Janus Henderson INVESTORS

CREDIT RISK MONITOR

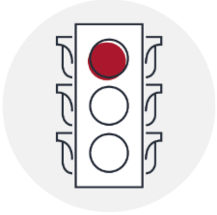
Goldilocks and the three bulls?

Jim Cielinski, CFA
Global Head of Fixed Income

Global disinflation, resilient US growth, and expectations of lower rates have coincided with a diminished risk of a shock to corporate earnings and a slightly better outlook for access to capital. Positives for credit include attractive all-in yields, increasing diversification benefits vis-à-vis equities as inflation falls, and the prospect of cash in money market funds shifting into bonds. That said, the jury is still out on whether credit fundamentals have truly turned a corner. We are cautiously optimistic. We are positive on credit overall but are maintaining a focus on quality companies with resilient cash flows.

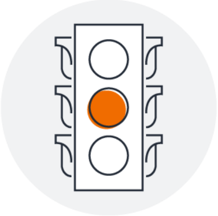
Two longer term cycle predictors move from red to amber

Core debt loads remain at very high levels and debt refinancing remains an issue in view of the looming maturity wall (refinancing calendar) and the decline in cash balances and interest cover.



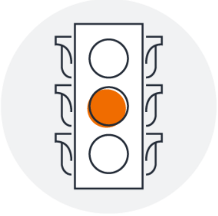
HIGH DEBT LOADS
Key metrics: interest cover, leverage
Prognosis: stock of debt high; refinancing costs elevated

Falling rates and the slight easing in lending standards from tight levels – close to levels historically coincident with recessions – points to a slightly improved outlook for access to capital.



RESTRICTED CAPITAL ACCESS
Key metrics: liquidity cycle, real borrowing costs
Prognosis: Slight improvement in lending standards from tight levels

The earnings recessions rolling through many industries in much of the developed world appear to have moved beyond their nadir. The earnings outlook looks to have stabilised.



EXOGENOUS SHOCK TO CASH FLOW
Key metrics: earnings, earnings revisions
Prognosis: earnings growth looks to be stabilising

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.

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The value of an investment and the income from it can fall as well as rise and you may not get back the amount originally invested.

'Soft landing' narrative dominates, but perfect soft landings are rare

- Disinflation globally, better-than-expected US economic data, and consensus expectations of interest rate cuts in 2024 saw credit rallying in Q4 2023, with spreads in Europe ending 2023 close to 10-year average levels, albeit tighter than average in the US.
- A "soft landing" is not a done deal though. Notwithstanding historically low unemployment, past tightening cycles suggest that a perfect soft-landing scenario (slowing inflation to target levels while avoiding a recession/materially rising unemployment) is a feat seldom achieved.

Debt loads – one of our three long-term credit cycle indicators – still flashing red

- Government debt could remain elevated in 2024 given a busy election year across the world, heightened geopolitical tensions, energy transition costs, and climate-related risks.
- Corporate debt loads remain an issue given weaker credit fundamentals and a looming refinancing calendar. We expect defaults to continue to edge up, albeit from low levels.

Access to capital and earnings/cash flows – better on the margin

- Access to capital – another of our traffic lights – has shifted from red to amber, reflecting a slight easing in lending standards and rates coming down. However, lending standards remain tight in absolute terms with ongoing weakness in credit growth, although private debt is offering an alternative source of funding.
- The risk of a shock to earnings – normally associated with recession or a big geopolitical event – has also diminished. The earnings outlook (see page 4) looks to have stabilised.
- The flip side on earnings is that falling inflation can squeeze revenues and, alongside sticky wage inflation (tight labour market), result in margin contraction.

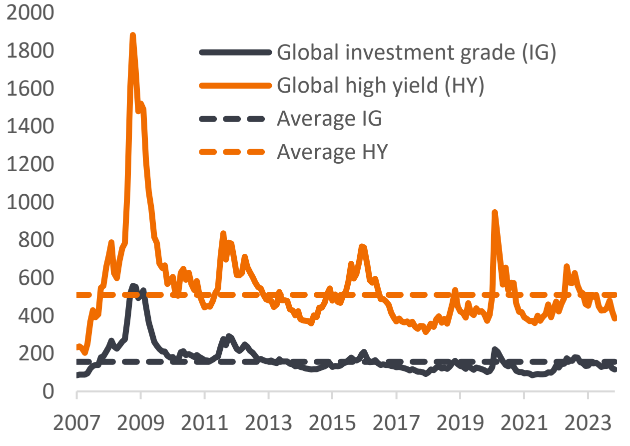
Cautiously optimistic – leaning more toward investment grade (IG)

- Real rates are elevated, monetary aggregates and leading indicators like the Conference Board Leading Economic Index remain in negative territory, and the lagged effects of previous central bank tightening are still feeding through.
- We think there is more to play for in IG credit, which is better protected in the event of a more marked slowdown. Relative to IG, high yield doesn't sufficiently price in a range of possible growth outcomes.
- Positives for credit include attractive all-in yields, the prospect of inflows from money market funds into bonds, improving diversification vis-à-vis equities as inflation falls, and the possibility of spreads tightening further if the soft-landing narrative holds.

Valuations

Quality-adjusted spreads (bps) tighten

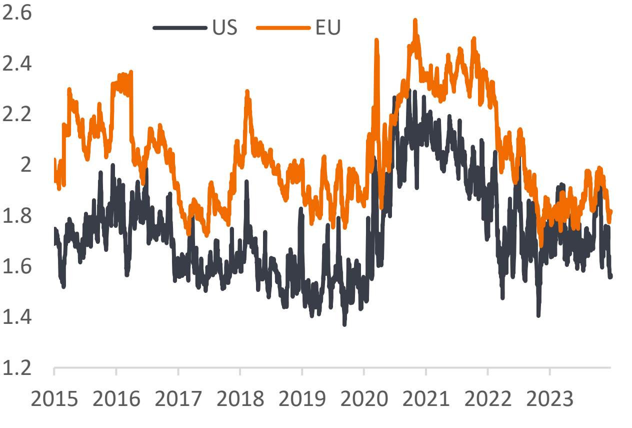
Credit spreads, notably for high yield, are below long-term averages on ratings-adjusted basis.



Source: Bloomberg indices as at 31 December 2023. 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.

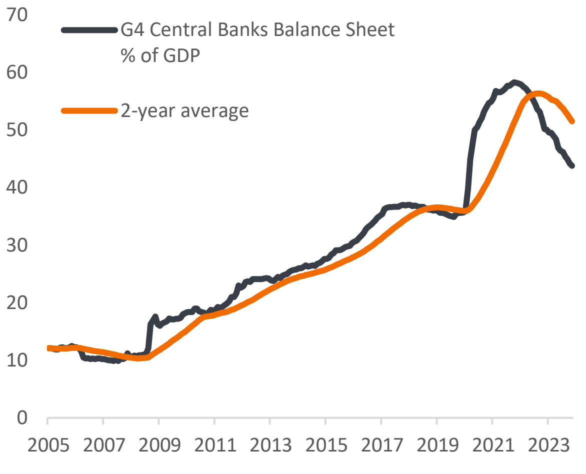


Source: ICE BofA corporate bond indices as at 31 December 2023. Spread ratio is calculated by dividing the BB spread by BBB spread. IG = investment grade. See Important Information for full information on underlying indices.

Cycle indicators

Central bank liquidity (% GDP) falls

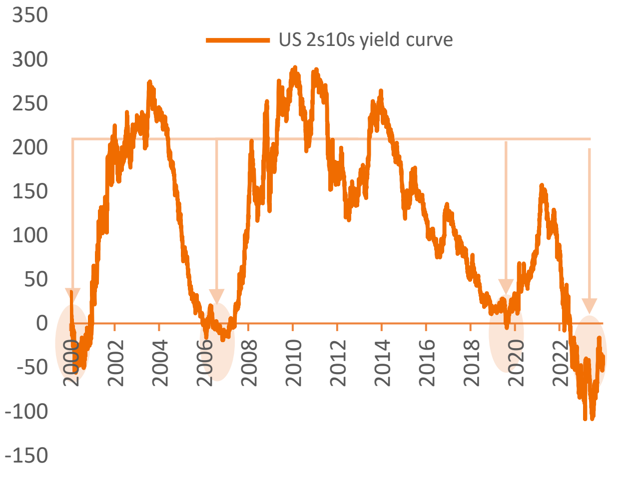
G4 central bank balance sheets continues to fall below the two-year average.



Source: Janus Henderson Investors as at 31 December 2023.

2s 10s yield curve slope flattens (bps)

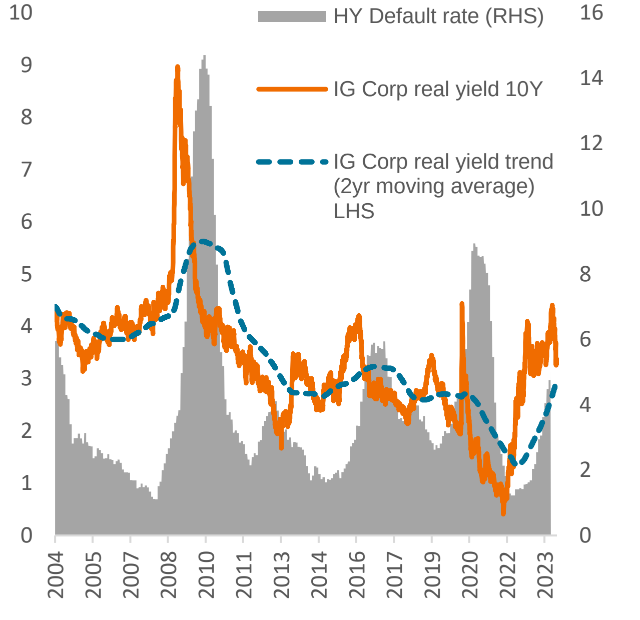
The US government bond yield curve slope remains in negative territory, indicating ongoing recession risk.



Source: Bloomberg 2-year and 10-year government bond yields to 31 December 2023. **Past performance does not predict future returns.**

Real rates (%) look to be turning

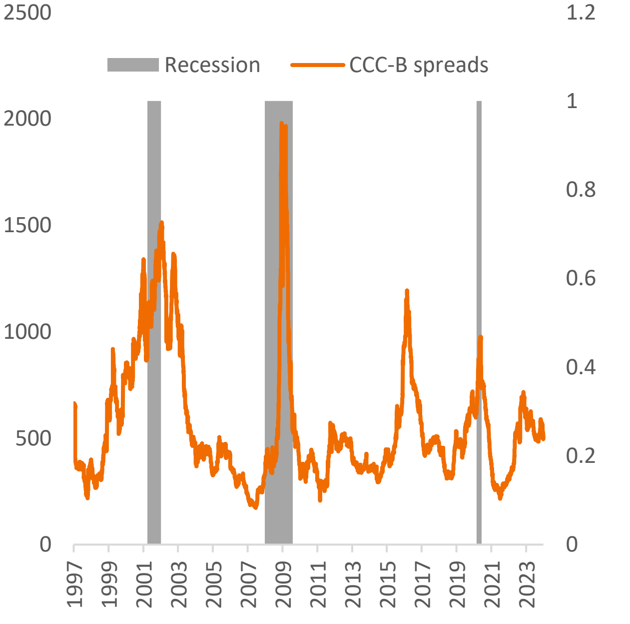
Sharp moves higher in real yields tend to lead a default cycle. Although real yields may be peaking, the lagged impact of higher financing costs is likely to see further modest rises in high yield defaults.



Source: Janus Henderson calculations, Bloomberg, Moody's, as at 31 December 2023. HY = high yield, IG = investment grade. Default data is as of 29 September 2023. 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 (bps) stabilises

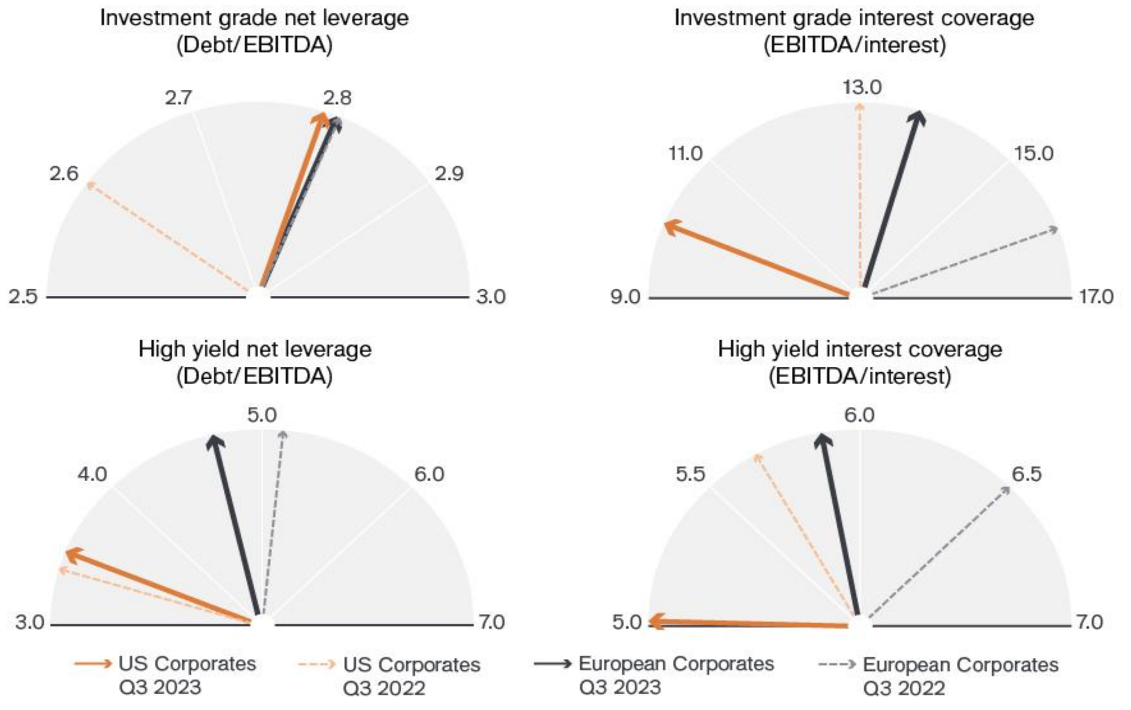
Weaker performance trends in lower quality (CCC) is a warning sign of stress – this is shown by periods where the orange line rises sharply from low levels. The differential was little changed over Q4 of 2023.



Source ICE BofA US High Yield CCC and ICE BofA US High Yield B spread-to-worst shown. Data as at 31 December 2023.

Issuer fundamentals still showing mild weakening

Interest coverage has continued to edge lower across US and European corporate bond issuers (both Investment Grade and High Yield). The picture for net leverage is more mixed.



Source: JPMorgan. Net leverage and interest coverage is as at Q3 2023, except for European high yield which reflects Q2 2023 data, the latest available complete dataset at the time of publication. Data is subject to change.

Earnings growth (%) outlook appears to have stabilised

Year-on-year earnings per share growth revisions for 2023 were mainly positive in developed and emerging markets, the exceptions being the UK and China.

Region	22	23F	24F	Revisions on '23 forecasts since last Quarter
Global	**11**	**0**	**10**	↑
Developed	10	1	9	↑
US	6	2	11	-
Eurozone	20	5	5	-
UK	28	-13	5	↓
Japan	3	14	8	↑
Emerging	16	-4	18	↑
China	2	14	15	↓

Source: Refinitiv Datastream data, 31 December 2023. 2022, 2023 and 2024 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.**

"Lower inflation implies a return to the historical negative correlation between bonds and equities, and that makes bonds a lot more attractive. We'd expect this return to historical correlations, in which bonds start to rally in a slowdown, to offer some protection, particularly when holding high quality issues like investment grade bonds."

Jim Cielinski
Global Head of Fixed Income

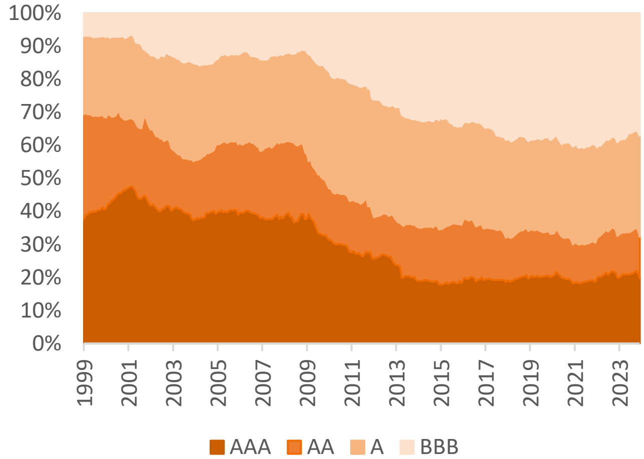
Sterling market snapshot

	31/12/2023	YTD change
Market size £mm	589,974	+9.3%
No. of issuers	351	-108
Yield	5.04%	-31bps
Credit spread (OAS)	134bps	-33bps

By maturity	2-year	5-year	10-year	30-year
Gilt yield	3.98%	3.46%	3.54%	4.14%
Swap yield	4.03%	3.38%	3.29%	3.36%
Credit spread (OAS)	100	129	136	108

Source: ICE BofA indices and Bloomberg. Data as at 31 December 2023.
*Credit spread data based on BofA Sterling Non-Gilt index using maturity bands with similar duration to the 2,5,10 and 30-year gilts. See Important Information for full information on underlying indices.

Sterling Non Gilt Index - ratings breakdown (%)

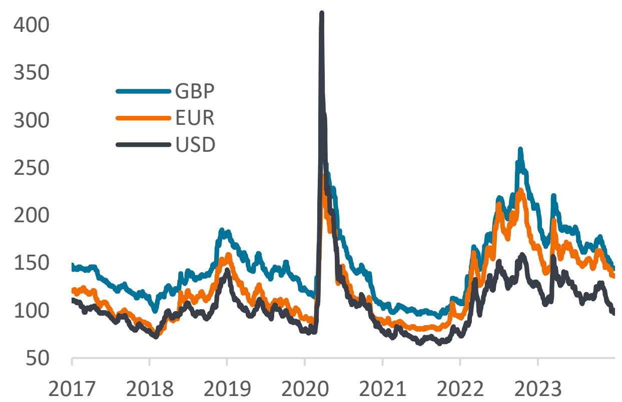


Source: ICE BofA indices. Data as at 31 December 2023. See Important Information for full information on underlying indices.

Spreads (bps)	10-year Average	Current	Last Q-end	Last Q-end chg
Non-Gilt index	124	**115**	132	-17
Non-Gilt 15+ index	134	**108**	130	-22
A Financials	142	**131**	153	-22
A Industrials	114	**90**	107	-17
A Utilities	133	**100**	129	-29
BBB Financial	231	**219**	244	-25
BBB Industrials	173	**152**	181	-29
BBB Utilities	151	**126**	162	-36

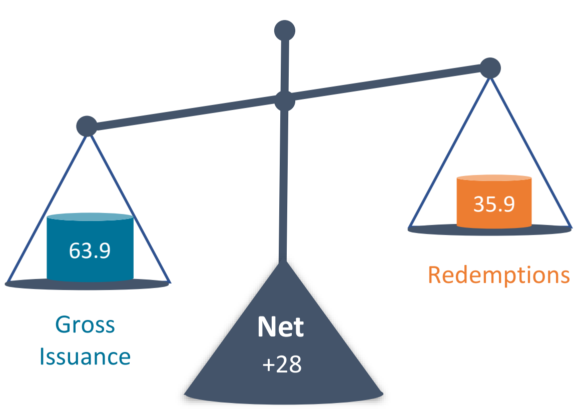
Source: ICE BofA indices and Bloomberg. Data as at 31 December 2023. See Important Information for full information on underlying indices.

GBP corporate bond spreads vs other markets (bps)



Source: ICE BofA indices and Bloomberg, 1-10 year corporate bond indices in GBP, USD and EUR. Data as at 31 December 2023. See Important Information for full information on underlying indices.

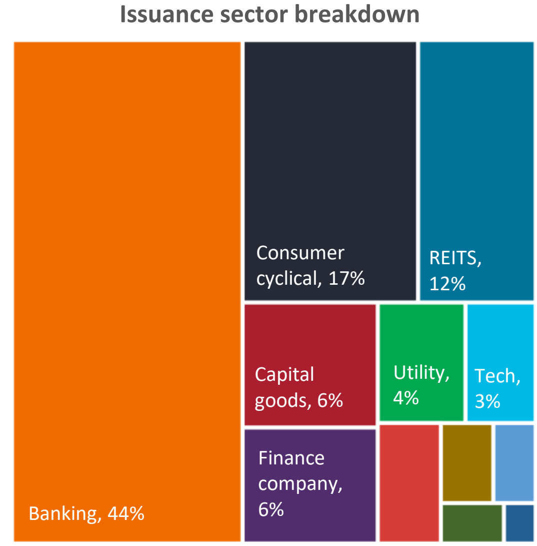
Sterling Corporate Issuance, 2023 YTD £bn



Source: Barclays Credit Research. Data as at 31 December 2023.

Maturity

Issuance sector breakdown



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
5	**GBP Corporate bond spreads vs other markets:**
	GBP Corp = ICE BofA 1-10 Year Sterling Corporate Index OAS
	USD Corp = ICE BofA 1-10 Year US Corporate Index OAS
	EUR Corp = ICE BofA 1-10 Year Euro Corporate Index OAS
	Table: Sterling corporate bond market data:
	ICE BofA Sterling Non-Gilt Index
	Data for 2,5,10 and 30-year spreads based on weighted OAS of bonds in that maturity bucket, calculated using ICE Sterling Non-Gilt Index constituents
	ICE BofA Single-A Sterling Financials Index
	ICE BofA Single-A Sterling Industrials Index
	ICE BofA Single-A Sterling Utilities Index
	ICE BofA BBB Sterling Financial Index
	ICE BofA BBB Sterling Industrials Index
	ICE BofA BBB Sterling Utilities Index
	ICE BofA Sterling Non-Gilt 15+ Index

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