AXA IM's Bond Performance Barometer

Moving from a regulatory optimized portfolio to a more economically optimized portfolio

#4

January 2022

Dutch pension reform update

It is unlikely that parts of the NPC will be implemented in 2022

New Pension Contract

- It is **unlikely** that parts of the NPC are allowed to be **implemented before 2023**, in 2020 it will become clear if the current introduction date of 1.1.2027 will be hold or posponed.
- In Q4 2021 it was announced that an **earlier indexation** at a lower (105%) funding level will be allowed in 2022, but there is **little interest** with pension funds to make use of this ability.
- The number of pension funds in the Netherlands is steadily declining, in Q3 2021 10 funds less compared to a year ago, more interest in **Buy-outs**, but “Sociale Partners” are against this option.
- **Higher pension contributions** and lower built up of pension claims are agreed for 2022 in order to close the gap to the funding level required for the NPC (100%)

Matching

- In the NPC, the pension ambition levels are still based on a projected return, which is dependent on the interest rate curve. **Interest rate hedging keeps pivotal role** in new pension system.
- AXA IM expects a **major shift to credits and SSA bonds and a sell-off of AAA government bonds**, to capture a much-needed higher yield return in the Matching portfolio.
- At higher funding levels, **Inflation protection will become more important**, via Inflation Linked swaps or bonds.
- **Per January 1, 2022 the new UFR** will be a step closer to the swap curve and reducing the UFR funding level.

AXA Investment Managers

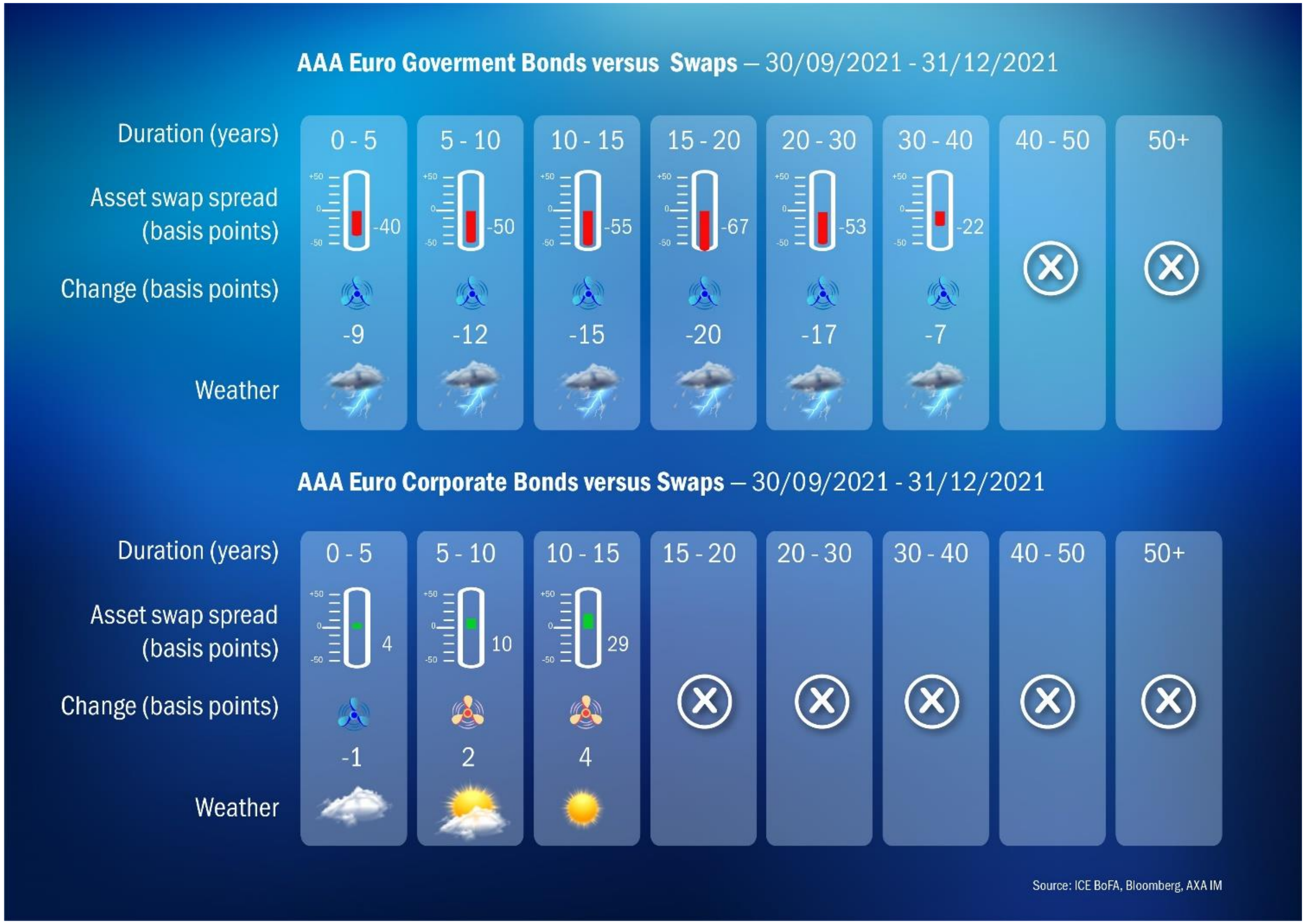
AXA IM Bond Performance Barometer has been launched in April 2021

By matching the transition strategy to the market situation, the barometer aims to support strategies for increasing returns and smart transition management.

- The Bond Performance Barometer will be published on **a quarterly basis** to show where you can make **a positive return by construction.**
- Objective of the barometer is to help our Dutch institutional clients **navigate through the market 'weather'** by providing a **clear and easy to understand infographic** explaining the relationship between governments bonds and corporate bonds, as well as **changes across asset allocation 'buckets'** in the Dutch Pension Fund universe during the pension reforms transition period.
- The key elements included at the barometer's launch are:
  - **5-year buckets**: We show the **spread and yield levels for various buckets, based on residual maturity**. In these maturity buckets we group fixed income securities with similar maturities.
  - **Temperature: Asset Swap Spread**: The 'temperature' represents how much additional return can be generated over the risk-free rate. **The asset swap spread is an indicator, illustrating the additional income on the swap rate, which is a proxy for the risk-free rate**. It shows the relative pricing of bonds with comparable characteristics (duration and credit rating).
  - **Change**: The pace at which this additional return is changing is also monitored. This is the 'spread change' in the Barometer. It shows the **development of the Asset Swap Spread over the last 3 months**.
  - **Weather:** The level of the Asset Swap Spread defines the weather. So sunny weather indicates that the asset swap spread is high.

AXA IM Bond Performance Barometer: AAA govies and credits

The differences between AAA Euro Govies and AAA Euro Credit spreads have widened in Q4 due to a decline of the Govies rates and most in the 10-15 year bucket due to widening of the credit spread rates



Please note that empty buckets in the Barometer graphics mean there are no bonds present in these maturity buckets in the index.

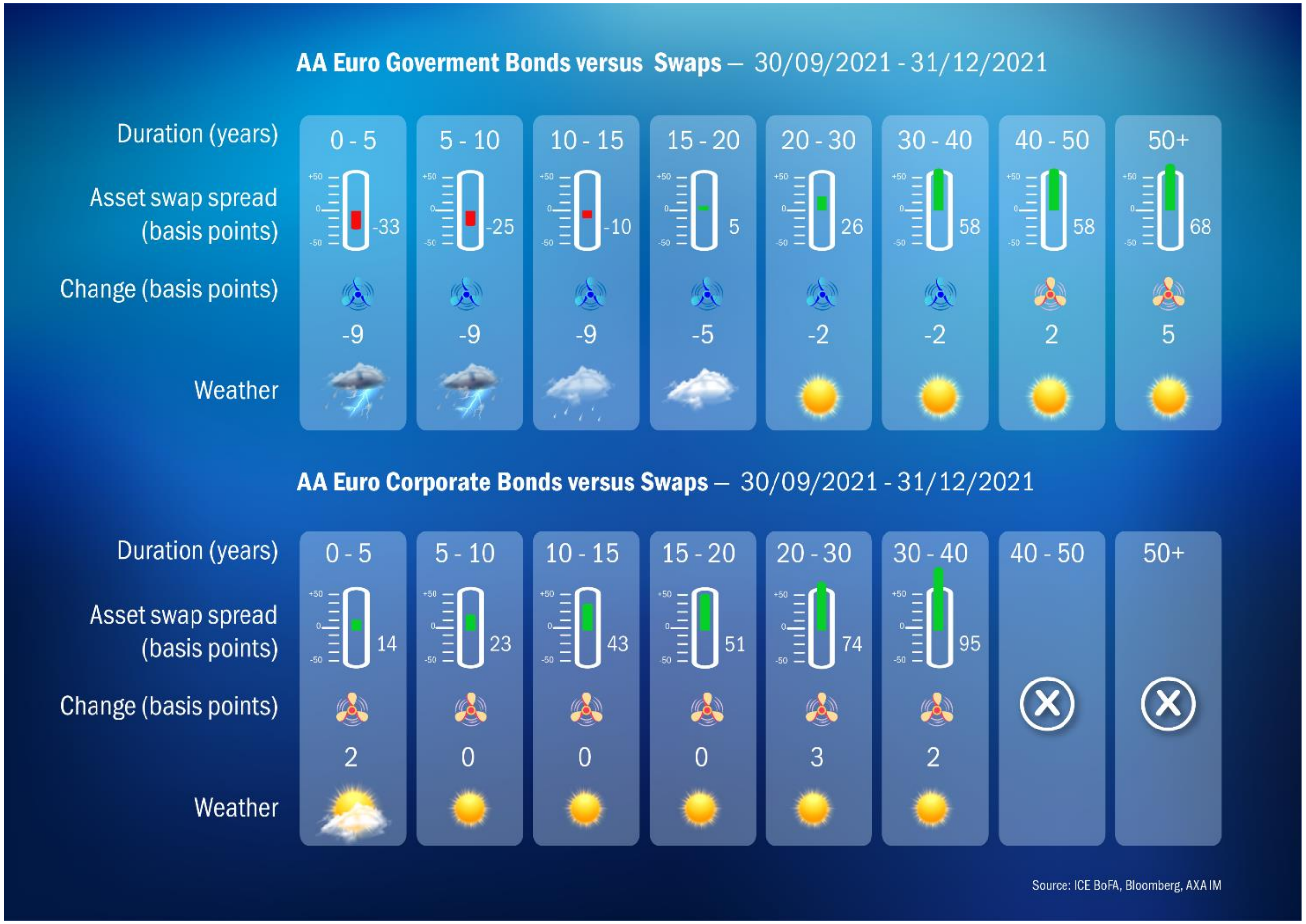
Asset Swap Spread (ASW): the level of the asset swap spread as at December 31st, 2021.

Spread Change: the change in the asset swap spread compared to September 30th, 2021.

Weather: a visualization of the asset swap spread level as at December 31st, 2021

AXA IM Bond Performance Barometer: AA govies and credits

The differences between AA Euro Govies and AA Euro Credit spreads remained pretty much the same in Q4 due to a similar development in asset swap spreads for as well sovereign bonds as credits



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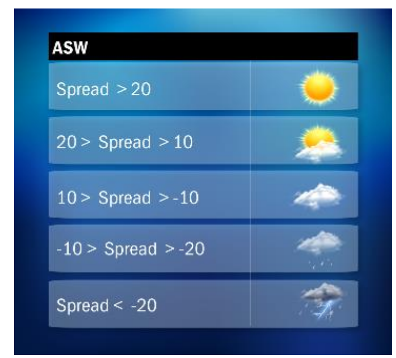
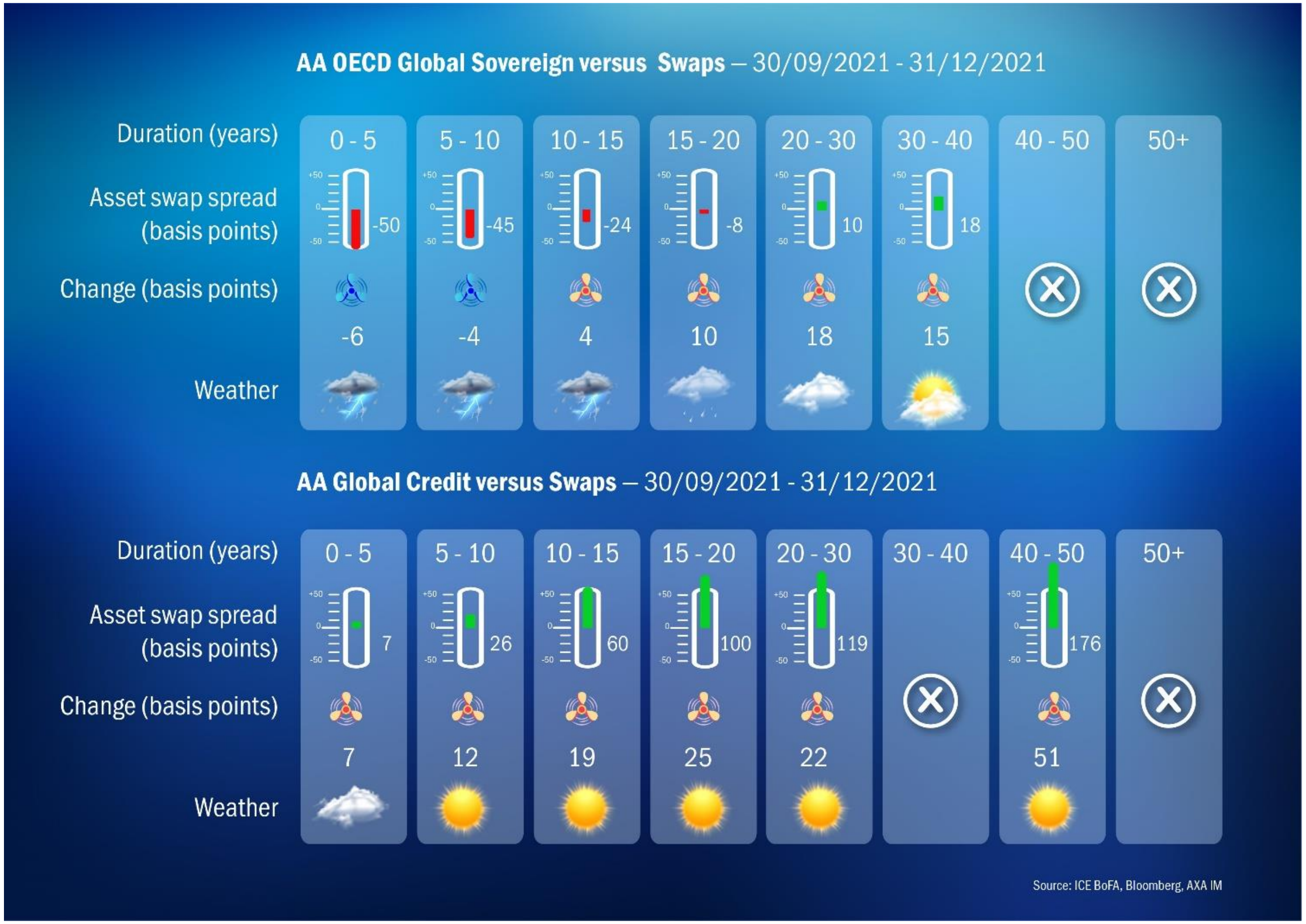


AXA IM Bond Performance Barometer: AA Global Sovereign & AA Global Credit

Difference between AA Global Sovereign bond spread - AA Global Credit spread has widened substantially in Q4 due to a bigger steepening of the Global Credit yield curve compared to AA Global Sovereign yields



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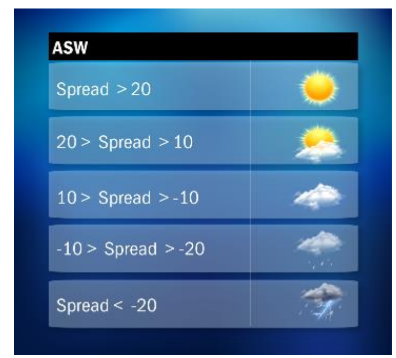


Please note that empty OECD and global credit buckets in the Barometer graphics mean some data are missing to convert the ASW to a hedged ASW,

Yield to Maturities

Government and Credit yield curves up and flattening in Q4

Yield to Maturity As at 31/12/2021	0 - 5	5 - 10	10 - 15	15 - 20	20 - 30	30 - 40	40 - 50	50+
AAA Euro Govies	-60	-33	-7	-3	9	25		
AAA Euro Credit	-6	25	72					
AA Euro Govies	-50	-8	31	54	74	92	99	109
AA Euro Credit	-4	36	83	106	129	154		
AA OECD Global Sovereign - hedged back to Euro -	-42	-9	22	39	41	37	25	109
AA Global Credit – hedged back to Euro	24	81	124	172	203	185	245	197

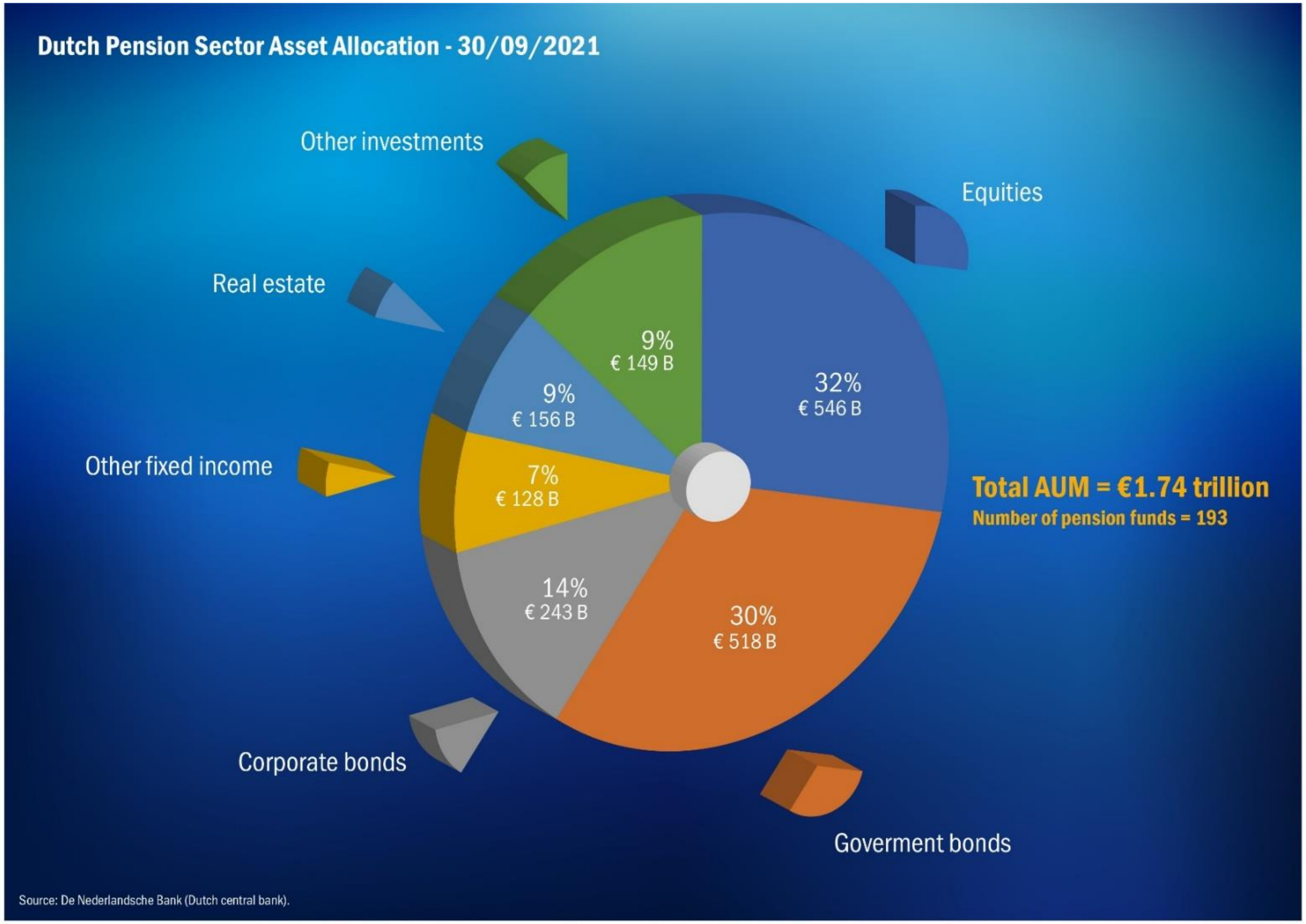
Yield to Maturity As at 30/09/2021	0 - 5	5 - 10	10 - 15	15 - 20	20 - 30	30 - 40	40 - 50	50+
AAA Euro Govies	-67	-38	-5	5	19	35		
AAA Euro Credit	-22	7	57					
AA Euro Govies	-58	-17	26	52	74	94	98	106
AA Euro Credit	-22	19	69	99	128	154		
AA OECD Global Sovereign - hedged back to Euro -	-49	-9	32	54	67	71	66	71
AA Global Credit – hedged back to Euro	-11	60	108	166	197	190	233	209

The overview of the **Yield to Maturities** summarizes **what you're going to make if you would invest a security right now.**

Please note that empty buckets in the Barometer graphics mean there are no bonds present in these maturity buckets in the index.

Over a one-year period, the allocation to government bonds fell from 35% to 30%

We observe an increase in the allocation to equities, real estate and other investments



Monetary tightening is starting but so far is expected to be modest

Fixed Income Markets Q4 2021

- Markets have **adapted to higher inflation and the onset of a modest monetary tightening cycle**. Up to three rate hikes by the Fed are priced in for the coming year with more beyond that. However, we don't expect further aggressive increases in rate expectations.
- **Inflation is expected to peak soon** and come down. The bias is to **modestly higher bond yields**. However, central banks have moved to a more hawkish stance and that poses a risk to higher rates.
- **Government bond total returns to end the year in negative territory**. Normally government bonds do not suffer two consecutive years of negative returns.
- We expect Euro rates to remain in well contained ranges and look to be short duration when yields on Bunds are close to -0.40%.
- **Yield curves have flattened** and the key influences in the coming quarter will be the firming up of expectations on the timing of Fed and other central bank rate hikes, tapering of bond purchases and the relative influence of the Omicron variant on growth forecasts and what actually happens with inflation.
- Yields will start 2022 somewhat higher than a year earlier.
- **Credit fundamentals are good and support outperformance relative to government bonds**. Defaults remain low and many issuers are in the "rising stars" category in the high yield market.
- Demand for credit remains strong and **no significant spread widening is envisaged** in the forecast horizon. The main risk comes from both rates (higher inflation) or a growth slowdown (COVID-19).
- **Credit is favoured for carry opportunities** with no expectation of significant spread widening.

Source: Market Outlook AXA IM as at December 2021

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