Janus Henderson INVESTORS

CREDIT RISK MONITOR

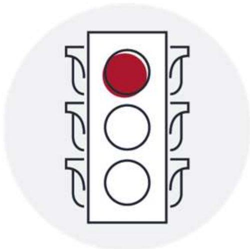
Jim Cielinski, Global Head of Fixed Income

Rates uncertainty and market volatility remain in focus for investors in credit as central banks move more aggressively on their tightening path. Credit spreads have widened, but levels are far from pricing in a recession. One of the challenges investors face at an inflection point in the cycle is how to navigate the uncertainty and volatility, where portfolios can be particularly susceptible to gains or losses.

Like the Fed can fall into the trap of getting anchored to its tightening path, we as investors need to be nimble and ensure we do not get tied to our expectations, but instead focus on identifying the signposts that indicate to add or reduce credit risk within portfolios. Our quarterly 'Credit Risk Monitor' aims to do this through a snapshot of the corporate bond markets.

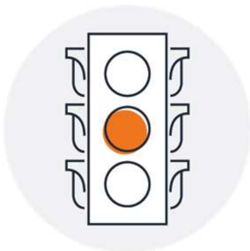
Why the cycle matters

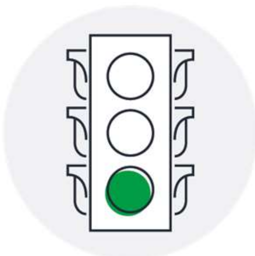
- Historically, corporate credit excess returns have been positive two-thirds of the time or more*, but investors must bear the asymmetry of credit markets where downside corrections can be severe.
- Monitoring the credit cycle and top-down risks is good risk management. The challenge for investors is that every cycle is different and requires a combination of data and judgement.
- No single indicator or dataset can be reliable in isolation, and the lags are uncertain. However, by considering the credit cycle within a framework and assessing the weight of evidence from the key metrics shown here, we can better understand the balance of risks and potential turning points.



HIGH DEBT LOADS
Key metrics: interest cover, leverage
Prognosis: debt is everywhere, but interest costs remain controlled

RESTRICTED CAPITAL ACCESS
Key metrics: liquidity cycle, real borrowing costs
Prognosis: liquidity trends fading as ultra-accommodative policy is removed





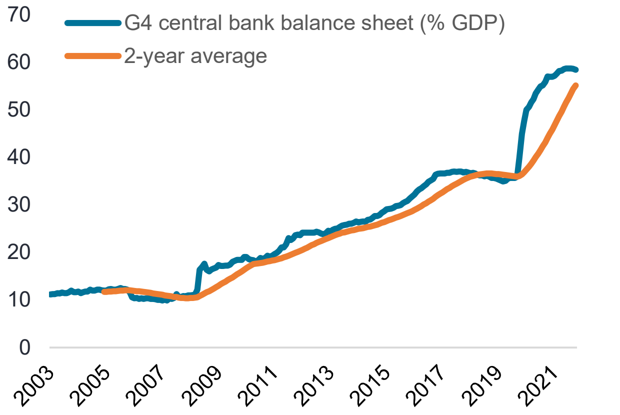
EXOGENOUS SHOCK TO CASH FLOW
Key metrics: earnings, earnings revisions
Prognosis: earnings robust, but growth appears to have peaked

Based on quarterly excess returns on global investment grade and high yield indices since 1999.

Cycle indicators

Central bank liquidity (% GDP) flatlines

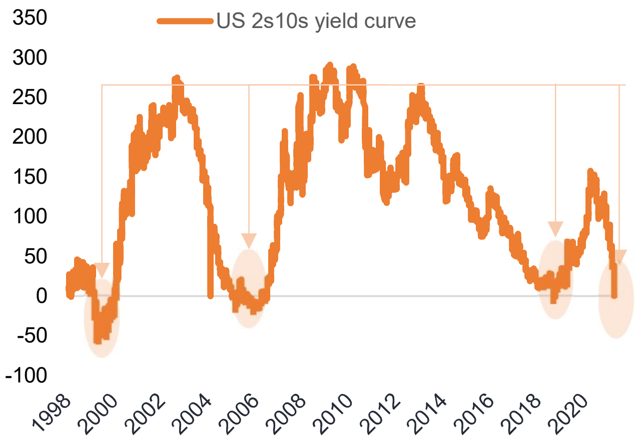
Central bank asset purchases (QE) are above their longer-term average, though balance sheet growth has slowed.



Source: Janus Henderson Investors as at 31 March 2022.

Yield Curve slope (bps) inverts

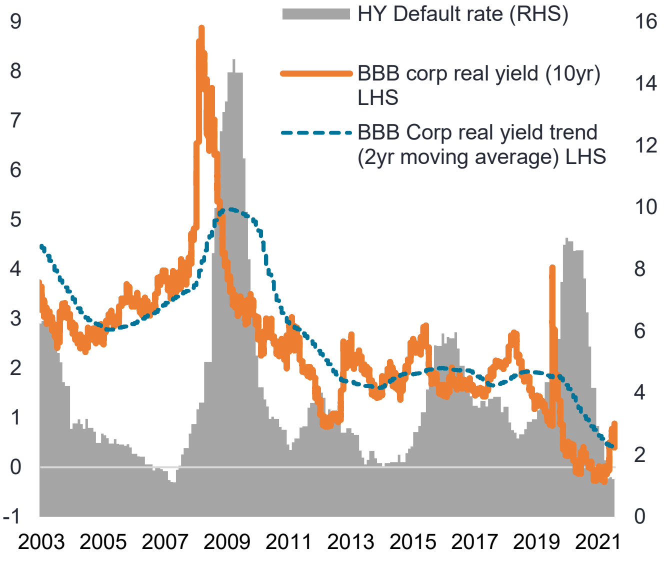
Yield curve flattened to zero (an inversion) signals a turn in the cycle and elevated recession risks.



Source: Bloomberg 2-year and 10-year government bond yields to 31 March 2022.

Real rates and defaults (%) remain low

Sharp moves higher in real yields tend to lead a spike in defaults.

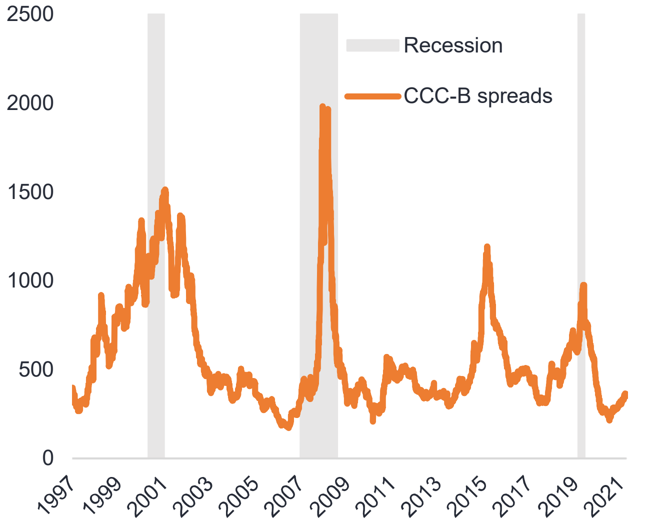


Source: Janus Henderson calculations, Bloomberg, Moody's, as at 31 March 2022.

Note: data beyond 2021 are estimates, and there is no guarantee that past trends will continue. See Important Information for full information on underlying indices.
Past performance is not a guide to future performance.

CCC v B spreads differential (bps) muted

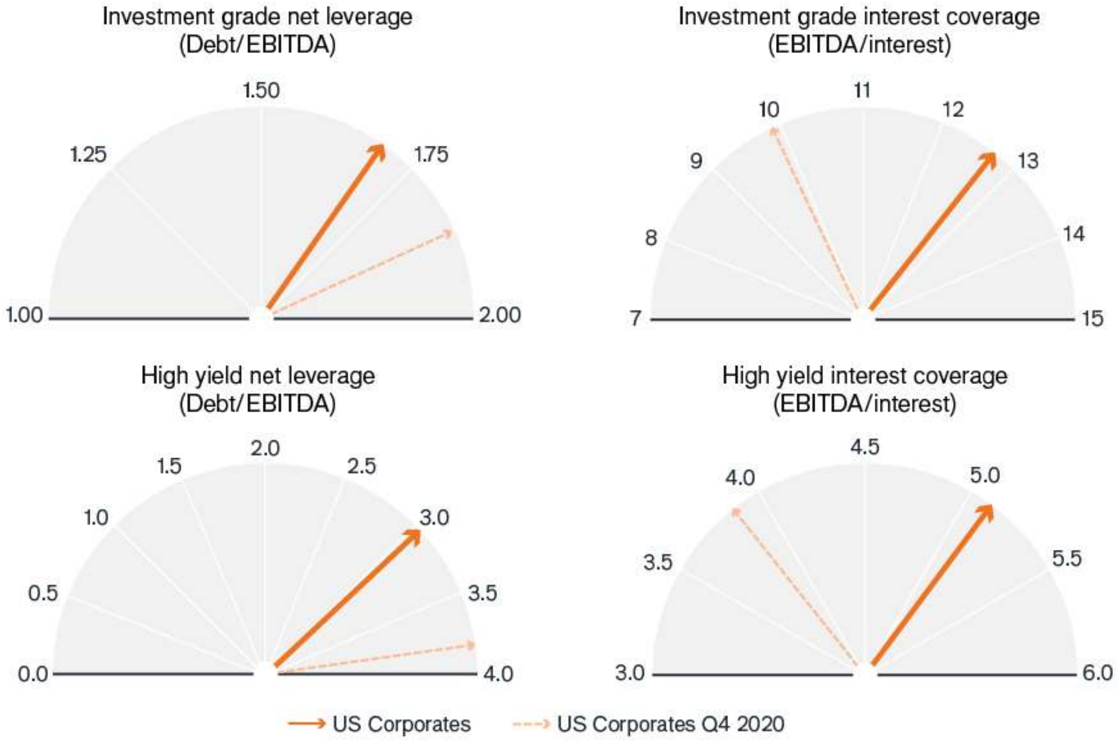
Weaker performance trends in lower quality (CCC) is a warning sign of credit stress – this is shown by periods when the orange line rises sharply from low levels as highlighted.



Source ICE BofA US High Yield CCC and ICE BofA US High Yield Option-adjusted spreads shown. Data as at 31 March 2022.

Issuer fundamentals improve with earnings growth

Net leverage falls across IG and HY while interest cover at or close to decade highs



Source: Morgan Stnaley research, Bloomberg, MCSI, IBES, Factset. Net leverage for US as at 31 December 2021. Note: MS use consensus GICS sector EBITDA growth estimates and zero debt growth to estimate median net leverage and interest coverage ratios based on a sample of US and European IG and HY corporates.

Earnings growth (%) appears to have peaked

Year-on-year earnings per share growth sees upward revisions for most regions

Region	21	22F	23F	Revisions on 22 forecasts since last Quarter
Global	**54**	**9**	**8**	↑
Developed	*55*	*9*	*8*	↑
US	52	10	10	↑
Eurozone	76	8	8	↑
UK	87	9	3	↑
Japan	55	8	6	↑
Emerging	*50*	*10*	*10*	↓
China	7	16	15	↓

Source: Reuters-Eikon-Datastream Data, 5 April 2022.
2022 and 2023 data are estimates, and there is no guarantee that past trends will continue.
Past performance is not a guide to future performance.

> "While this cycle has progressed quicker than most, investors should be wary of reducing risk too early on recession fears."
>
> **Jim Cielinski**
> Global Head of Fixed Income

The credit cycle turns

The first quarter made for a bumpy start to 2022 for credit markets, as more aggressive policy tightening was priced with mounting inflationary pressures, partly due to supply disruption from the conflict in Ukraine. Investors demanded additional yield to compensate for the shroud of uncertainty. While spreads have recovered somewhat, the risk of policy error from tightening into an extended slowdown lingers on.

The battle against inflation ensues

- Central banks across the globe are laser focused on fighting inflation almost at any cost.
- With inflation largely a function of supply disruption rather than excess demand, raising rates to get inflation under control is at risk of overshooting.

Access to capital markets weakens

- Our ‘access to capital markets’ traffic light has turned to amber, as central bank liquidity wanes and balance sheets shrink. Quantitative tightening is underway or imminent.
- The favourable starting point of excess liquidity is key, as real rates remain low.
- Markets respond to change more than level, however, and trends are weak.

Recessions don’t just happen

- Slower growth is already unfolding as inflation erodes real income, risks such as recession or stagflation are exacerbated.
- However, recessions tend to be triggered by an overtightening in policy. We believe there is still a chance of an economic soft landing, but probabilities are falling.

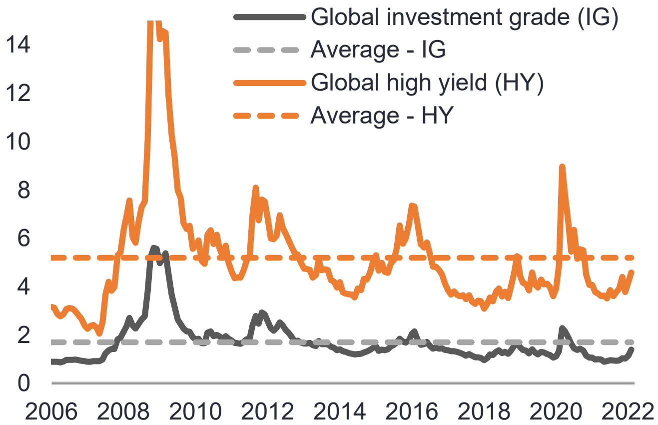
How quickly is the cycle turning?

- Closely watching recessionary indicators – such as yield curve inversion – is prudent and while the cycle is turning, the speed and the magnitude of the turn is more difficult to forecast.
- While the trend of improving credit fundamentals may have peaked, they just underwent the strongest 12-month improvement in history. It’s downhill from here, but from an exceptional starting point.
- While this cycle has progressed quicker than most, investors should be wary of reducing risk too early on recession fears and should not overlook the chance of a dovish pivot further down the line. Our view is to wait for central banks to panic before getting fully invested in credit.

Valuations

Quality-adjusted credit spreads (%) widen

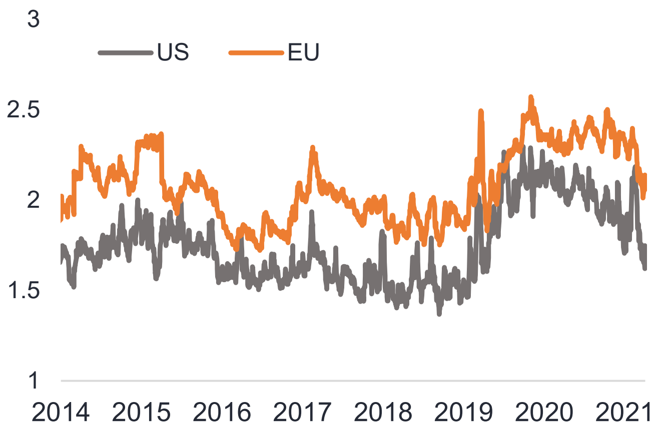
Spreads trade tighter than long-term averages, but drift wider on quality-adjusted basis.



Source: Bloomberg indices as at 31 March 2022. Option-adjusted spreads shown. See Important Information for full information on underlying indices.

High yield vs investment grade (spread ratio) falls

A higher BB/BBB ratio can be taken to indicate better value in BB-rated bonds compared with BBB-rated bonds.



Source: ICE BofA corporate bond indices as at 31 March 2022. The spread ratio is calculated by dividing the BB spread by BBB spread. See Important Information for full information on underlying indices.

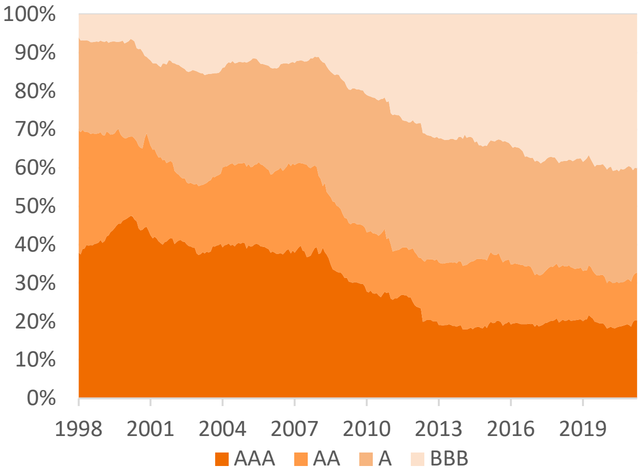
Sterling market snapshot

	31/03/2022	YTD change
Market size £mm	635,840	-4.0%
No. of issuers	449	-1
Yield	2.74%	+89bps
Credit spread (OAS)	1.20%	+22bp

By maturity	2-year	5-year	10-year	30-year
Gilt yield	1.35%	1.41%	1.61%	1.76%
Swap yield	2.00%	1.88%	1.65%	1.44%
Credit spread (OAS)	0.87%	1.16%	1.37%	1.40%

Source: ICE BofA indices and Bloomberg. Data as at 31 March 2022.
*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 (%)

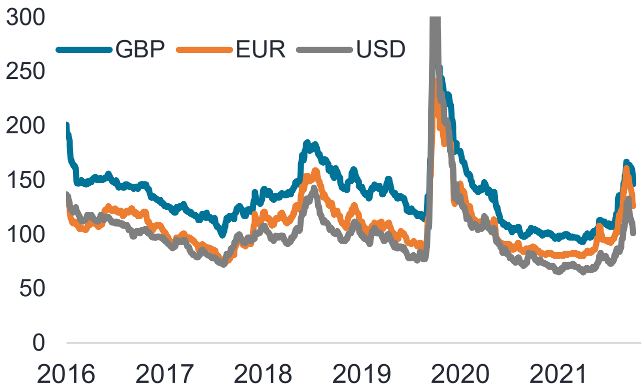


Source: ICE BofA indices. Data as at 31 March 2022. See Important Information for full information on underlying indices.

Valuations & Spreads (bps)	Average	Current	Last Q-end	Last Q-end chg
Non-Gilt index	131	**120**	98	+22bp
Non-Gilt 15+ index	136	**136**	117	+19bp
A Financials	155	**137**	96	+41bp
A Industrials	116	**111**	90	+21bp
A Utilities	137	**114**	116	-2bp
BBB Financial	262	**198**	156	+42bp
BBB Industrials	178	**169**	140	+29bp
BBB Utilities	160	**142**	109	+33bp

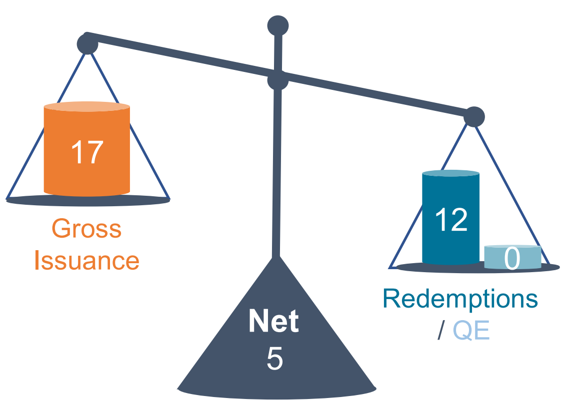
Source: ICE BofA indices and Bloomberg. Data as at 31 March 2022. See Important Information for full information on underlying indices.

GBP Corporate bond spreads versus other markets (bps)

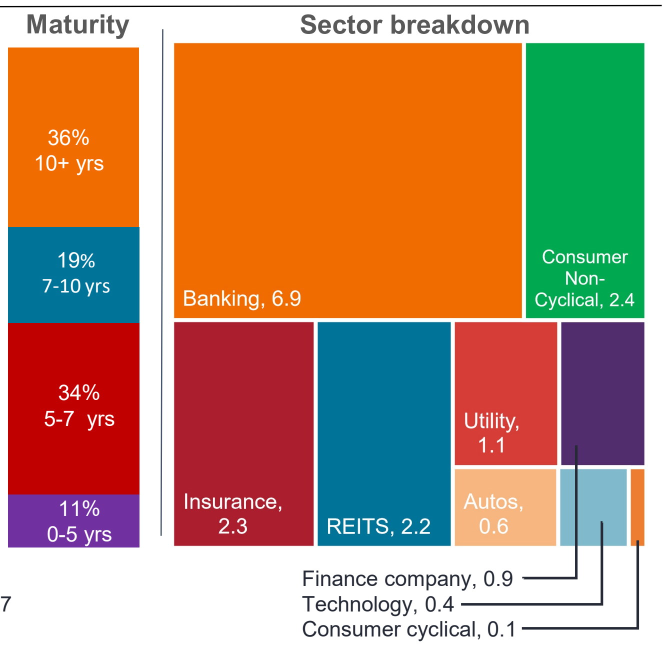


Source: ICE BofA indices and Bloomberg, 1-10 year corporate bond indices in GBP, USD and EUR. Data as at 31 March 2022. See Important Information for full information on underlying indices.

Sterling Corporate Issuance, 2022 YTD £bn



Source: Barclays Credit Research
Data as at 31 March 2022.



Important information

Page	Data sources
2	Bloomberg: G4 Balance sheet as a % of GDP (BSPGCPG4 Index)
	Bloomberg: 2-year and 10-year US government bond yields
	ICE BofA Single-B US High Yield Index and ICE BofA CCC & Lower US High Yield Index
	Bloomberg: US 10-year generic real yield and 7-10yr BBB Corporate spread
3	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
	Emerging earnings = MSCI Emerging Markets Index
4	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
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
	ICE BofA 1-3 Year Sterling Non-Gilt Index
	50% ICE BofA 3-5 Year Sterling Non-Gilt Index / 50% ICE BofA 5-7 Year Sterling Non-Gilt Index
	50% ICE BofA 5-10 Year Sterling Non-Gilt Index / 50% ICE BofA 10-15 Year Sterling Non-Gilt Index
	Bloomberg Sterling Corporates 20+
	ICE BofA Single-A Sterling Corporate Index
	ICE BofA BBB Sterling Corporate Index
	ICE BofA Single-A Sterling Financial Index
	ICE BofA BBB Sterling Financial Index
	ICE BofA 15+ Year Single-A Sterling Non-Gilt Index
	ICE BofA 15+ Year BBB Sterling Non-Gilt Index

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