

Talking Heads

Podcast on euro credit with Boutaina Deixonne

Chris Iggo: Hello and welcome to this week's BNP Paribas Asset Management Talking Heads podcast. Every week, Talking Heads will bring you in-depth insights and analysis on topics that really matter to investors. In this episode, we'll be discussing the state of play and outlook for the investment-grade and high-yield segments of the euro corporate bond market. I'm Chris Igo, Chief Investment Officer, AXA IM Core, part of BNP Paribas Asset Management, and I'm joined today by Boutaina Deixonne, who is Head of Euro Investment-Grade and High-Yield Credit. Welcome, Boutaina, and thank you for joining me today.

Boutaina Deixonne: Happy to be here.

CI: Boutaina, given the strong performance that we've seen in the Euro corporate bond market over the past few years, do you believe that Euro credit still offers attractive opportunities for investors today or has it become too expensive?

BD: As you said, Chris, over the past few years, euro investment-grade and high-yield markets have experienced significant spread tightening, which indicates actually that investors are comfortable with the current outlook for European corporates. We believe that companies are generally performing well with solid earnings and healthy balance sheets. Despite this tight spread, yields remain attractive.

Some might worry about valuation, but we believe that as long as corporate fundamentals remain stable as we have seen in Q4 earnings season and macroeconomic conditions stay supportive, the risk of a sharp reversal is limited. For now, we do not see a significant risk of a credit cycle reversal in 2026 unless there is a major deterioration in economic conditions which we consider unlikely at this point.

CI: That's a really important point, isn't it, that the macro backdrop is stable. When you look at the market across sectors, do you see a uniform picture in terms of yields or do you see areas where things are still more attractive on a relative value basis?

BD: As you said, we see some dispersion and some attractive opportunities, especially if we focus on specific sectors with specific underlying drivers.

What we like today, first, the banking sector. Our conviction is that European banks are in a historically good position. European banks are generally well capitalised with high levels of provisions and strong profitability, and this trend should remain favourable for revenues with still strong fees and commissions, but also a better outlook for net interest income with steeper curves. On the cost side, they will stay contained. Within banks, we like both senior bonds and subordinated bank debt because they offer an attractive risk-return profile. Within the subordinated area, we like additional tier one that will provide a higher yield for investors that are willing to accept additional risk. This would be the first sector.

We also have a positive view on real estate. This is not that consensual. We like the fundamentals of this sector and we expect them to improve as interest rates stabilise and rental income rises. Property valuation are recovering modestly, but are in positive territory now across most segments. Sub-sectors like residentials, like logistics, are performing relatively well and we have a preference to include this exposure in our portfolios. European real estate companies have clearly the financial flexibility to keep

their investment-grade today. Overall, a sector that should perform well and offering a nice pickup notably versus some cyclical sectors.

Another sector that we like is utility because of the defensive characteristics. We think that this sector, notably in the regulated business, should offer stable cash flow generation. Here we particularly like the subordinated segments of the utility sector for the pickup in yields it provides. Overall, we tend to prefer triple B rated bonds versus higher rated bonds with a five-to-10-year maturity.

CI: We talk about the euro bond market like it's a single market, but obviously there are different themes and different nuances. What we've seen at the macro level is some countries performing very well. I'm thinking of Spain and potentially Italy over the last year or so. Has that been reflected in opportunities in the bond market?

BD: To some extent, the answer is yes. Indeed, we have seen improving trends for Spanish and Italian banks notably, but also Italian corporate. We have seen a wave of upgrades of those countries which had a positive impact on the ratings of the issuer. Italian and Spanish bank are performing well in terms of revenues. They are also showing good capitalisation. Same for the non-financial side, sectors like telecoms, utilities offering again good fundamentals and a nice spread. Clearly, those countries are well represented in the portfolios.

CI: Are there areas that you've been avoiding? Are there areas that have been particularly weak?

BD: There is a sector that we dislike clearly – [the] chemical sector where we do not expect any short-term recovery given the intense competition. So, yes, we have been underweight this sector. The situation is different in high yield where we have seen idiosyncratic issues. Here, we have been avoiding credit that's suffered from, and continues to suffer, from lower volume, pressure on pricing and hence pressure on costs. Credit metrics, cash flow generation and ratings, have been under pressure, leading to a wider spread. So, within the chemical sector, selection is crucial. This does not mean that we do not invest at all, but that we need to be more prudent and more selective in our positioning.

The automotive sector is another industry that face a lot of challenges. The electric penetration is one of those. Competition from China is also another issue. Tariffs from the US administration is another problem. In investment-grade, we have seen some companies suffering. However, we do not expect a wave of fallen angels in this sector, rather some deterioration. Last year, one of the best performers in Euro investment-grade was actually the automotive sector despite all the challenges. This does not mean that we do not invest at all in the automotive sector, but selection is key here.

CI: You mentioned the high-yield market and I'm glad you did because that it's been a good performing sector. Default rates continue to be quite low by historical standards. How are you using high-yield to help boost performance across your portfolios?

BD: High-yield has historically been more sensitive to economic cycles. Understanding the outlook for the default rate is key for assessing risks and opportunities. We have been constructive on the credit asset class for many years now. This has been supported by a relatively contained default rate. We expect the default rate to remain relatively contained in the next 12 to 18 months, around three percent. This is somewhat higher than the historical lows, but still below the long-term average.

Today, we think that the yield of the high-yield market is attractive at around 5%. However, we think that the importance of selectivity is very high. I mentioned some sectors that are more vulnerable. We need to be even more prudent in terms of name selection. But there are opportunities and our job is to identify undervalued names and avoid the overvalued ones.

CI: We've talked about yield being attractive relative to equity dividend yields and cash. Do you see in your business continued demand for credit over the coming year?

BD: Demand for the asset class has been extremely important since 2023. We have seen huge amounts of inflows. This is true for both investment-grade and high-yield. What we see since the beginning of the year is that flows continue. This demand is largely related to the yield. The discussion that we have today with clients, I see two main strategies that stand out.

On the one hand, the short duration strategy in both investment-grade and high-yield. Investors that are more cautious or more concerned about duration and volatility in the sovereign bond markets will choose the strategy because it will offer compelling yield opportunities, good carry with lower interest rate sensitivity, with much lower drawdowns and much lower volatility.

On the other hand, some investors are really seeking broader exposure to the European credit market with more flexibility and less constraints. Here, we offer the total return strategy. Those clients will trust us to actively manage their portfolios to balance yield, risk, liquidity and generate the return from different drivers: investment-grade and high-yield, sectors, seniority. We will choose across a broad range of names and sectors with the best risk-return profile, while keeping this flexible and tactical approach.

So, overall investor demand remains positive and diverse depending on the risk appetite of those clients.

CI: Thanks very much for joining me today.

BD: Thank you, Chris.

CI: That's it for this week's episode of Talking Heads. If you would like to learn more about our investment insights, please reach out to your BNP Paribas Asset Management contact or check out Viewpoint, our website for investment insights at viewpoint.bnpparibas-am.com. We recommend subscribing to Talking Heads on your favourite podcast channel such as YouTube or Spotify. You'll receive your podcast episodes every week. If you like Talking Heads, leave us a positive review and a nice rating. You've been listening to the BNP Paribas Asset Management Talking Heads podcast with me, Chris Iggo, and Boutaina Deixonne, Head of Euro Investment-Grade and High-Yield Credit. Please do join us again on Talking Heads next week. Until then, goodbye and take care.