

European Credit Strategy: 2023 Initial Outlook

14 December 2022, 06:00 UKT



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Summary

The Long Road to Macro Recovery

- **Europe led the economic cycle down, and IG suffered the worst. European IG should lead the recovery**
- **Lev fin pricing is fair given a low-default view. Recession sensitivity and this year's outperformance point to better value in IG**
- **Inflation uncertainty is high, entry points are less generous. Still a trading market where we can buy on dips**

Themes We Like

The Long Road to Macro Recovery

- **Europe to outperform the US**

Europe is a shorter-duration, traditionally lower-beta market, and as it usually trades inside the US, there is substantial room to correct

- **Decompression between IG and HY, compression within IG**

IG should outperform in a rally, HY should underperform in an extended recession. Risk appetite within IG should increase

- **Prefer financials over corporates as supply imbalances ease**

Financials should benefit from positive nominal rates, while a return of corporate supply and an absence of ECB buying should normalize the relationship between fins and corps

Spread Forecasts – Dawn of the Decompression Trade

The Long Road to Macro Recovery

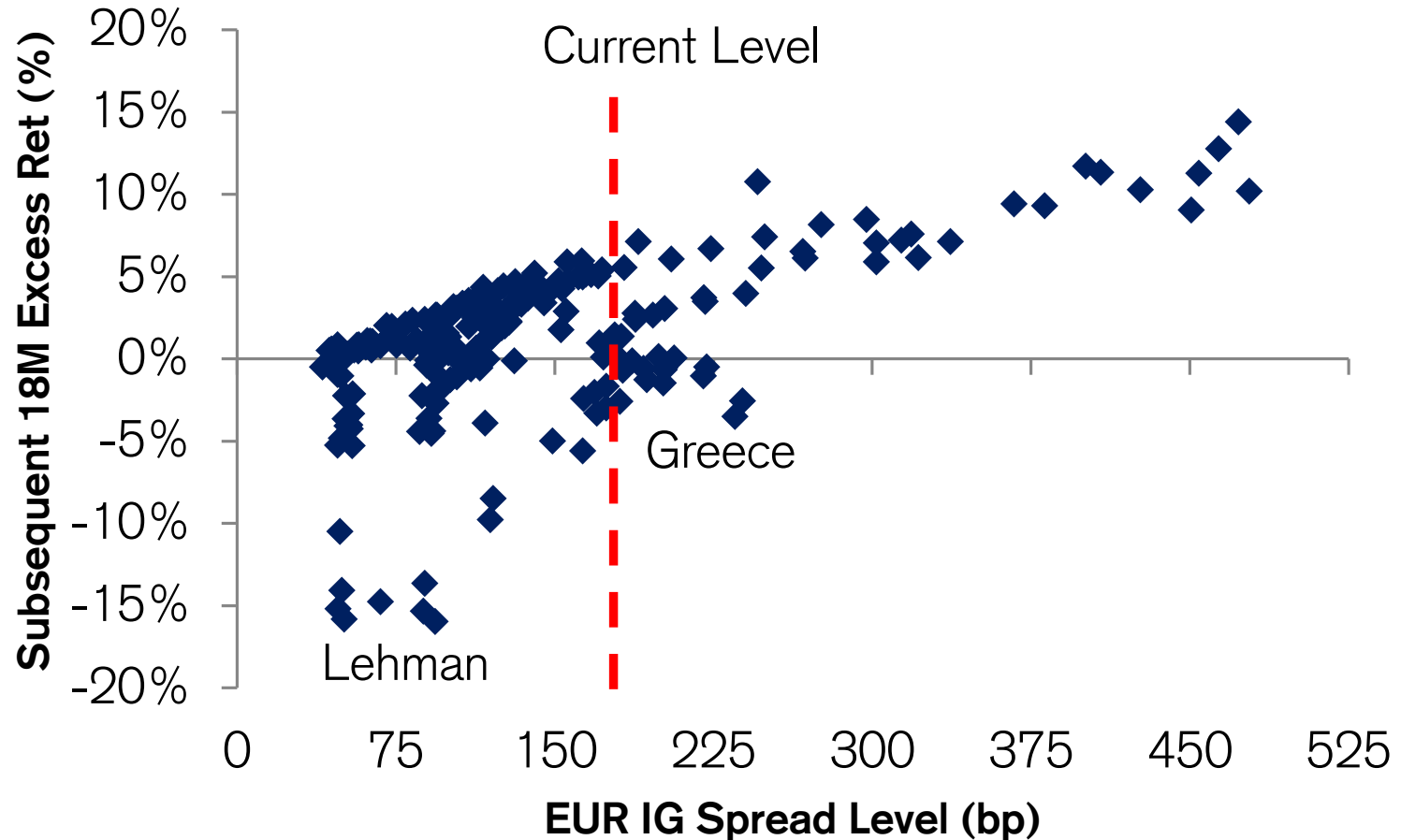
- **IG to end 2023 at 150 bps vs. 174 bps currently**
- **HY to end 2023 at 500 bps vs. 529 bps currently**
- **Loans to end 2023 at 630 bps vs. 658 bps currently**

Lev Fin Issuance

The Long Road to Macro Recovery

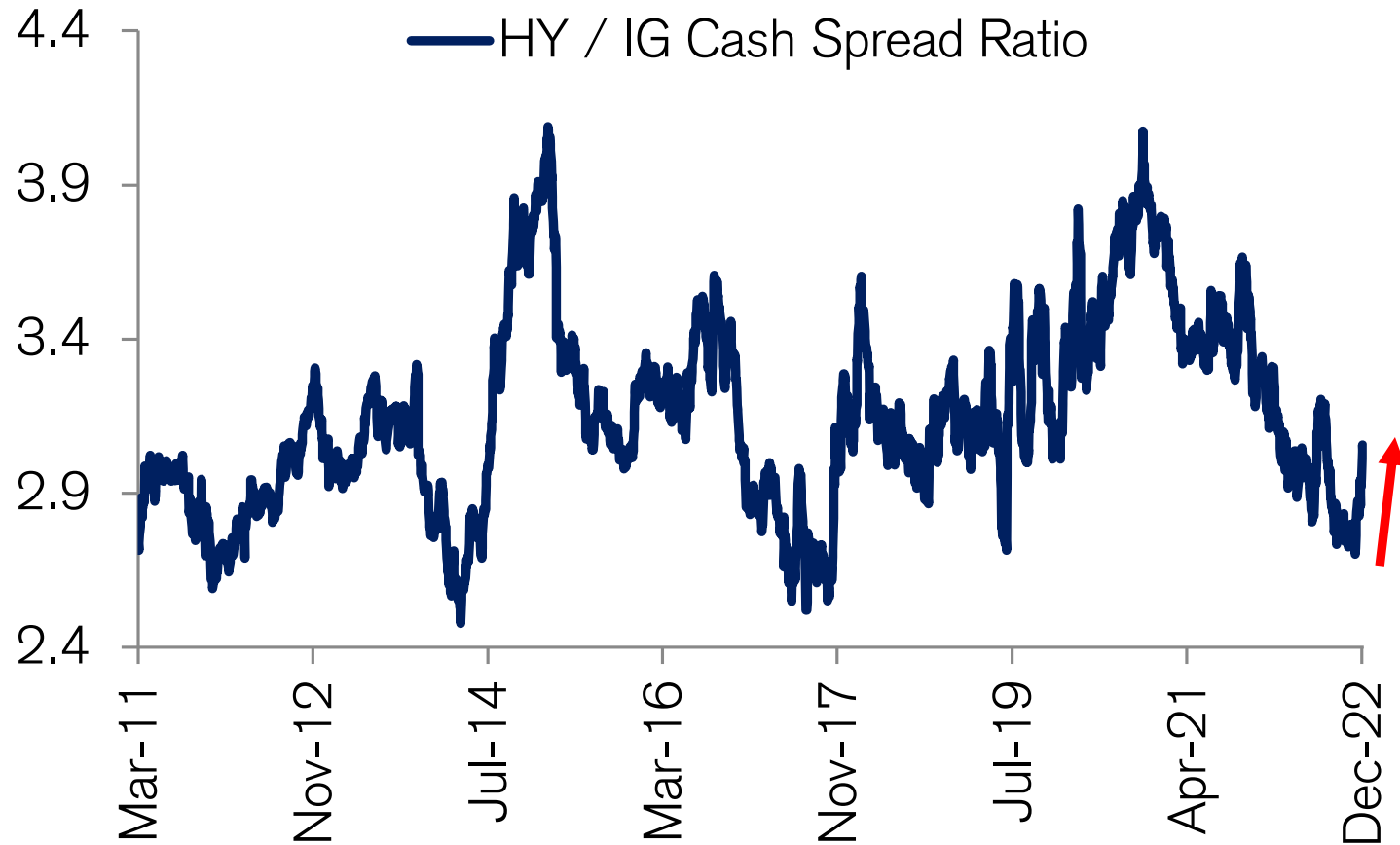
- **HY gross issuance to recover - 50bn in 2023 vs. 25bn 2022**
- **Gross loan issuance to recover - 60bn in 2023 vs. 35bn in 2022 - as IG performance supports CLO creation**

Valuations are constructive but point to dip-buying



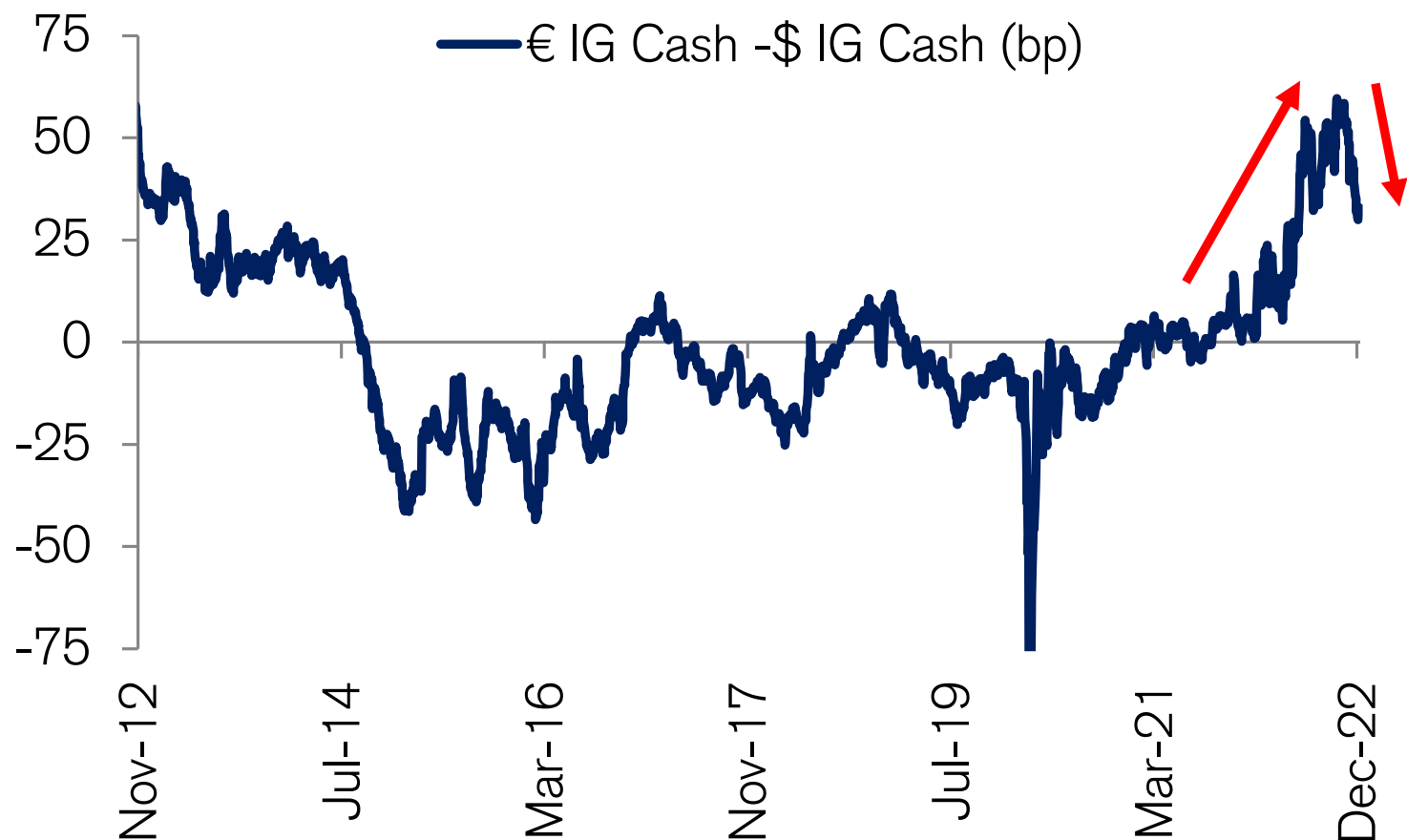
Source: Credit Suisse, Bloomberg

We prefer IG on relative value and recession proofing



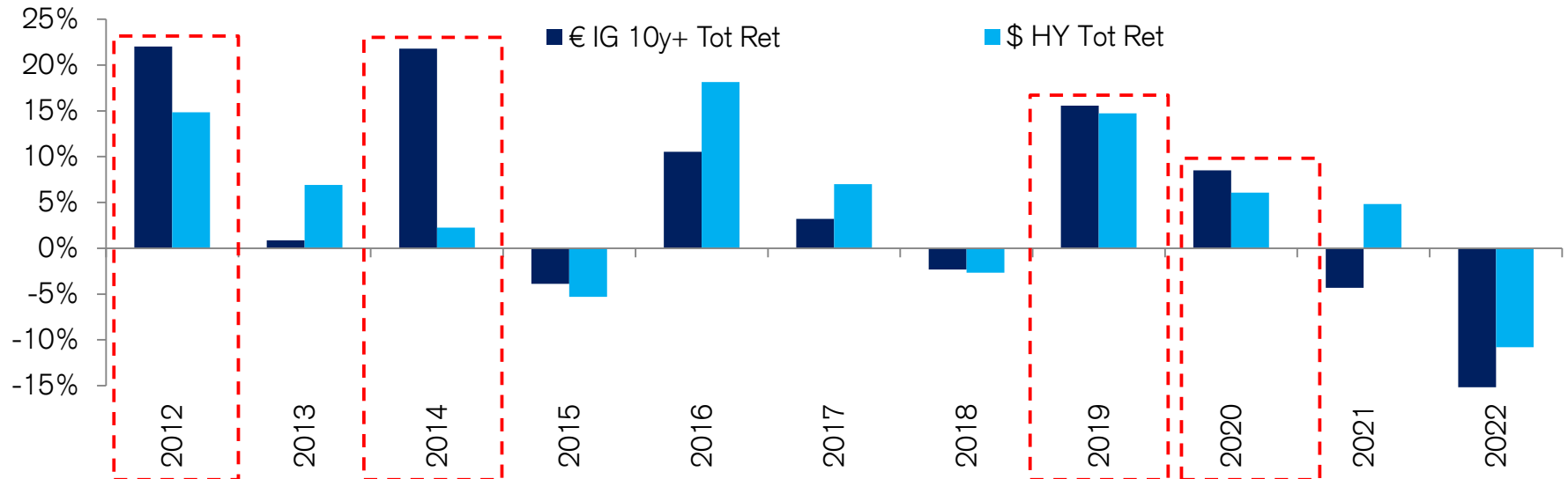
Source: Credit Suisse, Bloomberg

We think Euro IG should trade inside Dollars



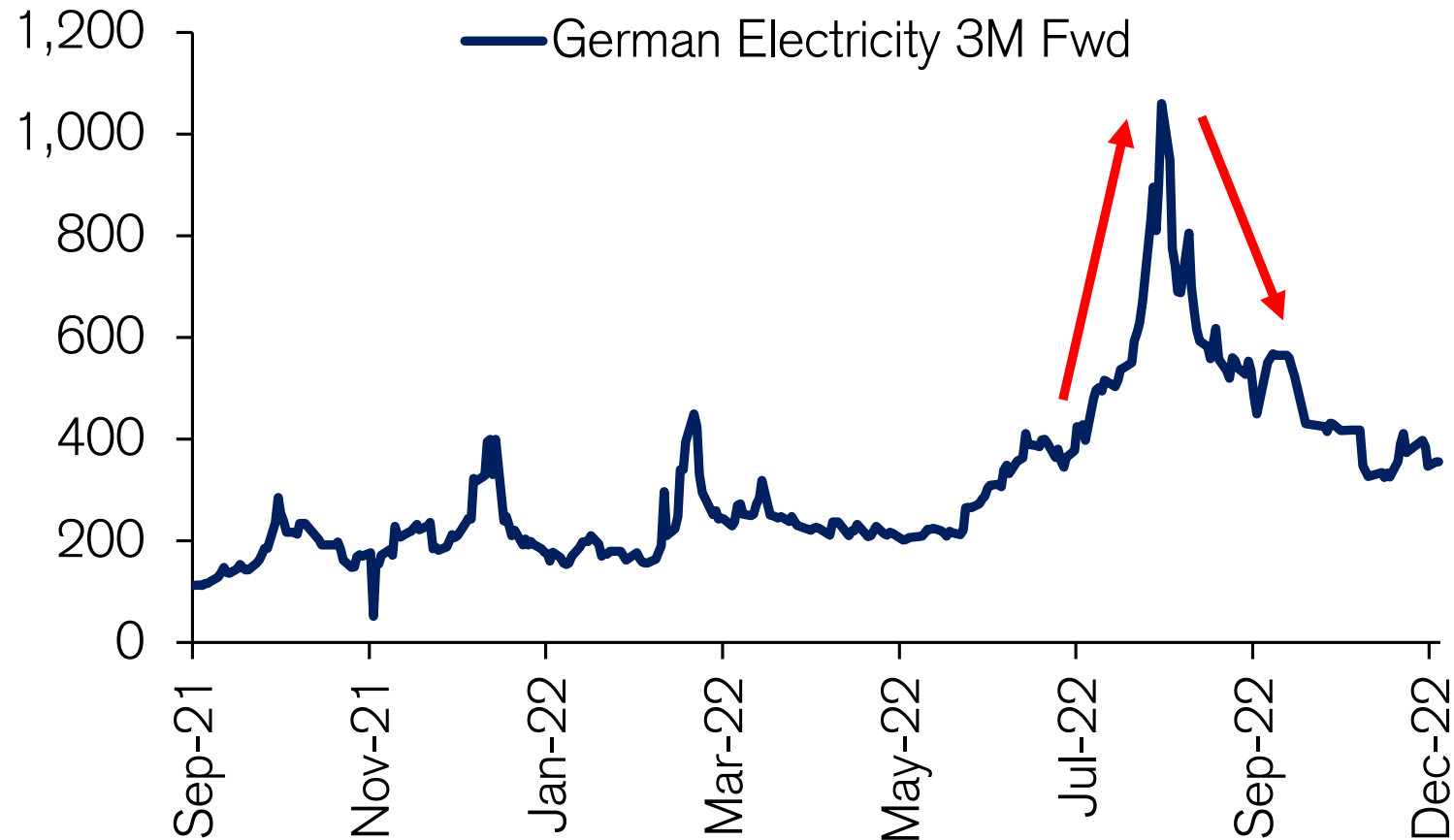
Source: Credit Suisse, Bloomberg

High beta IG can outperform HY in recovery years



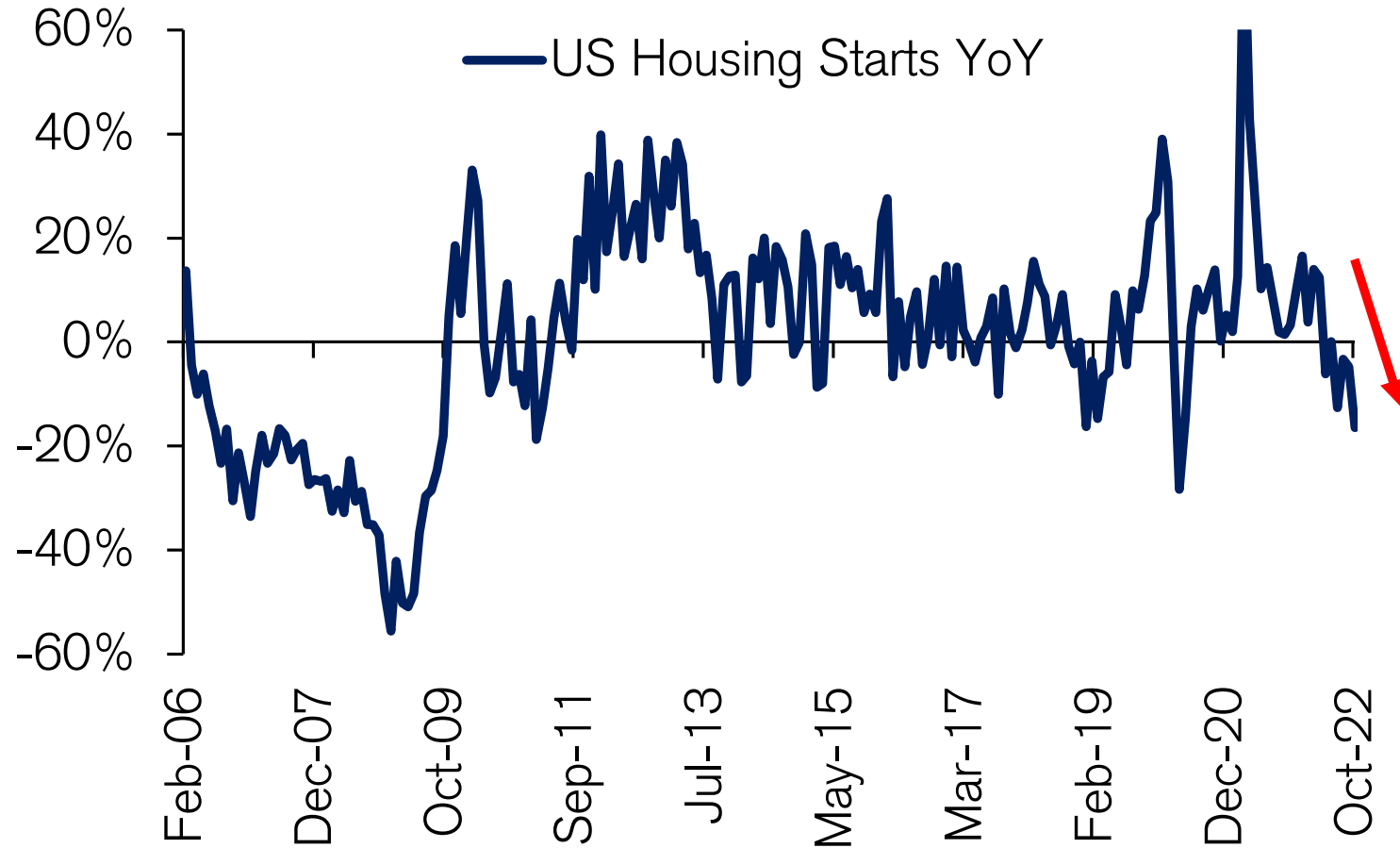
Source: Credit Suisse

Progress on the Negative Supply Shock



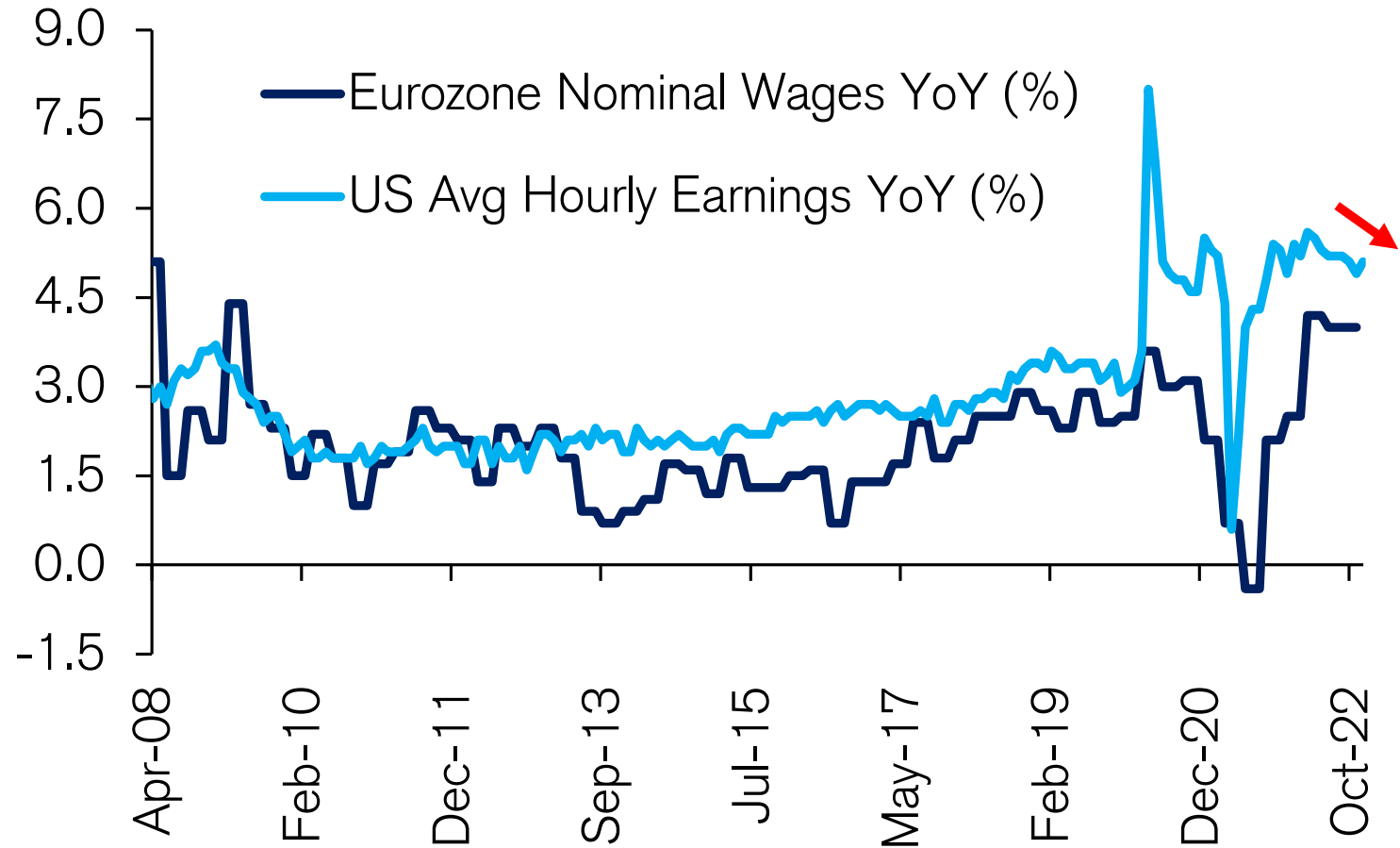
Source: Credit Suisse, Bloomberg

How hard does housing crack?



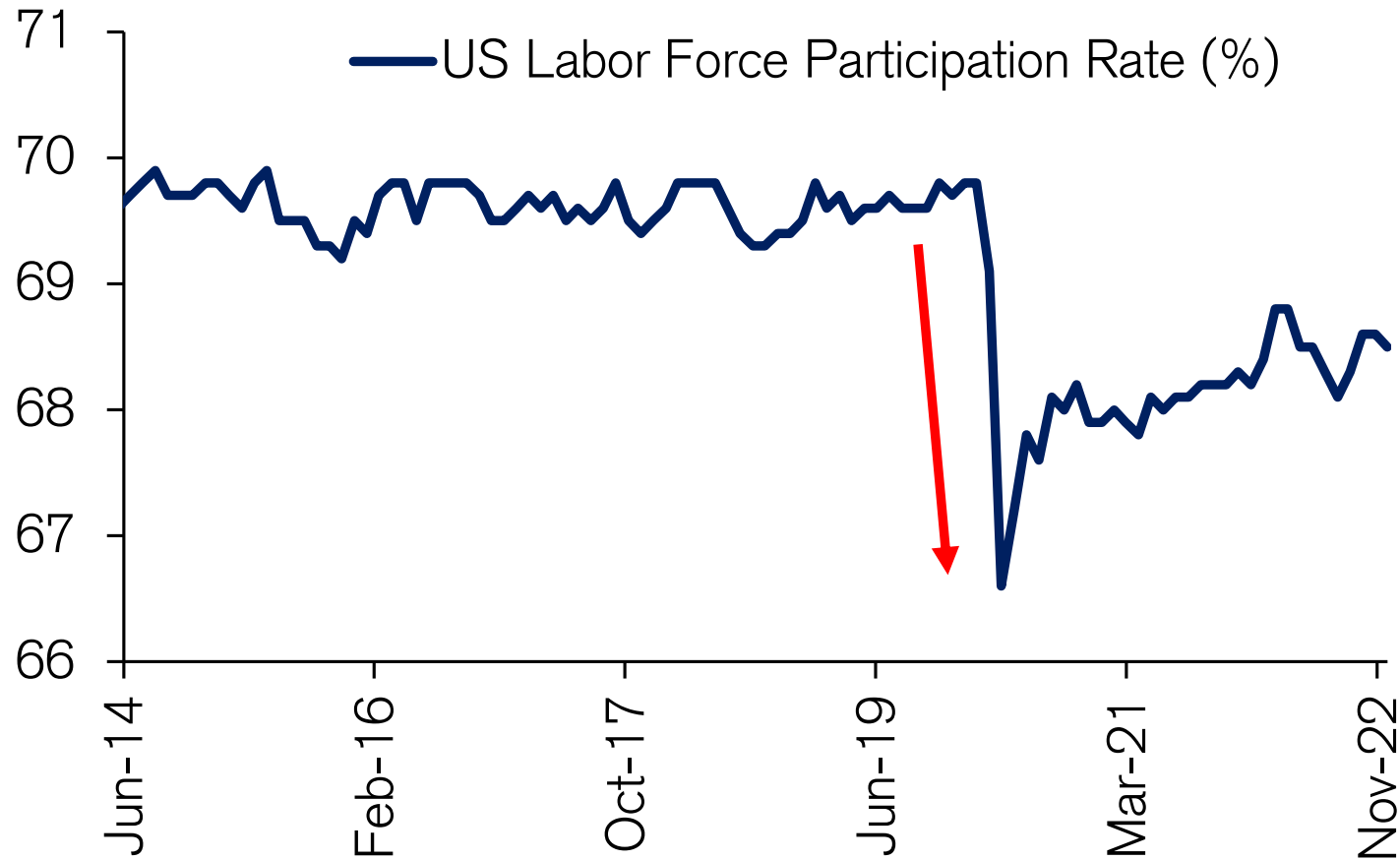
Source: Credit Suisse, US Census Bureau, Bloomberg

How sticky is wage inflation?



Source: Credit Suisse, BLS, Bloomberg, Eurostat

Will the missing workers come back?



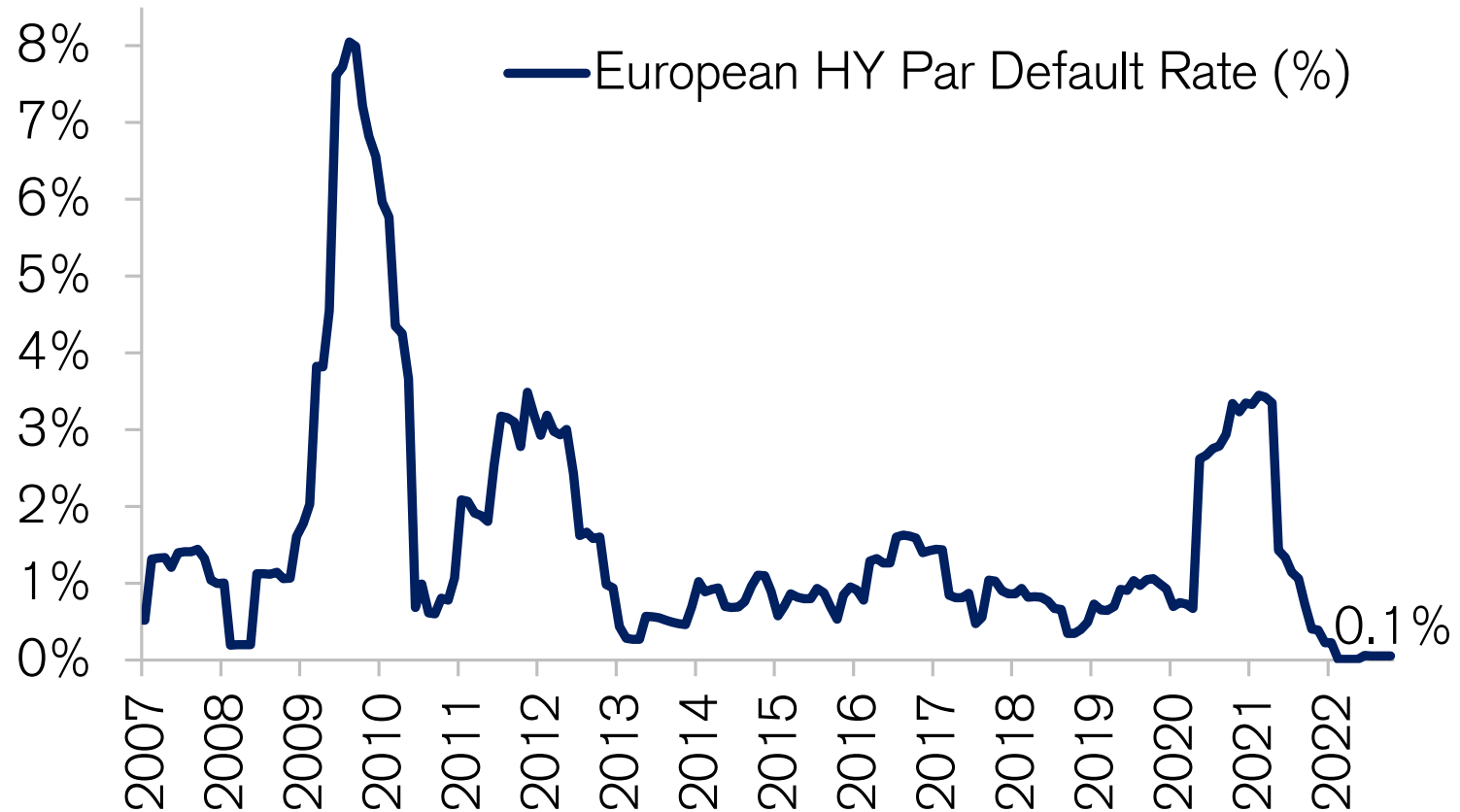
Source: Credit Suisse, Bloomberg, Labor Force Participation Rate of Men Seasonally Adjusted

Will labour market imbalances ease?



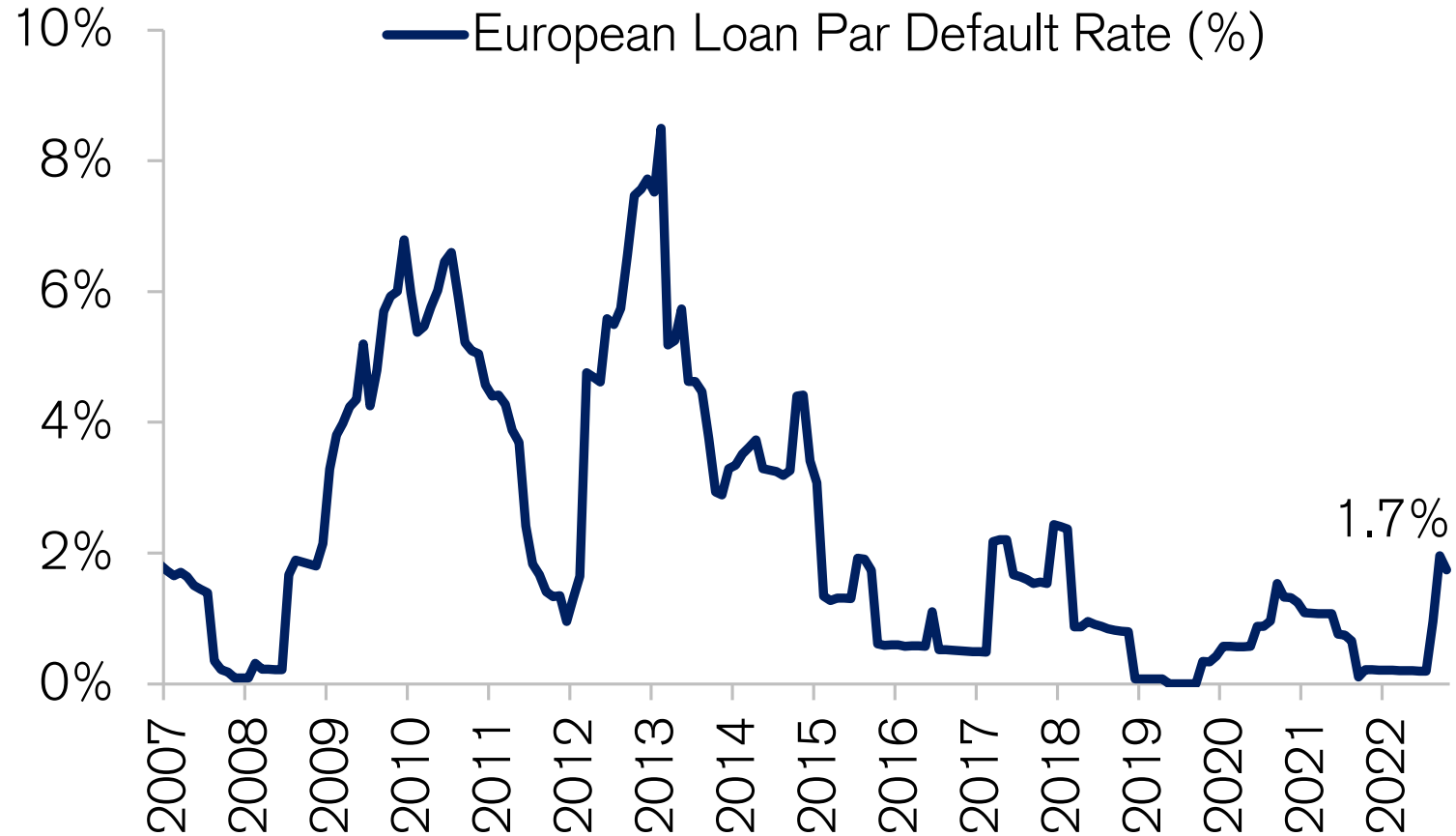
Source: Credit Suisse, Bloomberg, National Federation of Independent Business

Low HY default environment is a feature



Source: Credit Suisse

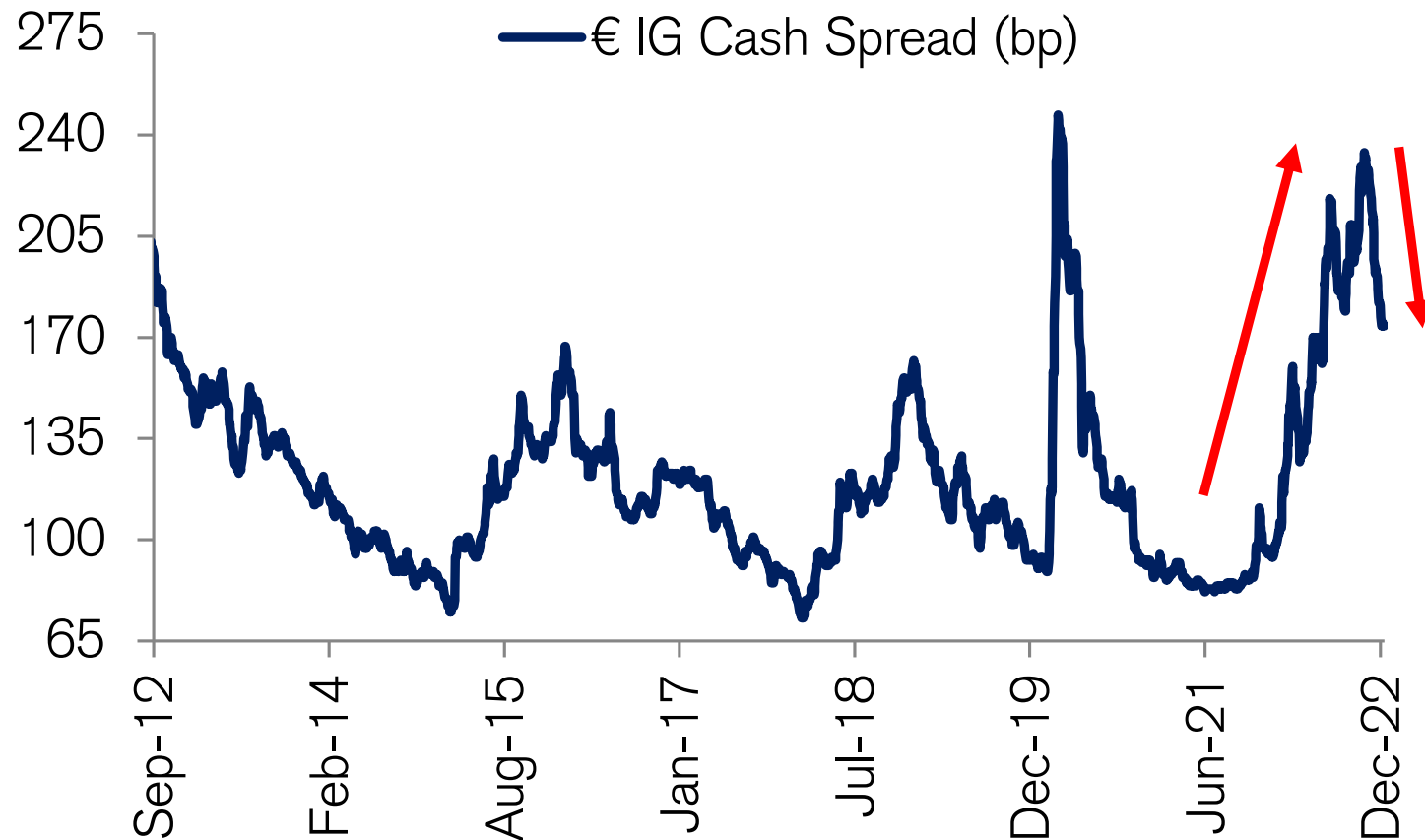
Loan issuers have more rates shock, steeper maturity wall



Source: Credit Suisse

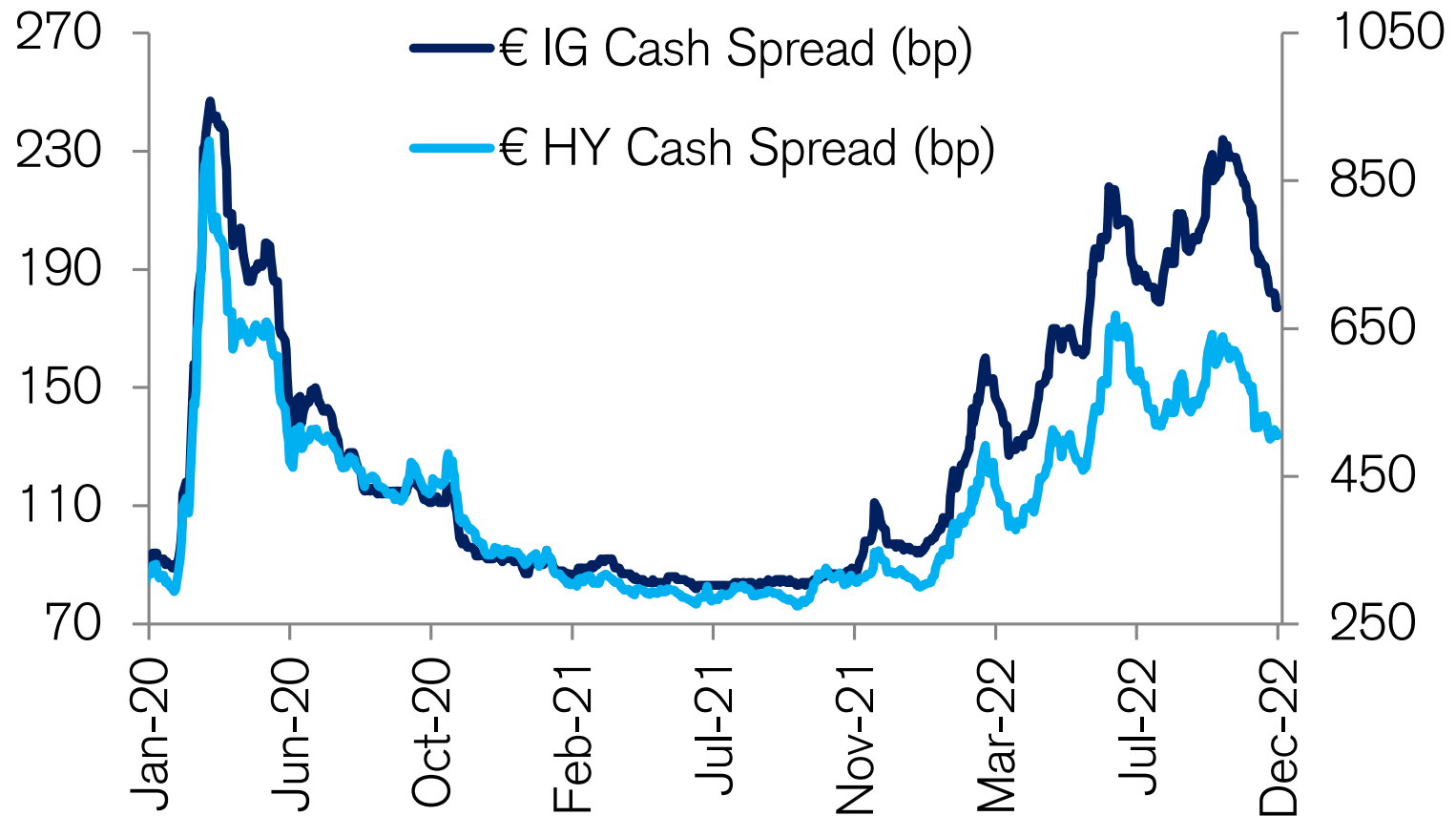
IG

Still decent value but less exciting



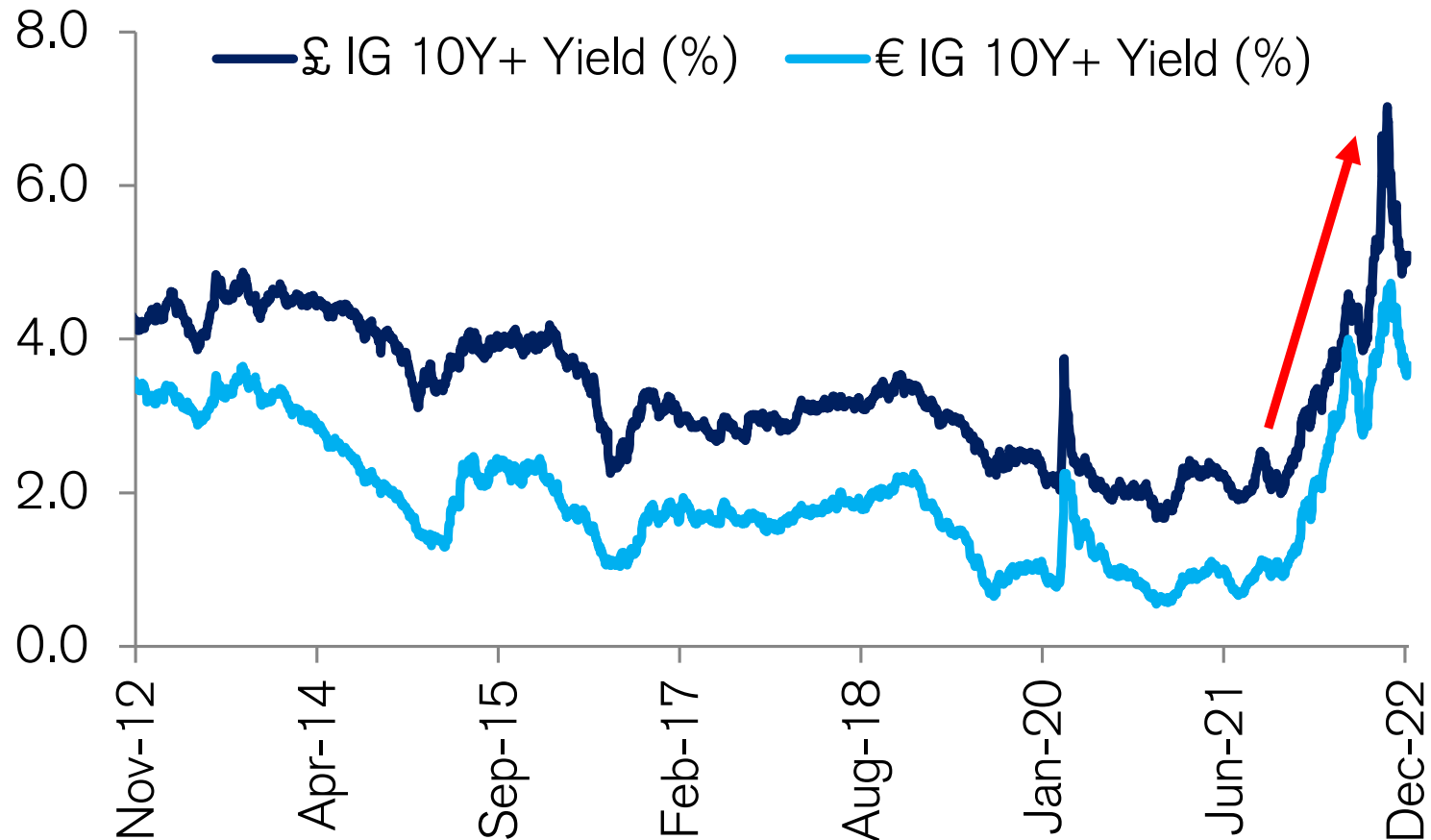
Source: Credit Suisse, Bloomberg

IG looks structurally cheaper than HY



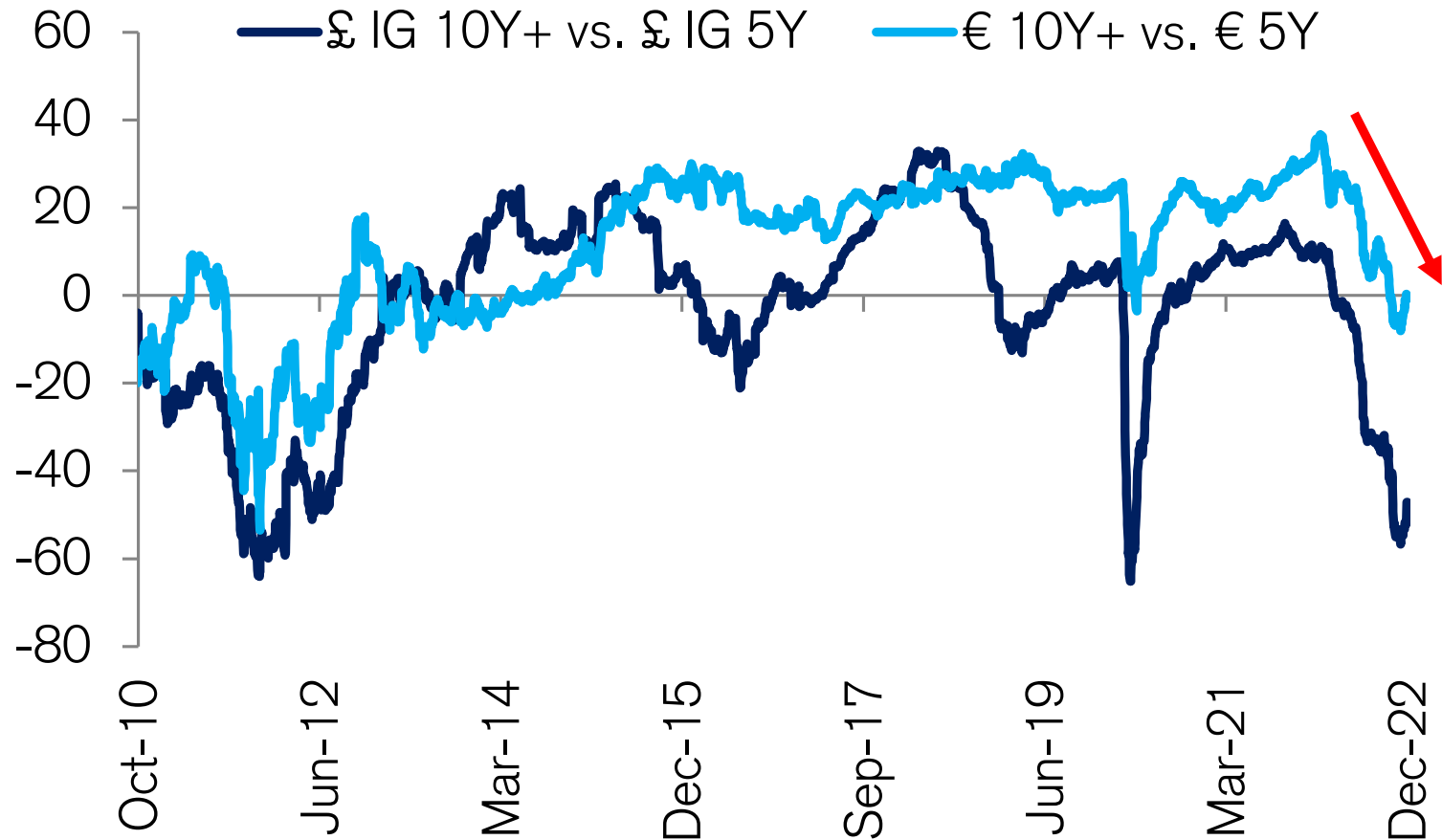
Source: Credit Suisse, Bloomberg

Yields have rallied but still near decade highs



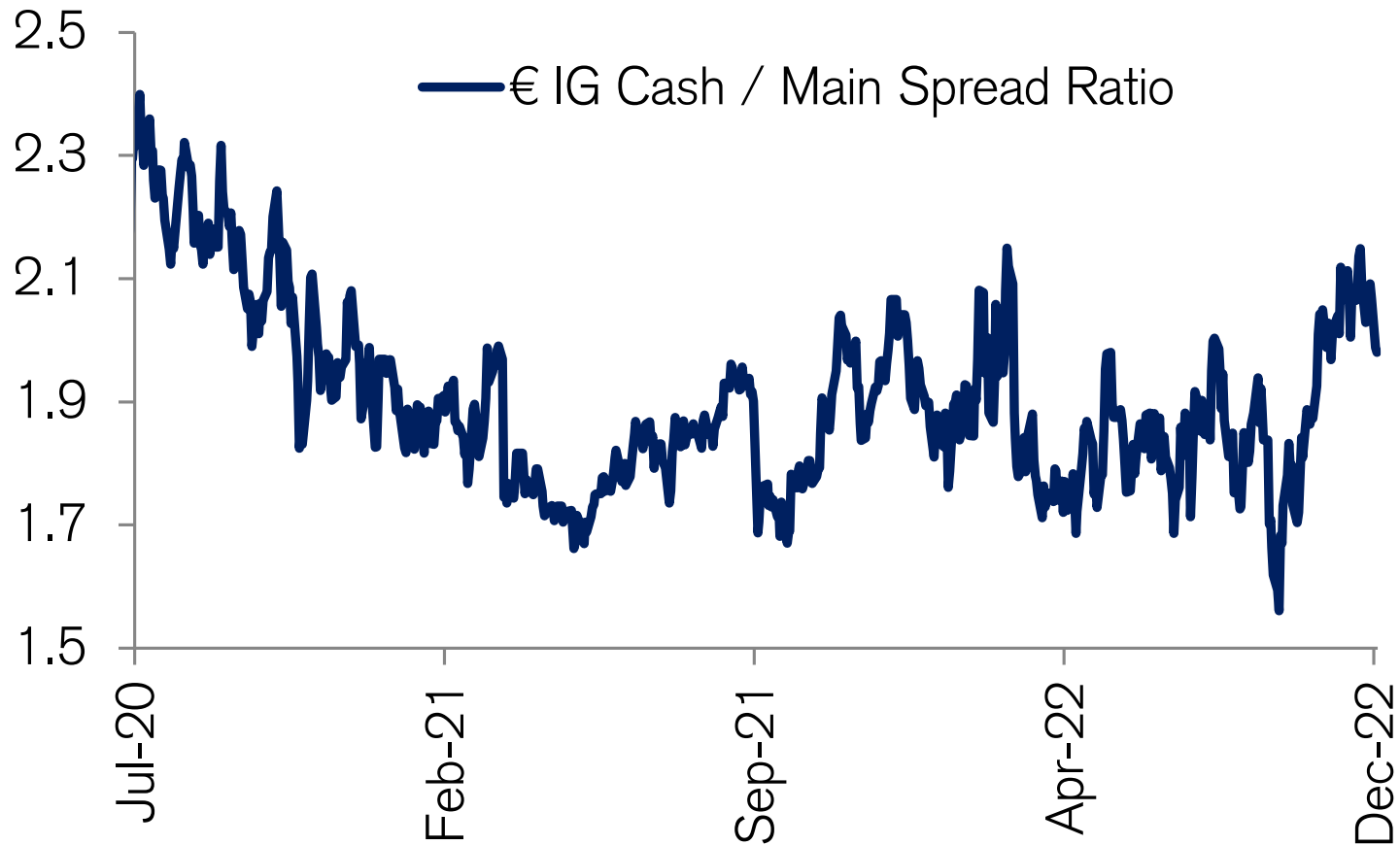
Source: Credit Suisse

Euro convexity is cheap compared with past crises



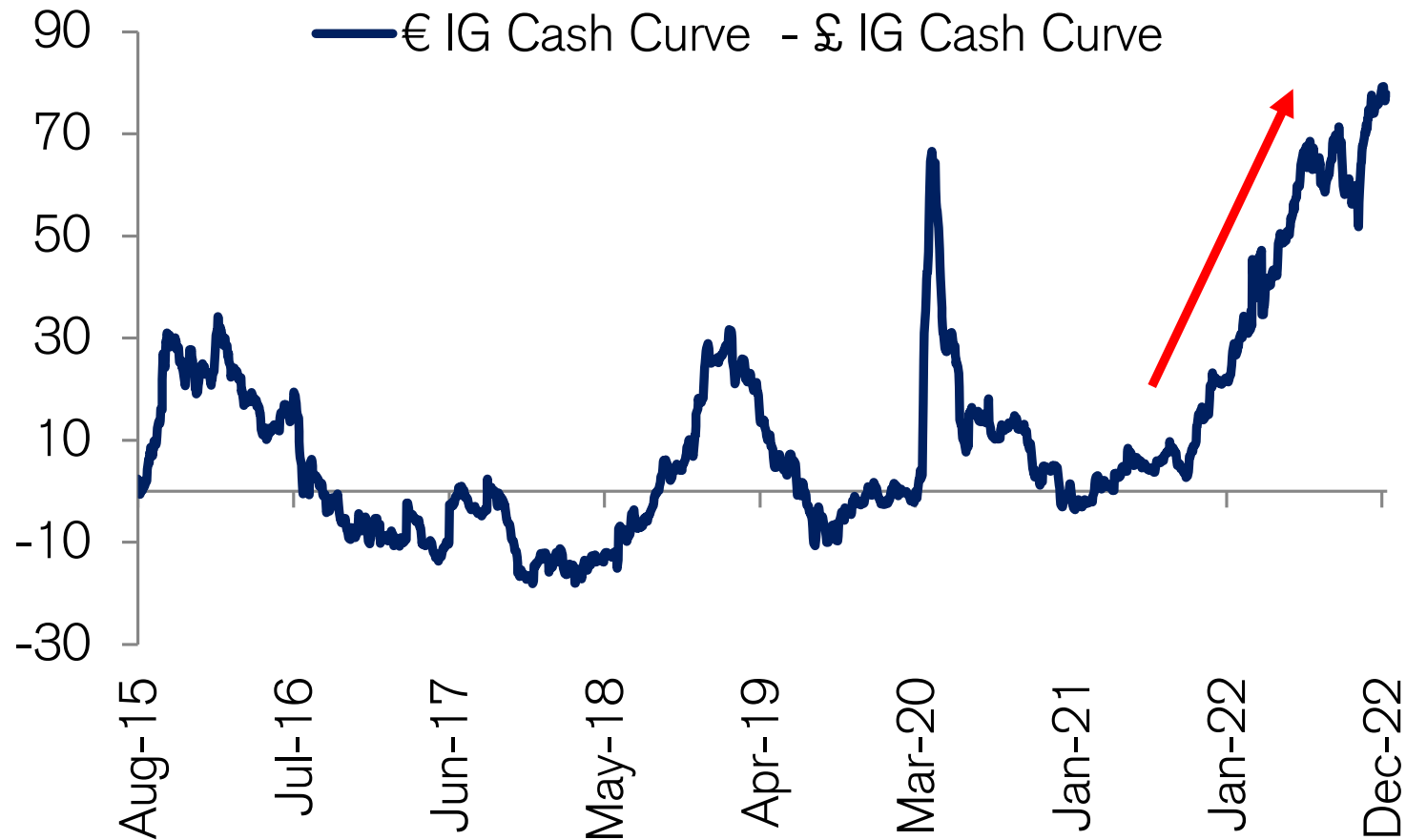
Source: Credit Suisse

Cash looks better as a long than CDS



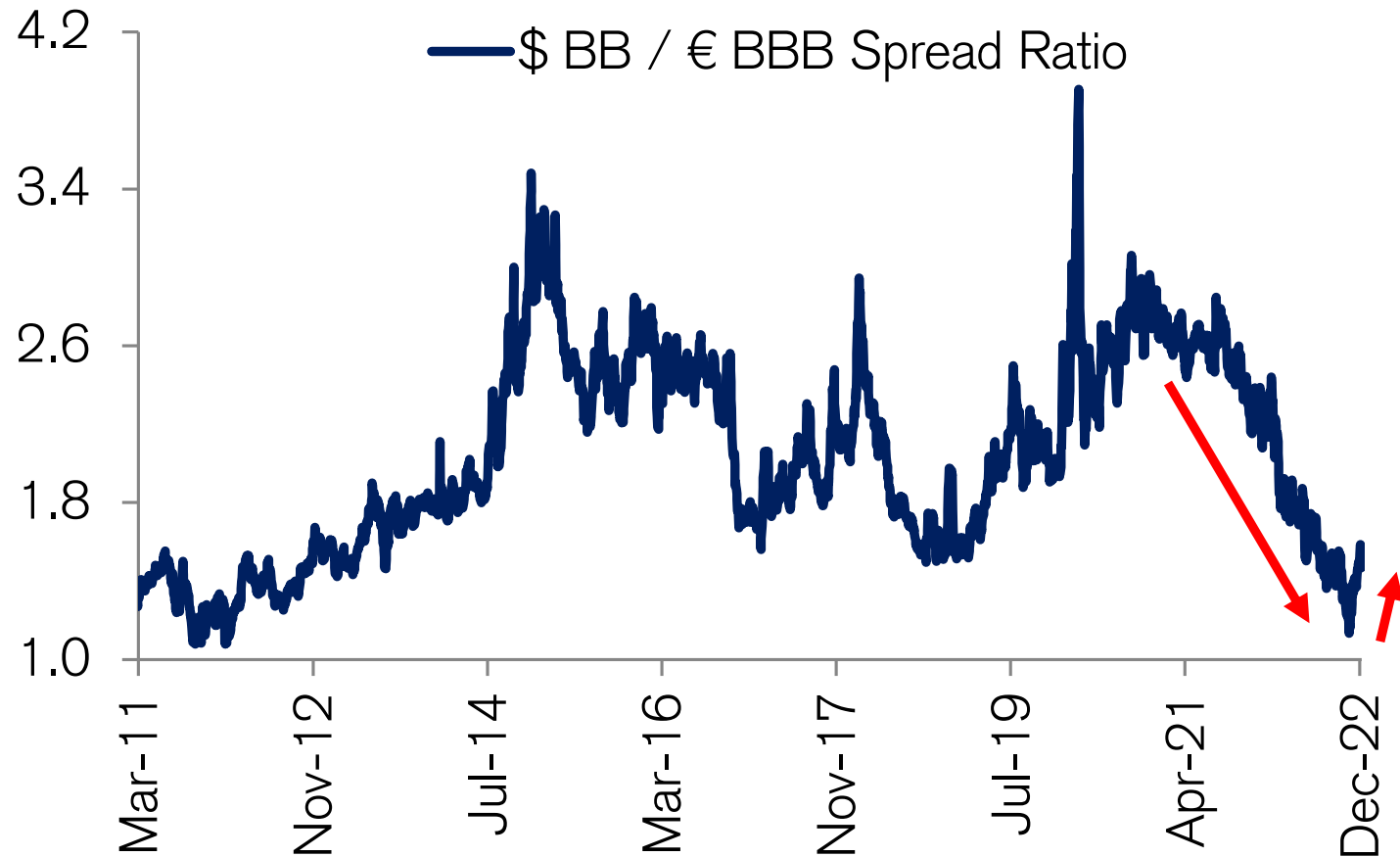
Source: Credit Suisse, Bloomberg

Plenty to do in RV – euro curves much steeper than sterling



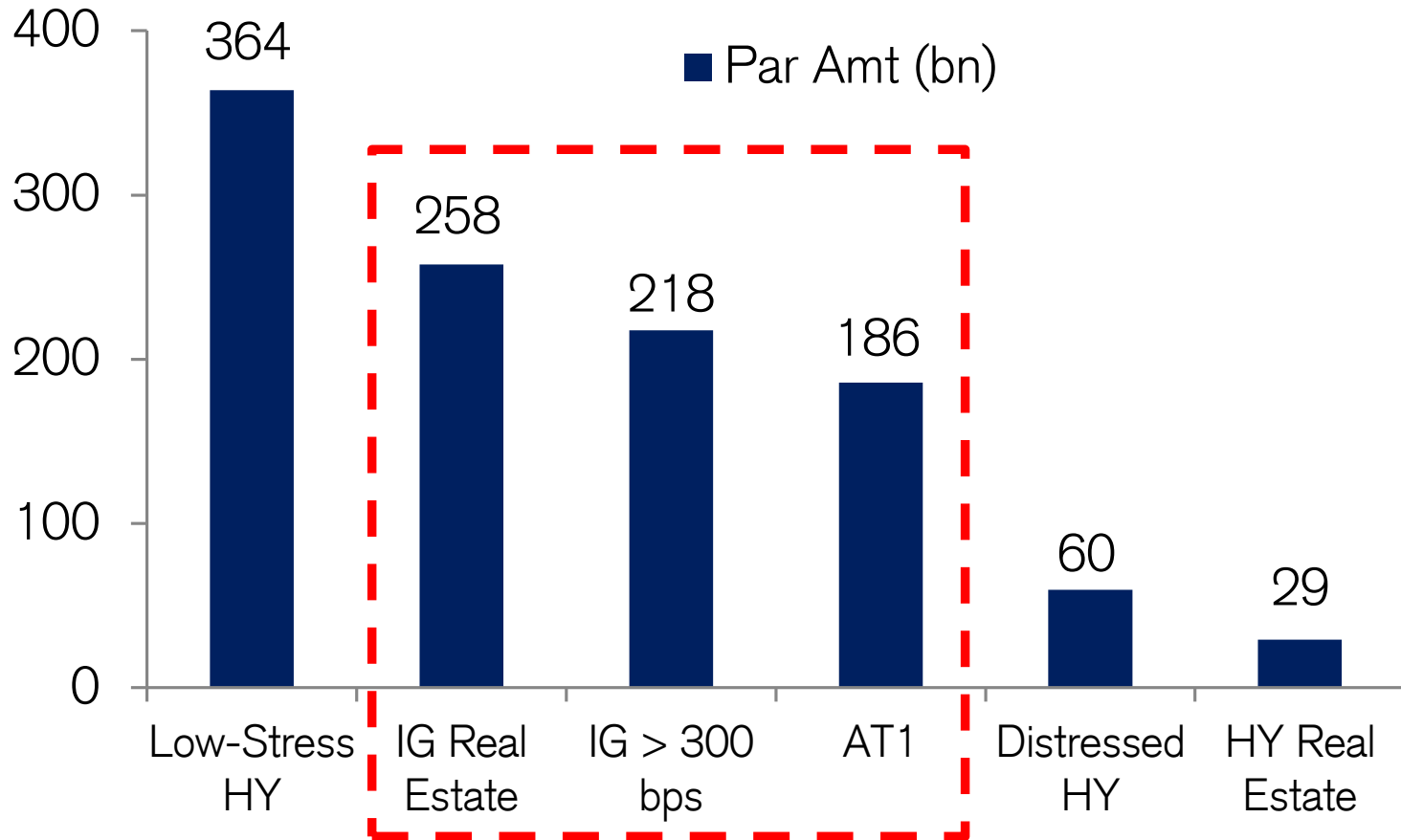
Source: Credit Suisse

Global investors should come to Europe



Source: Credit Suisse, Bloomberg

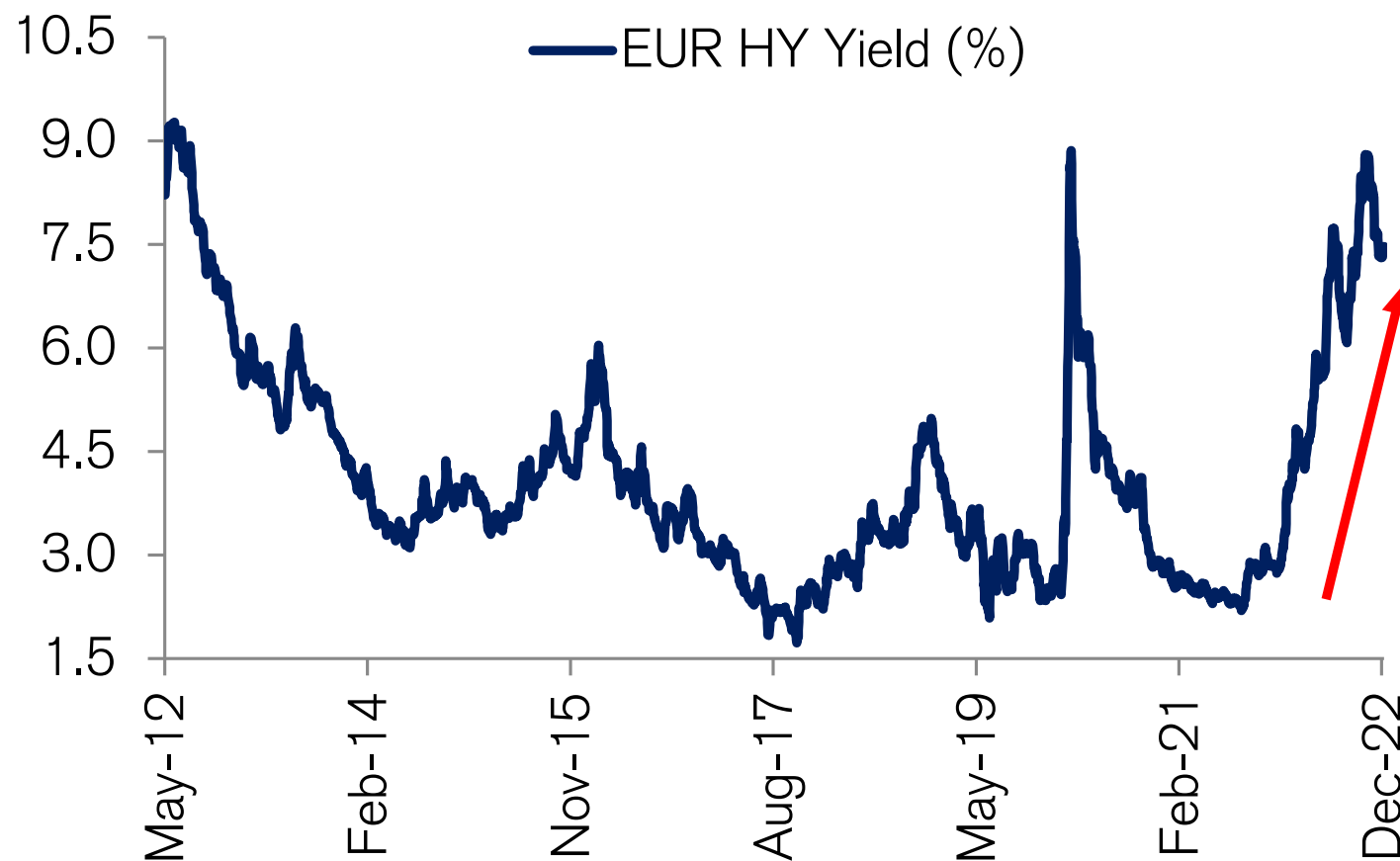
High beta IG is materially larger than benchmark HY



Source: Credit Suisse, Bloomberg

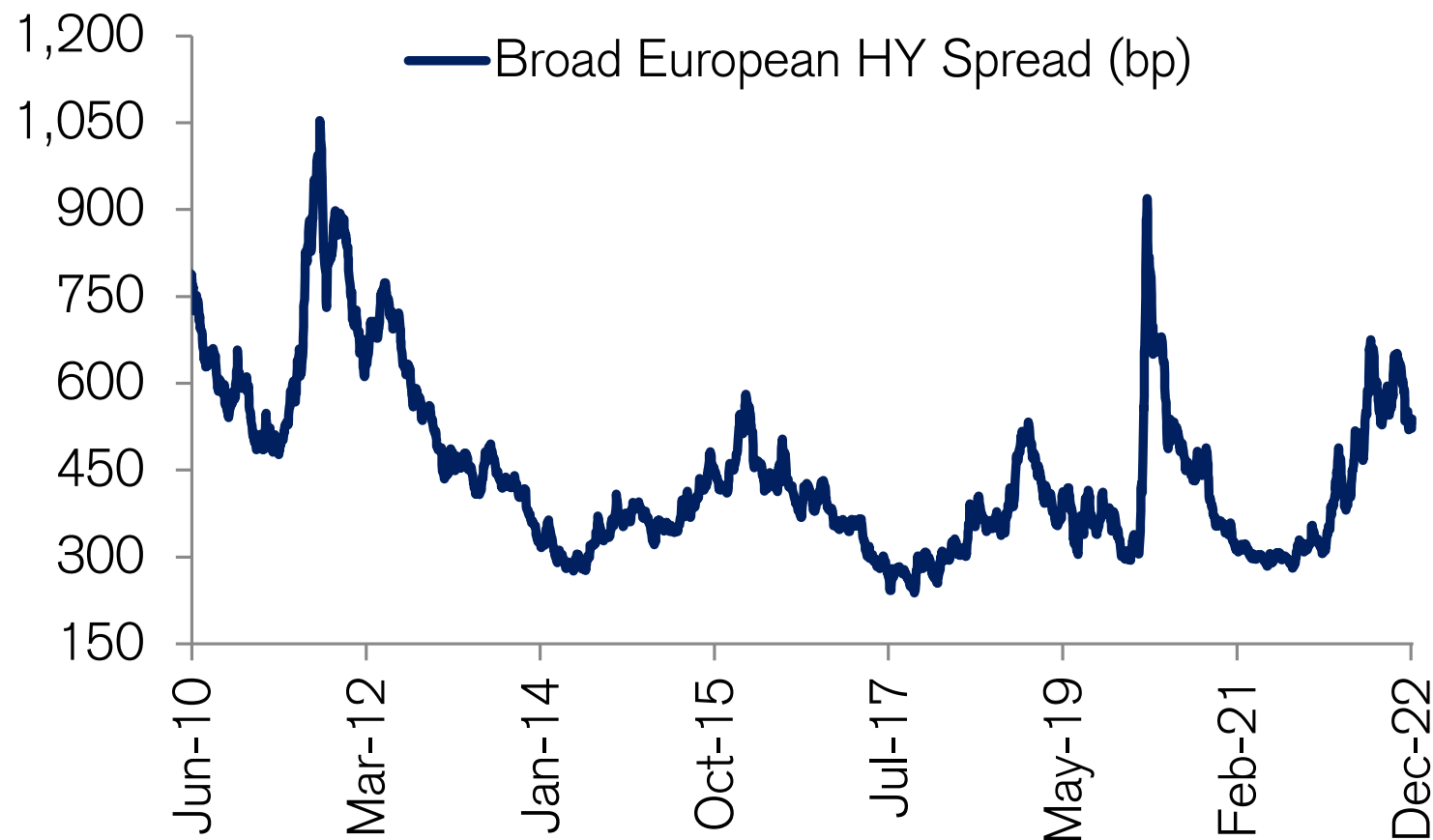
HY

Still a solid entry point on (nominal) yield



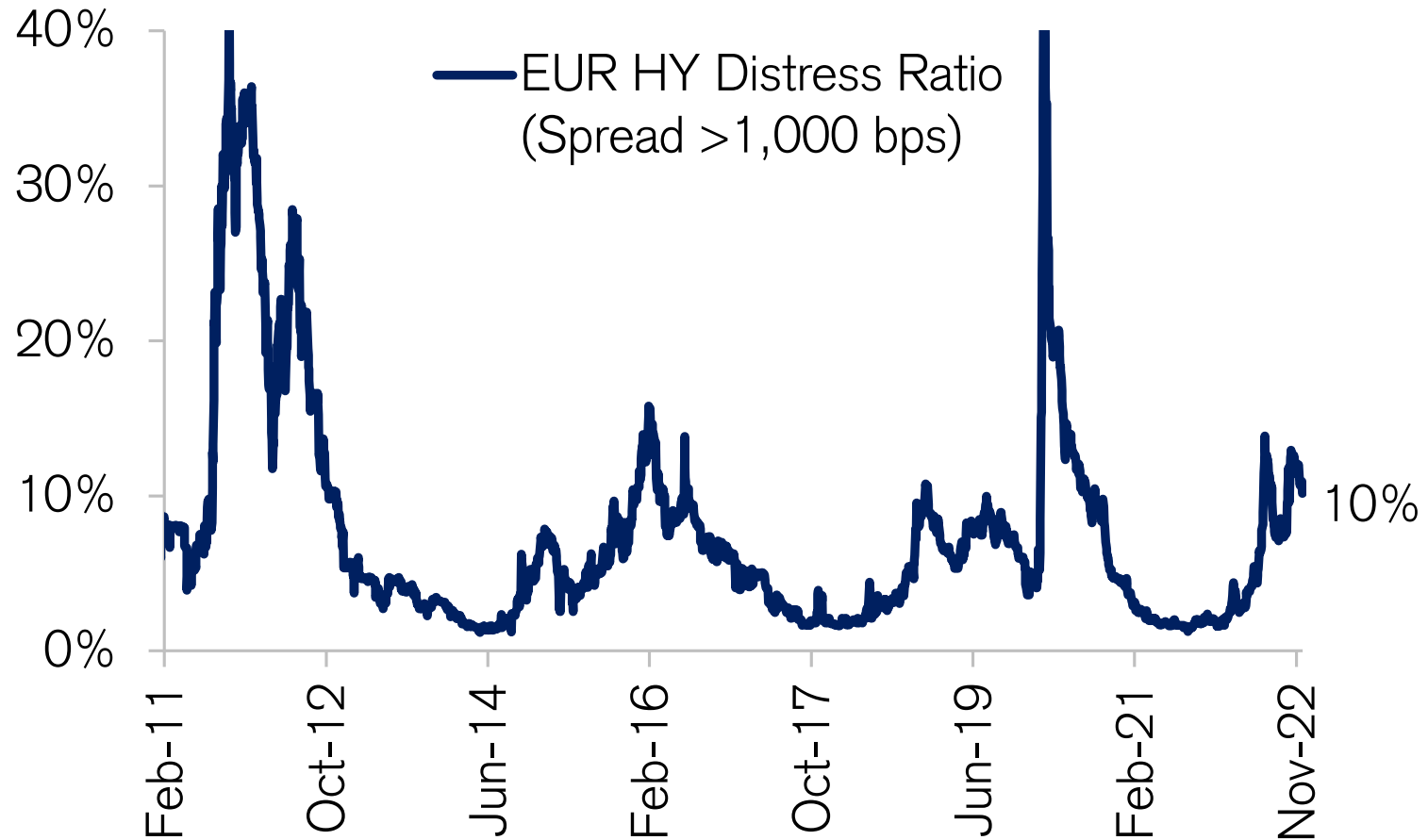
Source: Credit Suisse, Bloomberg

Spread levels are less exciting



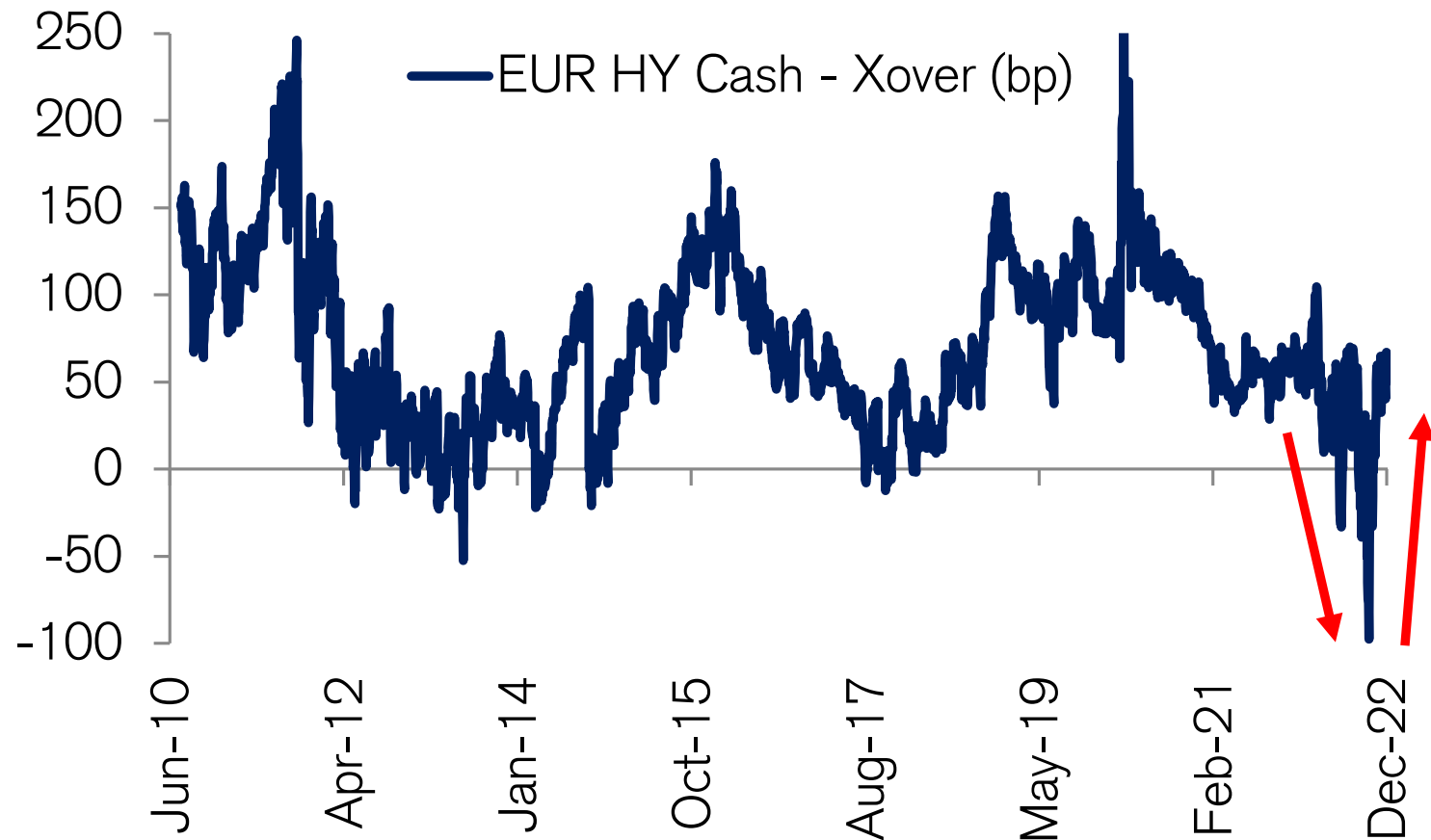
Source: Credit Suisse, Bloomberg

HY distress is very tame



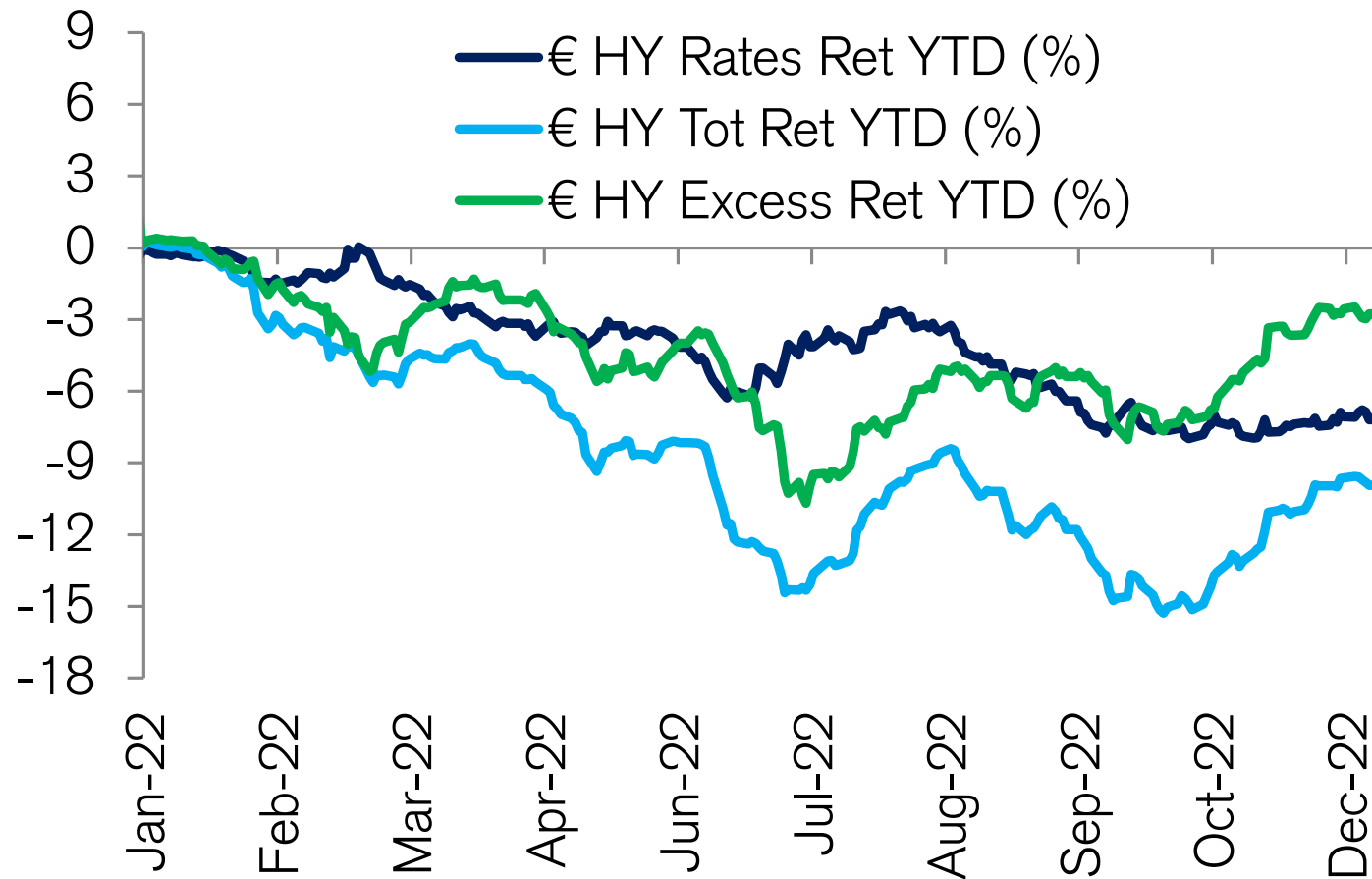
Source: Credit Suisse

Basis was both opportunity and threat



Source: Credit Suisse, Bloomberg

A grim year but most of the damage was in rates



Source: Credit Suisse, Bloomberg

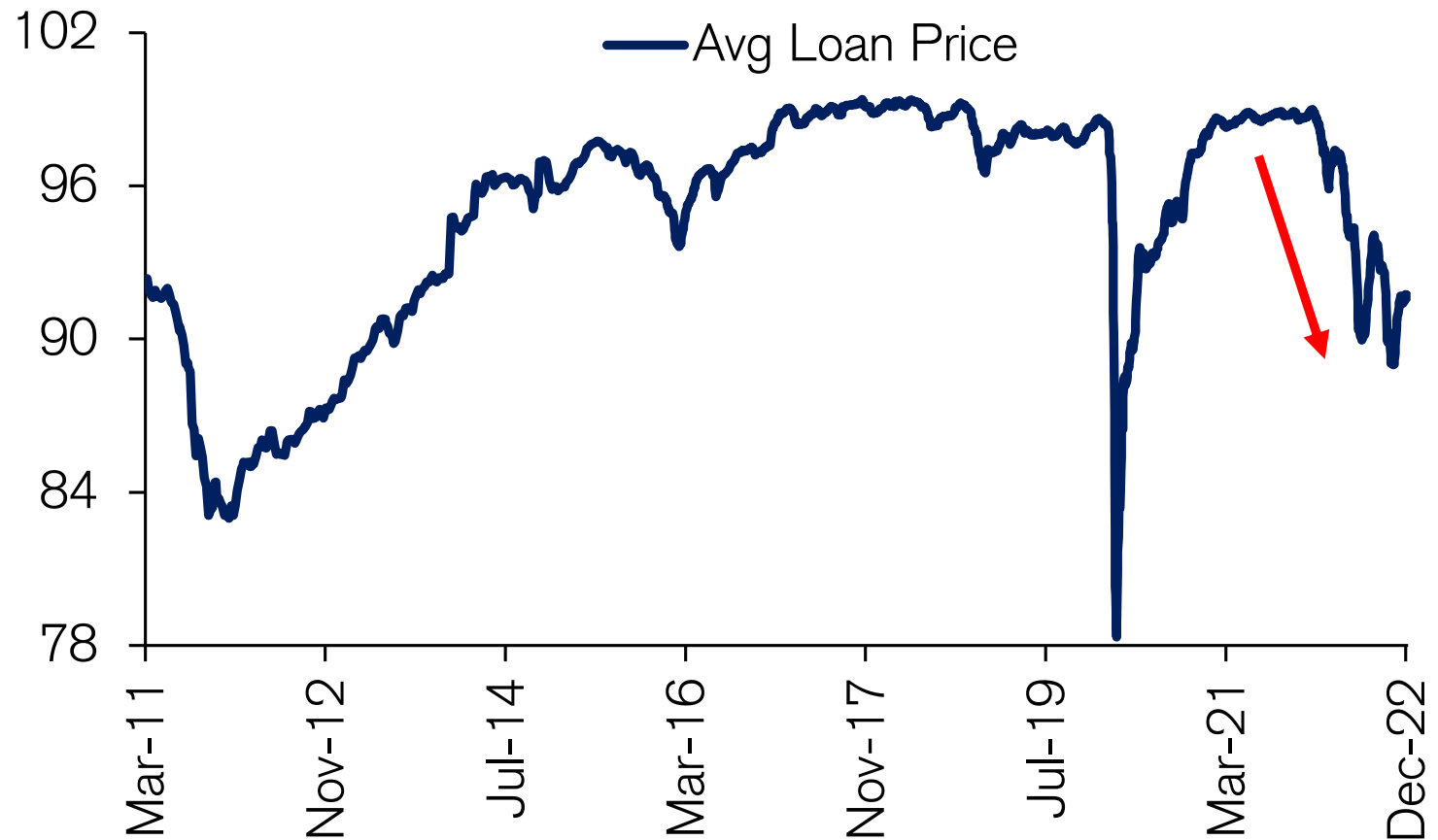
Loans

DMs are reasonably wide but far from crisis



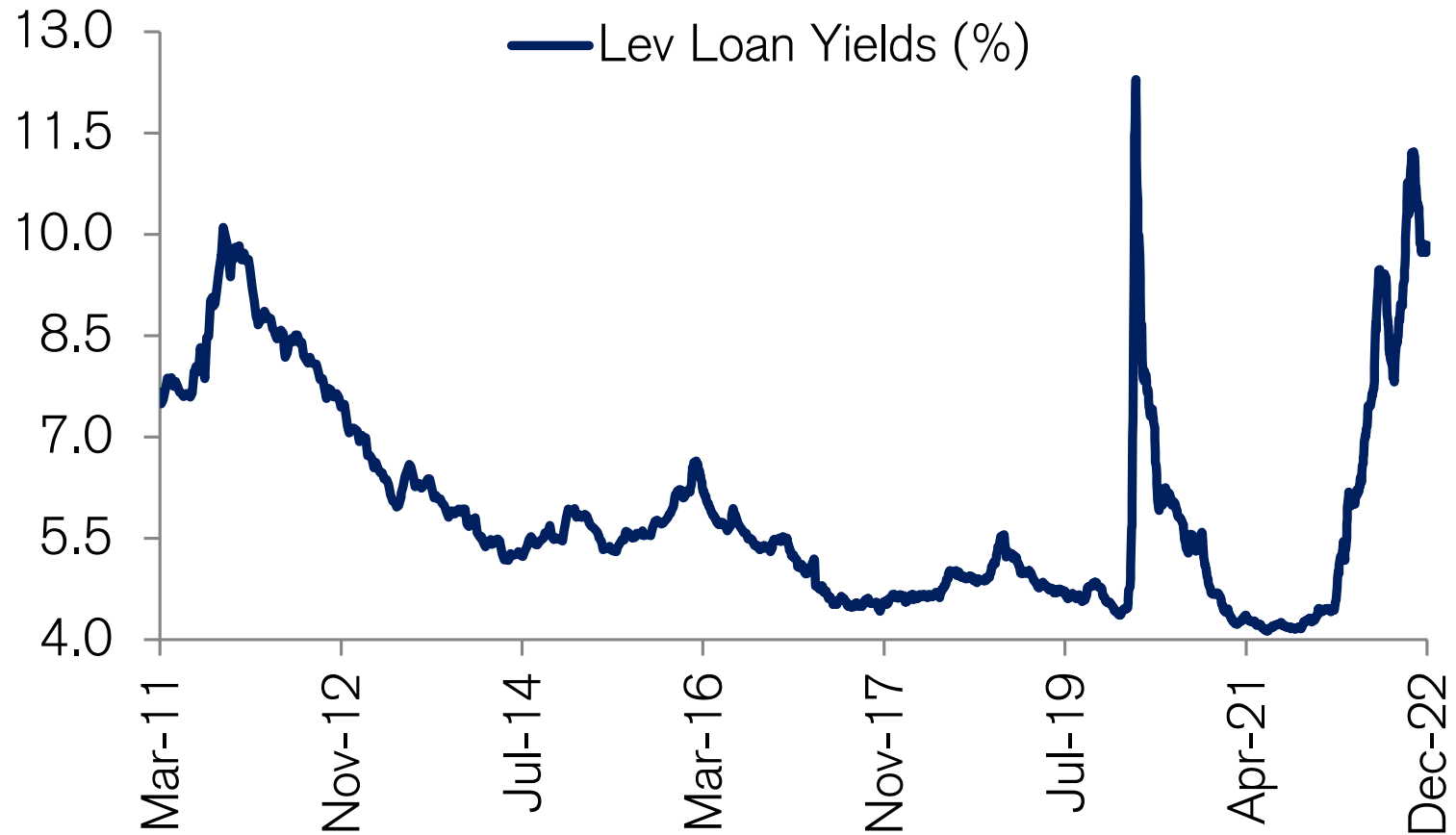
Source: Credit Suisse

Cash prices limit convexity



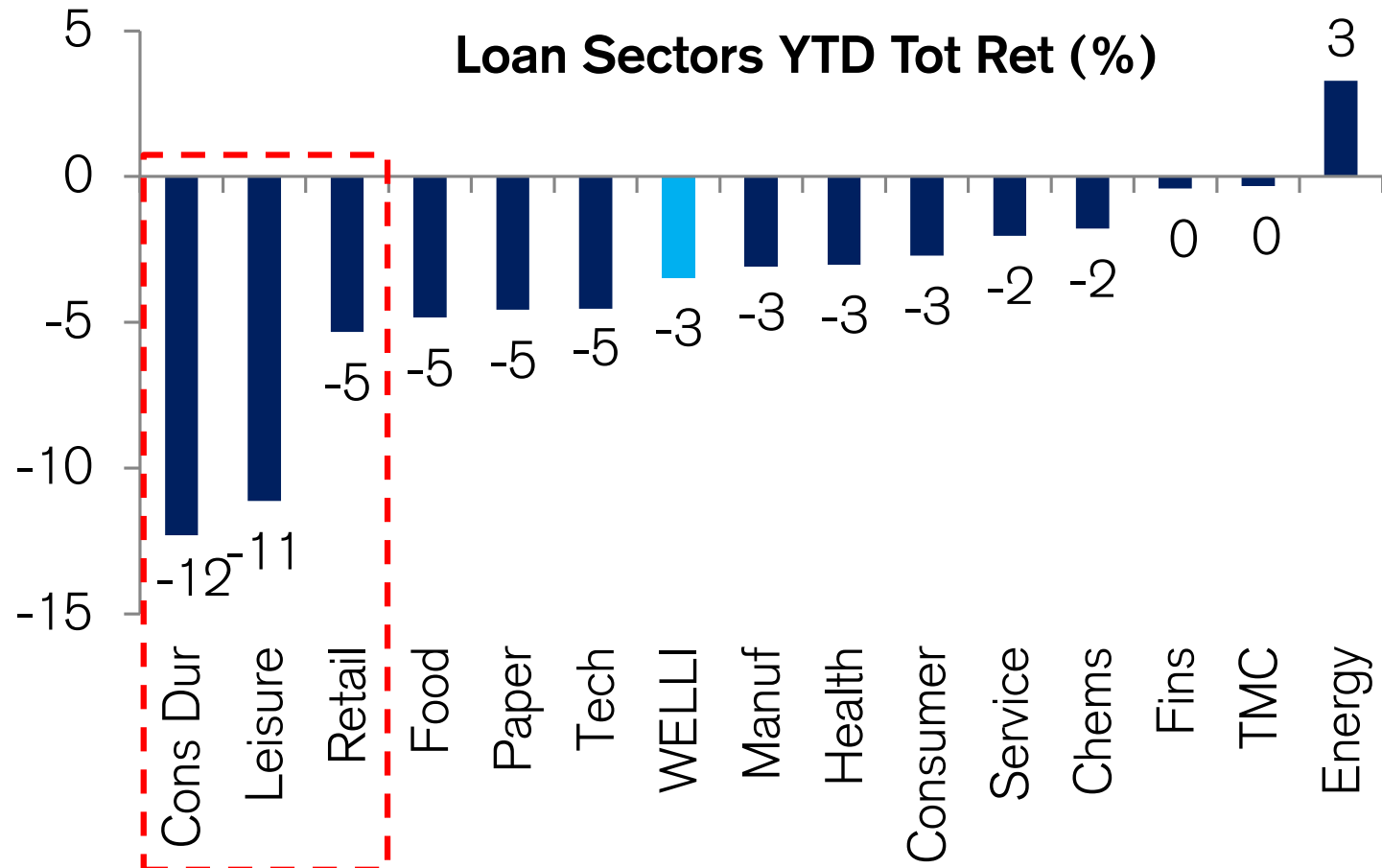
Source: Credit Suisse

Yields to drive (nominal) returns



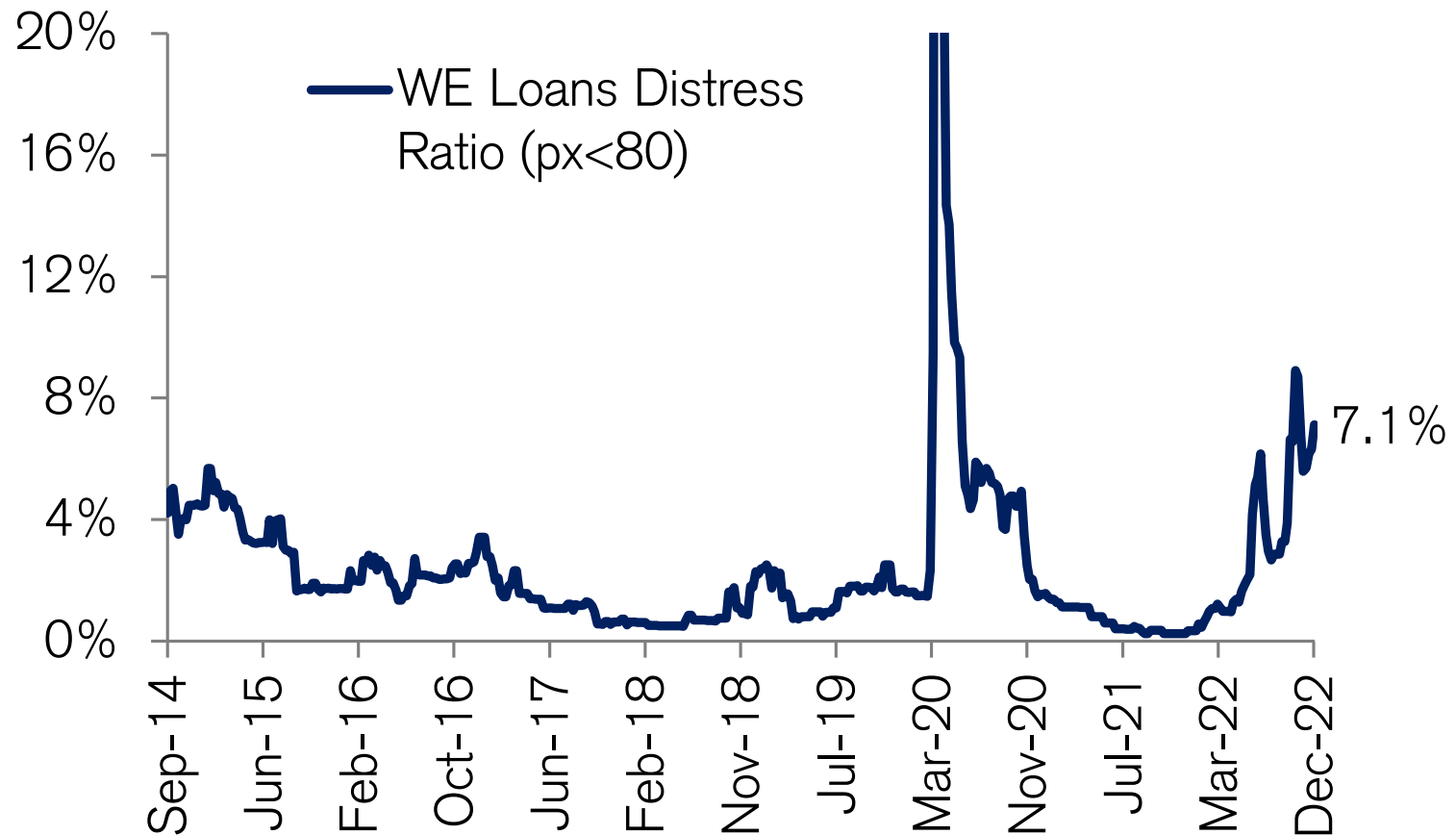
Source: Credit Suisse

Sector dispersion points towards consumer weakness



Source: Credit Suisse

Loan distress is even less frequent than HY



Source: Credit Suisse

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