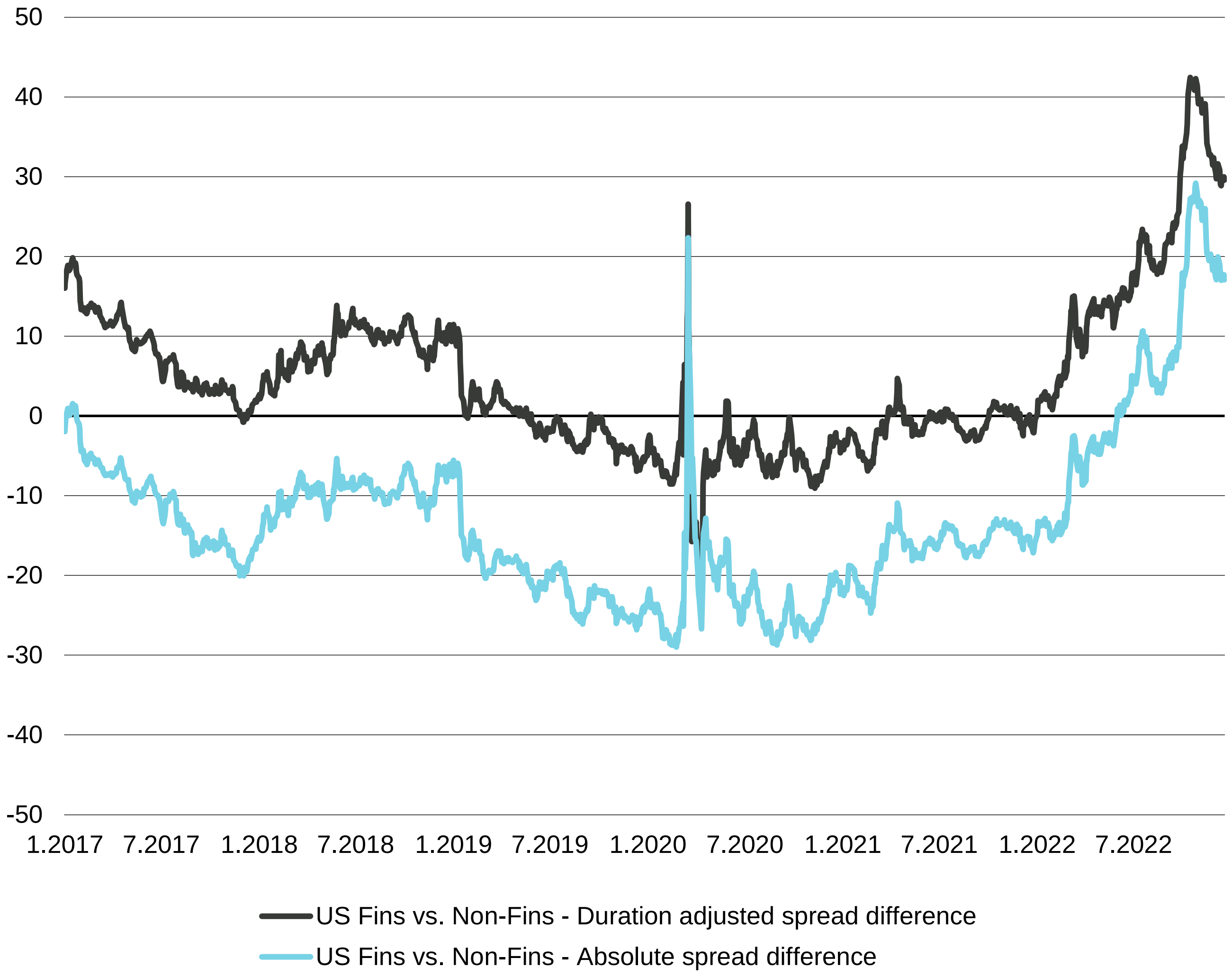
#9. On a global scale, various market segments provide opportunities…

Valuation

EUR vs. USD spread differential improving



Financials vs. Non-Financials at attractive levels



Source: Vontobel, Goldman Sachs, JP Morgan, as of 12.2022.

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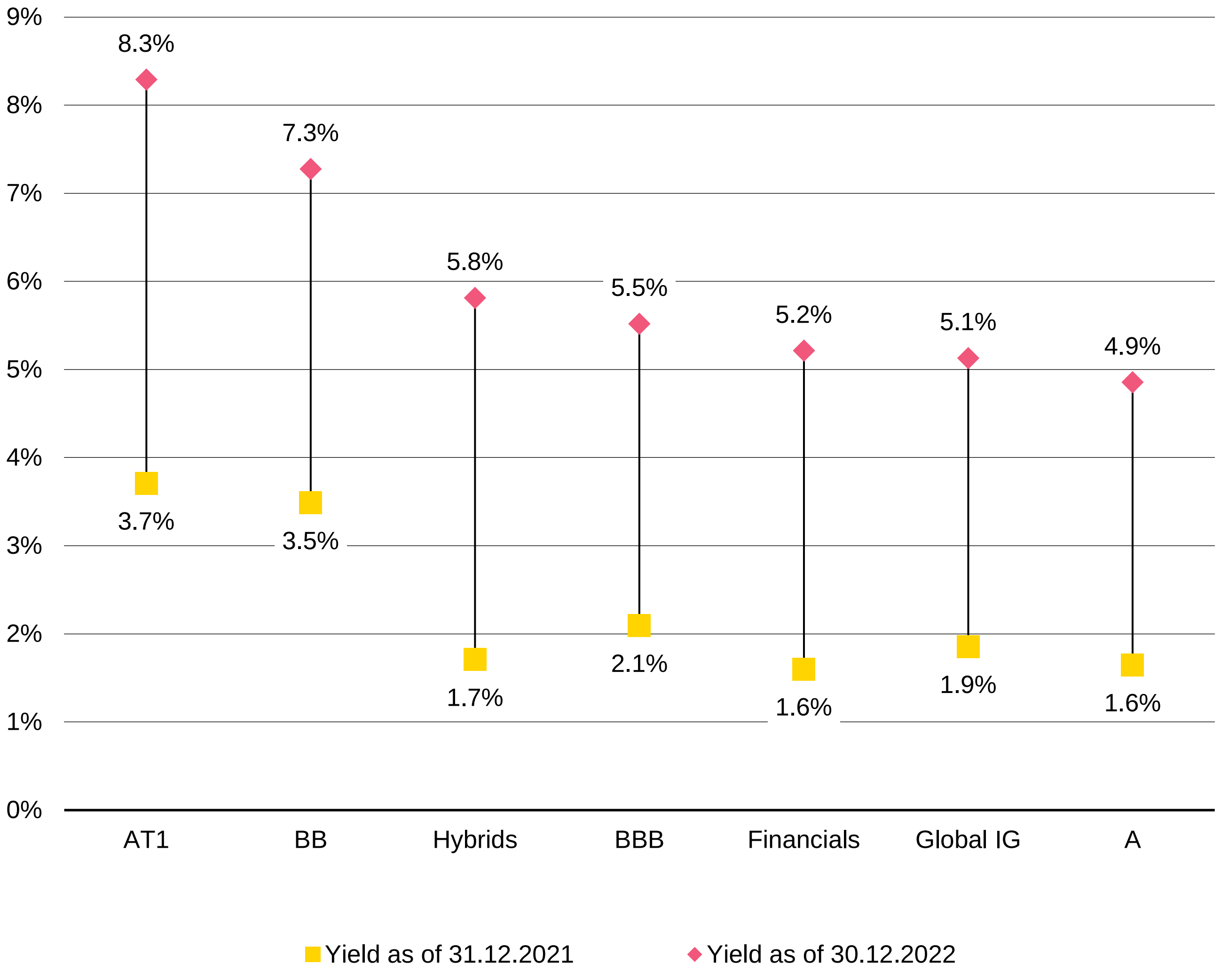
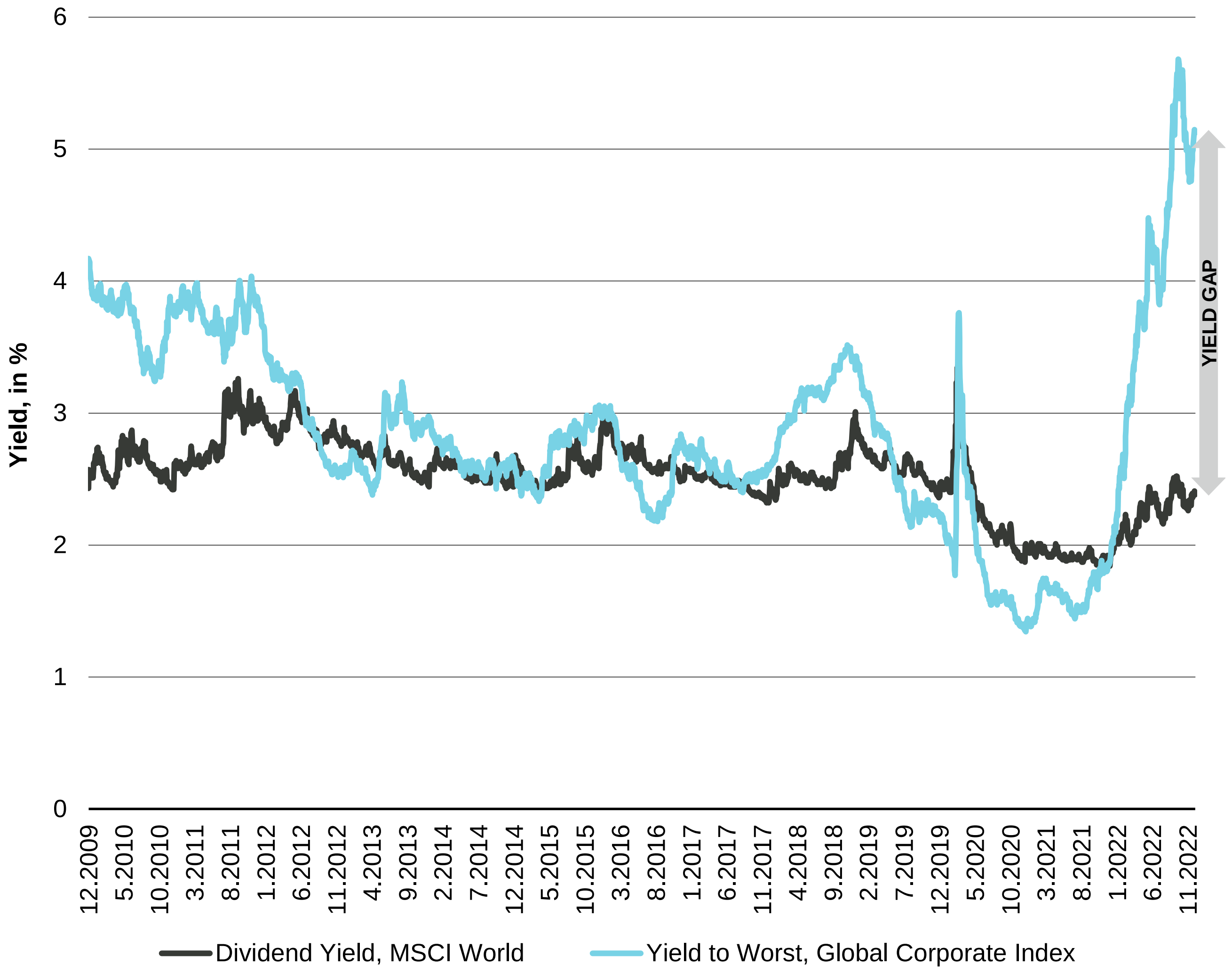
Valuation

…with corporate bond yields in all categories significantly higher.

Global Corporate Bond segments



Investment Grade yields are at decade highs



Note: Indices used from the BofA ML Index family with the yield to maturity in local currency. Source: Bloomberg, BofA ML, as of 12.2022.

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#10. How to benefit from this environment?

How does the world look?	**Macroeconomics:** Recession risk increasing but inflation trending lower. Visibility on central banks rates path increased.	**Microeconomics:** Resilient credit metrics, leaving corporates in a robust position to weather profit margin pressure.	**Technicals:** Lower issuance of corporate bonds is supportive.	**Valuation:** Substantially higher yields and wider spreads should attract investors.
How may investors extract value?	Diversify risks on a **global scale.** Take an active approach and screen for **mispricings** in various segments.	Benefit from a stable to **improving rating trend** and potential rising stars.	Screen for new issues with an **attractive premium** and **higher coupons**.	Benefit from **low cash price** bonds. In addition, higher coupons from new bonds translate into **higher income**.

Source: Vontobel Asset Management, as of 1.2023.

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This is not the end…

…as there are obviously more burning questions, and we are more than happy to share our thoughts with you.

Happy New Year!

Christian Hantel
Executive Director
Asset Management

Marc van Heems
Director
Asset Management

Pam Gelles
Director
Asset Management

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Thank you.

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