Janus Henderson INVESTORS

CREDIT RISK MONITOR

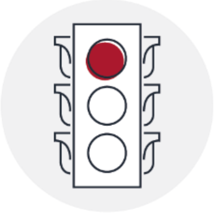
Dispersion is the name of the game

Spreads tightened and strong investor appetite supported credit issuance as investors focused more on the benign implications for credit (e.g, contained default rates, firmer cash flows) of upside surprises to macro data than to diminished expectations of interest rate cuts. We foresee the possibility of further spread tightening but accompanied by rates volatility if strong (US) growth causes supply-led disinflation to evolve into demand-led inflation. At this point in the cycle, we expect greater return dispersion within sectors. Issuer selection will be even more critical at this juncture.

Jim Cielinski, CFA
Global Head of Fixed Income

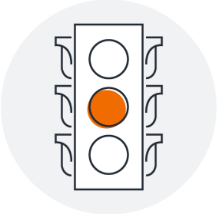
Longer term cycle predictors unchanged

Company revenues are gradually growing into elevated debt loads. Pared back rate cuts, however, could prove problematic for more leveraged companies.



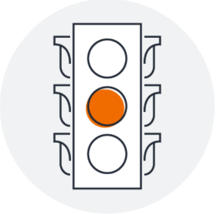
HIGH DEBT LOADS
Key metrics: interest cover, leverage
Prognosis: Debt high, refinancing costs elevated, idiosyncratic stress points emerging.

Strong investor appetite means public markets have been wide open to companies seeking funding. Real yields have crept higher, however, and bank lending standards remain tight.



RESTRICTED CAPITAL ACCESS
Key metrics: liquidity cycle, real borrowing costs
Prognosis: After a stellar quarter for issuance, we expect some moderation.

Earnings growth and cash flow are improving but is regionally uneven. This traffic light would be green if only looking at the US, but earnings prospects are less buoyant elsewhere.



EXOGENOUS SHOCK TO CASH FLOW
Key metrics: earnings, earnings revisions
Prognosis: Improving earnings but greater dispersion.

Note: Our traffic lights represent historically reliable predictors of credit cycles on a medium- to long-term basis. They indicate the direction of the cycle. They do not predict the precise timing, shape or magnitude of a turn in the cycle. Our Credit Risk Monitor is not designed around valuations and is not intended to be used as a market-timing tool.

Resilient growth drives gains in credit markets

- Credit markets benefited from spread tightening and (mostly) positive total returns in the first quarter as investors focused on the positive impact on credit metrics of stronger-than-expected US growth and employment data in the US, and stabilising growth and lower-than-expected inflation in Europe.
- Spread tightening helped absorb some of the upward pressure on yields as sticky US inflation led markets in Q1 to pare back forecasts for US Federal Reserve (Fed) rate cuts for 2024 (down from 6 cuts to 2).

Dispersion across economies and within sectors

- Central bank policy became less synchronised as the Swiss National Bank and several Emerging Market banks cut rates. Expectations grew that the European Central Bank could cut rates ahead of the Fed. This has implications for yield levels in different regions, particularly as spread tightening momentum slows.
- Returns from higher quality companies with strong fundamentals and pricing power will likely diverge notably from those of weaker, highly leveraged companies that, for example, have a capital structure ill-suited to cope with higher financing costs. Issue/issuer selection will be critical for investors.

Strong demand has allowed companies to front-load financing

- Companies found investors receptive to new issuance. In Q1 alone, the US investment grade (IG) market had already funded c40% of its projected 2024 issuance. High yield (HY) issuance rebounded: in Q1 Euro HY gross issuance was €18bn (+72% v Q1 23) while US HY was $85bn (+110% v Q1 23, Morgan Stanley).
- We think default rates may rise slightly in the coming months as the impact of higher rates catches up, but we are not expecting a surge. The number of defaults reached 37 globally in Q1 according to S&P Global Ratings, this is fewer than in the same period of 2023 but above the 10-year average of 27.

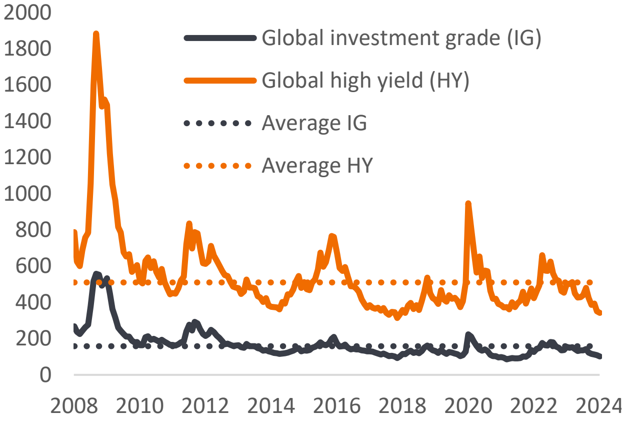
Selective opportunities remain in global credit markets

- As we get to more expensive valuations and later in the cycle, we think it makes sense to look globally to economies that either have a friendlier policy or growth backdrop.
- We see Europe as relatively attractive, given a clearer path to lower rates, while Emerging Market debt also looks attractive given the scope for further monetary policy easing.
- We continue to like securitised credit, especially in the mortgage space, while in corporate credit, banks look to be in good shape for this stage in the cycle and real estate is exhibiting better access to capital.
- The risk is that supply-led disinflation shifts towards demand-led inflation, creating further rates volatility and a bumpier credit cycle.

Valuations

Quality-adjusted spreads (bps) tighten

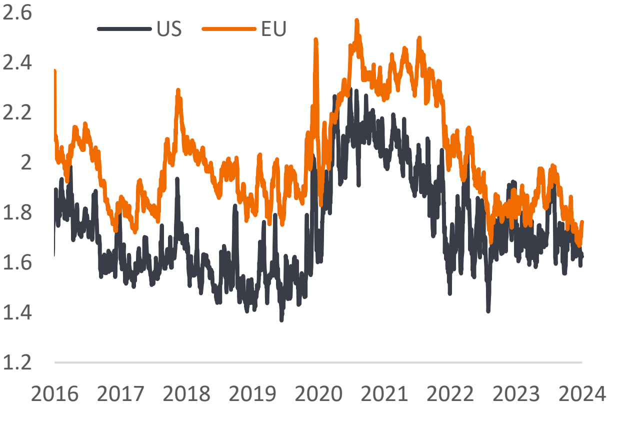
Credit spreads, notably for high yield, are below long-term averages on ratings-adjusted basis.



Source: Bloomberg indices as at 31 March 2024. Option-adjusted spreads (OAS) shown. Average is over the last 20 years. See Important Information for full information on underlying indices. **Past performance does not predict future returns.**

High yield vs IG (spread ratio) rangebound

A lower BB/BBB ratio could indicate worse value in BB-rated bonds compared to BBB-rated bonds.

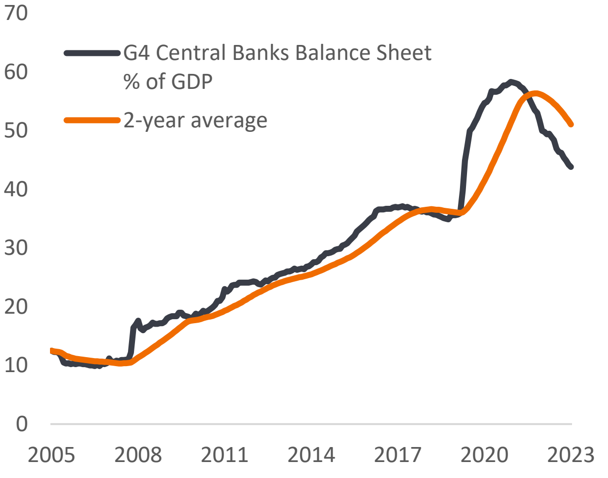


Source: ICE BofA corporate bond indices as at 31 March 2024. Spread ratio is calculated by dividing the BB spread by BBB spread. IG = investment grade. See Important Information for full information on underlying indices.

Cycle indicators

Central bank liquidity (% GDP) falls

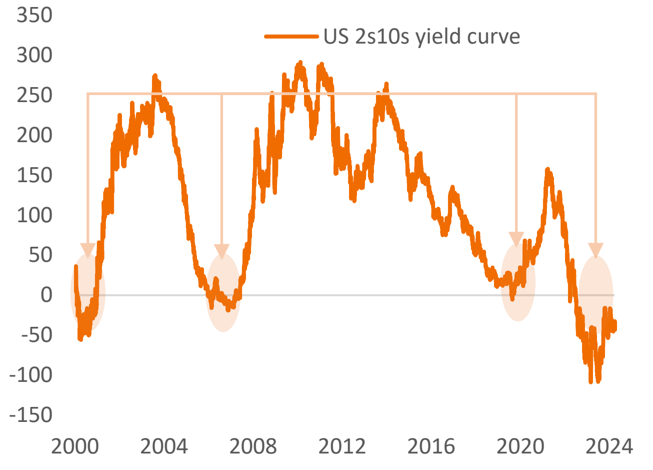
G4 central bank balance sheets continues to fall below the two-year average.



Source: Janus Henderson Investors as at 31 December 2023.

2s 10s yield curve slope flattens (bp)

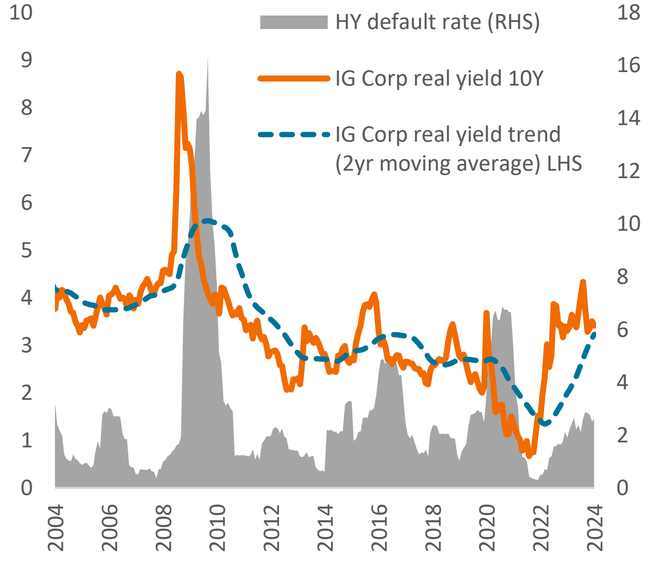
The US government bond yield curve slope remains in negative territory: its potency as a recession risk indicator has been less convincing this cycle.



Source: Bloomberg 2-year and 10-year government bond yields to 31 March 2024. **Past performance does not predict future returns.**

Real rates (%) edge higher

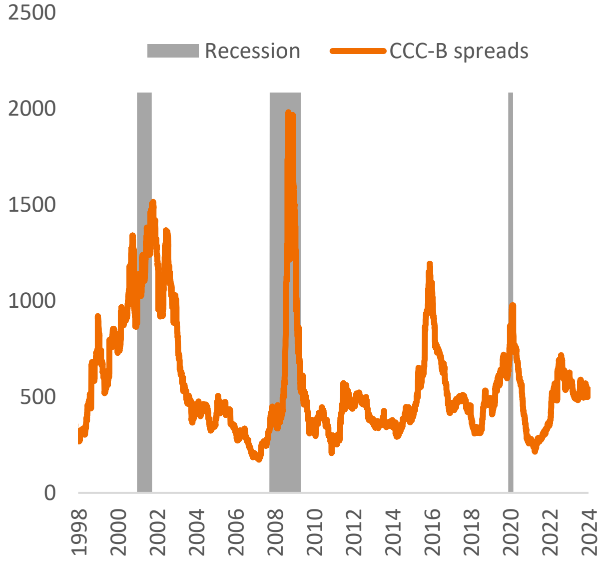
Sharp moves higher in real yields tend to lead a default cycle. Although real yields may be peaking, the lagged impact of higher financing costs is likely to see further modest rises in high yield defaults.



Source: Janus Henderson calculations, Bloomberg, J.P.Morgan, as at 31 March 2024. HY = high yield, IG = investment grade. Note: There is no guarantee that past trends will continue, or forecasts will be realised. The views are subject to change without notice. See Important Information for full information on underlying indices.
Past performance does not predict future returns.

CCC v B spreads differential (bp) edges up

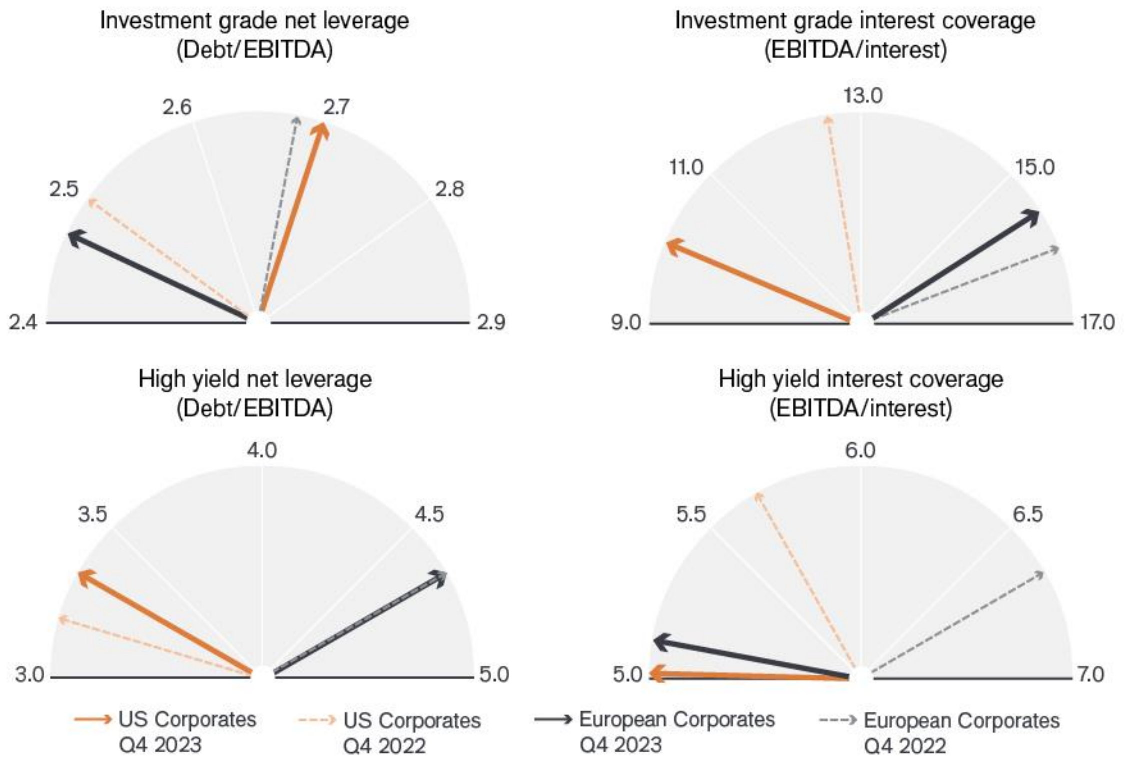
Weaker performance trends in lower quality (CCC) is a warning sign of stress – this is shown by periods where the orange line rises sharply from low levels. The differential climbed slightly during Q1 2024.



Source ICE BofA US High Yield CCC and ICE BofA US High Yield B spread-to-worst shown. Data as at 31 March 2024. Basis point (bp) equals 1/100 of a percentage point, 1bp = 0.01%.

Issuer fundamentals exhibit mild weakening

Interest coverage has deteriorated (moved lower) across US and European corporate bond issuers (both Investment Grade and High Yield). The picture for net leverage is more mixed, with earnings offering support.



Source: JPMorgan. Net leverage and interest coverage is as at Q4 2023, except for European high yield which reflects Q3 2023 data, the latest available complete dataset at the time of publication. Data is subject to change.

Earnings growth (%) outlook robust but moderated recently

Year-on-year earnings per share growth forecasts for 2024 remain robust but there has been some moderation in expectations recently.

Region	23F	24F	25F	Revisions on '24 forecasts since last quarter
Global	**0**	**9**	**13**	↓
Developed	1	8	12	↓
US	3	10	14	-
Eurozone	4	3	10	↓
UK	-13	2	8	↓
Japan	15	9	9	↑
Emerging	-7	20	16	↓
China	11	20	14	↓

Source: Refinitiv Datastream data, 31 March 2024. 2023, 2024 and 2025 data are estimates. There is no guarantee that past trends will continue, or forecasts will be realised. The views are subject to change without notice. **Past performance does not predict future returns.**

"One of the recent unfolding stories is the dispersion across different economies with respect to monetary policy. Central banks are not moving together as much as they used to. We think this dispersion will continue and will be important for credit markets and rate markets."

Jim Cielinski
Global Head of Fixed Income

Important information

Page	Data sources (supplementary information)
2	**Quality-adjusted spreads (%):**
	Global IG = ICE BofA Global Corporate Index data used
	Global HY = ICE BofA Global High Yield Index data used
	High yield vs investment grade (spread ratio)
	US ratio: ICE BofA BB US High Yield Index / ICE BofA BBB US Corporate Index
	Euro ratio: ICE BofA BB Euro High Yield Index / ICE BofA BBB Euro Corporate Index
3	Bloomberg: G4 Balance sheet as a % of GDP (BSPGCPG4 Index)
	Bloomberg: 10-year minus 2-year US government bond yields
	Bloomberg: US 10-year generic real yield and 7-10yr BBB Corporate spread
	ICE BofA Single-B US High Yield Index and ICE BofA CCC & Lower US High Yield Index
4	**Earnings growth (%)**
	Global earnings = MSCI AC World Index
	Developed earnings = MSCI World Index
	US earnings = The MSCI USA Index
	Eurozone earnings = The MSCI EMU Index (European Economic and Monetary Union)
	UK earnings = MSCI United Kingdom Index
	Japan earnings = TOPIX Index
	China earnings = MSCI China Index

Glossary

Balance Sheet	A financial statement that summarises a company's assets, liabilities and shareholders' equity at a particular point in time. Each segment gives investors an idea as to what the company owns and owes, as well as the amount invested by shareholders. It is called a balance sheet because of the accounting equation: assets = liabilities + shareholders' equity.
Volatility	The rate and extent at which the price of a portfolio, security or index, moves up and down. If the price swings up and down with large movements, it has high volatility. If the price moves more slowly and to a lesser extent, it has lower volatility. Higher volatility means the higher the risk of the investment.
High-yield or "junk" bonds	Involve a greater risk of default and price volatility and can experience sudden and sharp price swings.
Credit Spread	The difference in yield between securities with similar maturity but different credit quality. Widening spreads generally indicate deteriorating creditworthiness of corporate borrowers and narrowing indicate improving.
A yield curve	Plots the yields (interest rate) of bonds with equal credit quality but differing maturity dates. Typically, bonds with longer maturities have higher yields.
Basis point (bp)	Equals 1/100 of a percentage point. 1 bp = 0.01%, 100 bps = 1%.

Important information

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