In Credit

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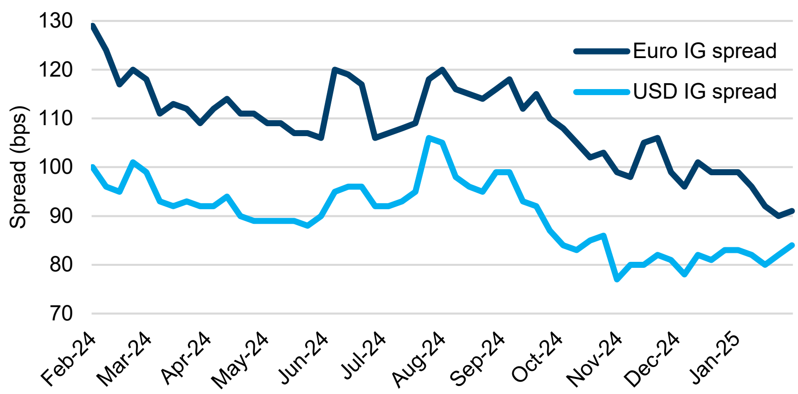
Higher for longer

Markets at a glance

	Price / Yield / Spread	Change 1 week	Index QTD return*	Index YTD return
US Treasury 10 year	4.49%	-5 bps	1.0%	1.0%
German Bund 10 year	2.38%	-9 bps	0.1%	0.1%
UK Gilt 10 year	4.47%	-7 bps	1.4%	1.4%
Japan 10 year	1.32%	7 bps	-1.0%	-1.0%
Global Investment Grade	86 bps	1 bps	0.9%	0.9%
Euro Investment Grade	91 bps	1 bps	0.8%	0.8%
US Investment Grade	84 bps	2 bps	1.0%	1.0%
UK Investment Grade	76 bps	0 bps	1.5%	1.5%
Asia Investment Grade	112 bps	-4 bps	1.0%	1.0%
Euro High Yield	312 bps	-7 bps	1.1%	1.1%
US High Yield	267 bps	-1 bps	1.4%	1.4%
Asia High Yield	543 bps	-6 bps	0.1%	0.1%
EM Sovereign	287 bps	-1 bps	1.7%	1.7%
EM Local	6.3%	-4 bps	2.6%	2.6%
EM Corporate	244 bps	-2 bps	1.1%	1.1%
Bloomberg Barclays US Munis	3.6%	-7 bps	0.9%	0.9%
Taxable Munis	5.1%	-6 bps	1.4%	1.4%
Bloomberg Barclays US MBS	35 bps	1 bps	1.0%	1.0%
Bloomberg Commodity Index	255.30	2.0%	6.0%	6.0%
EUR	1.0320	-0.3%	-0.3%	-0.3%
JPY	152.12	2.5%	3.8%	3.8%
GBP	1.2402	0.1%	-0.9%	-0.9%

Source: Bloomberg, ICE Indices, as of 7 February 2025. *QTD denotes returns from 31 December 2024

Chart of the week: US and European investment grade spreads



Source: Bloomberg, as of 7 February 2025

Macro/government bonds

The US yield curve marginally flattened over the past week, as short rates edged up in light of market expectations of a “higher for longer” US interest rate environment. This reflects the relative resilience of the US economy as well as the unknown impact of tariff policy, which is making it harder for the Federal Reserve to pursue anything other than a gradualist approach. President Trump kept to his game plan and said he would introduce 10% tariffs on China, and 25% tariffs on Mexico and Canada. However, he later agreed to postpone the tariffs on Mexico and Canada, as both countries agreed to greater enforcement measures on their respective borders against drugs and illegal migration. He also launched a 25% tariff on steel and aluminium, whose impact will be felt greatest in Mexico and Canada. Meanwhile, the US postal service suspended a de minimis exemption that previously allowed small parcels with a value of less than $800 to enter the US duty free – a policy aimed primarily at China.

On economic data, ISM services data surprised to the downside, although activity remains in expansionary territory. Nonfarm payroll data for January came in at 143,000 net new jobs, which was lower than expected, although its impact on the US Treasury market was largely offset by an upwards revision to the previous month’s data. The Fed’s more cautious approach meant that the market effectively pushed out the timing of the next interest rate cut until July/September. Price action in the US Treasury market set the tone for bond markets globally.

In the UK, the Bank of England cut interest rates by 0.25% to 4.5% – an action that had been widely anticipated by the market. The message delivered by senior policy makers was a cautious one, underpinned by three key judgements. First, the BoE expected progress on disinflation to continue, although policymakers anticipated a temporary rise in inflation due to an increase in regulated energy prices later this year. Second, the growth of supply capacity of the economy has weakened, constraining the level of slack in the UK economy. And third, emerging slack in the economy will act against second round effects in domestic prices and wages. The BoE also halved its growth forecast for 2025 to 0.75%, although it expected growth would subsequently recover to 1.5% in 2026 and 2027 as real incomes rise. The division between voting members was 7-2, with two members voting for a 0.5% rate cut. Bank governor, Andrew Bailey, cautioned markets against reading too much into this, stating that voting is not used as a ‘communication tool’. He also reminded his audience that despite the interest rate cut, monetary policy remains in clearly restrictive territory. In line with the Bank’s cautious messaging, financial markets pushed out the timing of the next quarter-point rate cut to June, with another to follow by September.

Investment grade credit

Global investment grade spreads were little changed last week as expensive market valuations (spreads) failed to dampen strong investor demand, which itself is probably led by the high yields available in most markets.

However, so far in 2025 there has been a notable dispersion between market performance. Year-to-date, US dollar IG spreads are around 2% wider while the euro market has spreads that are 10% tighter (see **Chart of the week**). All the while, shorter-dated corporate bonds have outperformed as credit curves have steepened.

At an industry sector level, the standout performer has been the banking sector where spreads are nearly 7% tighter this year globally, while utilities, tech and media have seen spreads widen so far in 2025 (all data according to ICE index).

High yield credit & leveraged loans

US high yield bond valuations were stable over the week, despite oscillating trade war headlines and a busy new issue calendar. The ICE BofA US HY CP Constrained Index returned 0.01%, while spreads were unchanged and ended the week at +284bps. According to Lipper, US high yield bond retail funds saw modest inflows, with $834 million contributed. This was a third consecutive weekly inflow.

Leveraged loans remained stable amid light new net issuance and ongoing inflows. The average price of the S&P UBS Leveraged Loan Index declined $0.01 to $96.5 over the week. Retail floating rate funds saw a record $2.3 billion inflow, largely driven by ETFs.

European HY had a strong week. In spite of a weak start last Monday, a much firmer tone took hold for the rest of week on the back of a lack of supply and strong technical, resulting in a return of 0.4% for the period. Spreads tightened 7bps to 312bps, while yields fell 10bps to 6.1% with strong market demand and given the light primary market. Inflows continued, largely into managed accounts but also ETFs. Corporate new issuance was light with only two offerings (DoValue, Loxam). Both came inside of initial price talk and were well oversubscribed.

In sector news, the auto sector continues to show signs of slowdown with the outlook being marked down (for example, Volvo) or a negative outlook from credit rating agencies (Schaeffler and IHOVER). In other news, the Nissan-Honda merger talks are breaking down.

It was a busy week in terms of ratings. There was positive news for Greek banks as they were upgraded to IG (Eurobank and the National Bank of Greece) or to BB+ (Piraeus). The Bank of Cyprus was also upgraded to IG. In downgrades, S&P had bad news for Altice International, with the rating agency following Moody's earlier action and downgrading the telecoms firm to CCC+ given 'increased risk of a distressed exchange'.

Default figures rose to 3.71% for the trailing 12 months, from 3.6% at the end of December. At the same time recovery rates have risen sharply to 55% from the 40% historical average.

Asian credit

The JACI delivered another positive week of 50bps (IG was +49bps and HY +52bps), thanks to favourable movement in core rates (+33bps) and spread returns (+17bps).

The US imposed an additional tariff of 10% on Chinese exports, effective from 4 February. China's retaliation includes, among other things, a 10% tariff on imports of crude oil and a 15% tariff on imports of coal and liquefied natural gas from the US. The tariffs took effect on 10 February. China will also restrict the exports of certain critical minerals to the US.

President Trump also said his administration would introduce 25% tariffs on all steel and aluminium imports into the US. The impact of these tariffs will be limited for China, given the low percentage of Chinese exports of both steel and aluminium. According to the GACC (General Administration of Customs of the People's Republic of China), the US only accounted for 0.6%-2.8% of China steel exports between January 2016 and September 2024 (versus 1.2%-8.2% from 2012-2015). The volume of China steel and aluminium exports into the US has declined over the years, following the 2018 implementation of a 25% tariff on steel imports and 10% on aluminium under Trump 1.0. Additionally, in May 2024 the Biden administration added more tariffs under Section 301 on Chinese steel and aluminium exports.

On another hand, to the extent that the additional US tariffs on steel and aluminium could result in the rerouting of excess global steel, there might be some negative impact on Indian steel producers. For context, through the past seven quarters India has been a net steel importer (FYE March 2024, 1.13mt; in the nine months to December 2024: 3.6mt) due to excess steel production in China, with some supply making its way into India. This was negative for domestic steel prices in India.

The Panama government is reportedly weighing the possibility of revoking the contract with Hutchison Ports, which is around 80% owned by CK Hutchison, in operating the Cristobal and Balboa ports near the Panama Canal. Hutchison Ports holds around a 90% stake in Panama Ports Company (PPC), which runs the ports, while the Panama government owns the remaining 10% stake. PPC commenced its operations in Panama in 1997 with a 25-year concession granted by the Panamanian government. This was renewed for an additional 25 years in 2021.

For the Macau gaming operators, the volume of visitors to Macau during the eight-day Lunar New Year (Spring Golden Week, 29 January-5 February) was softer than consensus. This was a 3.6% year-on-year decline to around 1.3 million versus the corresponding week in 2024. However, compared with the same period pre-Covid in 2019, visitor volume was actually up by around 9%.

Emerging markets

Emerging markets remain resilient despite tariff-induced volatility and uncertainty around US trade policy. EM sovereigns returned 0.52% on the week in US dollar terms with spreads tightening by 2bps. EM local returned 0.56%, of which 0.22% came from foreign exchange.

Last Friday, the Reserve Bank of India cut repo rates by 25bps to 6.25%, marking its first rate cut since 2020. This was expected by the markets as the Bank aims to spur growth in the Indian economy. The Indian rupee (INR) fell to a record low on 10 February after President Trump unveiled plans to impose tariffs on steel and aluminium imports. The USD/INR weakened to 87.95. Prime minister Modi and Trump are scheduled to meet this week, with trade discussions reportedly Modi’s top priority.

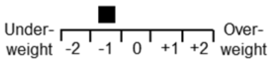
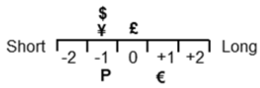
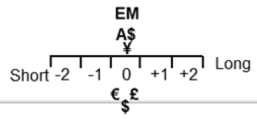
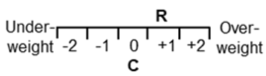
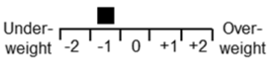
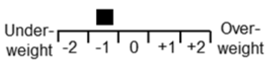
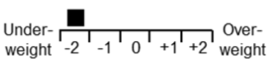
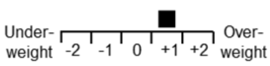
Venezuela's president, Nicolás Maduro, met with US 'Special Missions Envoy' Richard Grenell last week in Caracas. A deal was agreed on the acceptance of undocumented immigrants, as well as the release of six US citizens. Venezuela bonds gained more than half a cent last week. Notes maturing in 2027 were trading at 20 cents on the dollar, a rise of 0.8 cents.

After last week's tariff furore, Mexico president Claudia Scheinbaum's diplomatic efforts delayed US tariffs of 25% on the country until March. Meanwhile, China's authorities imposed retaliatory tariffs of 10%-15% on select US imports, as well as adding US firms to the ‘Unreliable Entity’ list and filing a complaint with the World Trade Organisation.

In the week ahead, CPI data will roll out from Hungary, India and Poland. Key central bank meetings involve the Philippines, Peru, Uruguay and Romania. Presidential elections will be held in Ecuador on Sunday, with polls expecting the re-election of market-friendly Daniel Noboa.

Fixed Income Asset Allocation Views

10th February 2025

Strategy and positioning (relative to risk free rate)		Views	Risks to our views
Overall Fixed Income Spread Risk		▪ Spreads remain near generational tights to start the year. Volatility remains below the early November peak and fundamentals remain stable. ▪ **The group remains negative on credit risk overall, with no changes to underlying sector outlooks.** ▪ The Federal Reserve has decreased to policy rate by 100bps since September. The CTI Global Rates base case view is that the pace and magnitude of additional cuts is uncertain and dependant on inflation data and labor market conditions. ▪ The group is monitoring Donald Trump's fiscal policy proposals and personnel appointments to anticipate 2025 policy rate path and industry differentiation.	▪ Upside risks: the Fed achieves a soft landing with no labour softening; lower quality credit outlook improves as refinancing concerns ease; consumer retains strength; end to Global wars ▪ Downside risks: Fed is not done hiking and unemployment rises, or the Fed pivots too early and inflation spikes. Restrictive policy leads to European recession. China property meltdown leads to financial crisis. 2024 elections create significant market volatility.
Duration (10-year) ('P' = Periphery)		▪ Longer yields to be captured by long-run structural downtrends in real yields ▪ Inflation likely to normalize over medium term, although some areas will see persistent pricing pressures	▪ Inflationary dynamics become structurally persistent ▪ Labour supply shortage persists; wage pressure becomes broad and sustained ▪ Fiscal expansion requires wider term premium ▪ Long run trend in safe asset demand reverses
Currency ('E' = European Economic Area)		▪ Dollar has been supported by US growth exceptionalism and depricing of the Fed while the ECB looks set to embark on a cutting cycle. ▪ Dollar likely to continue to be supported into year end, where a Trump presidency looks most likely, and with it a return to tariffs and America First policy.	▪ Central banks need to keep rates at terminal for much longer than market prices, to the detriment of risk and growth and to the benefit of the Dollar
Emerging Markets Local (rates (R) and currency (C))		▪ Disinflation under threat but intact; EM central banks still in easing mode. ▪ Real yields remain high. ▪ Selected curves continue to hold attractive risk premium.	▪ Global carry trade unwinds intensify, hurting EMFX performance. ▪ Stubborn services inflation aborts EM easing cycles. ▪ Uptick in volatility. ▪ Disorderly macro slowdown boosts USD on flight-to-safety fears
Emerging Markets Sovereign Credit (USD denominated)		▪ Index spreads rallied following the US election, despite Trump's protectionist platform, and remain at those cycle tights. ▪ The Group remains conservatively positioned and disciplined regarding valuations, reducing exposure where risk premium has compressed materially. ▪ Tailwinds: Strong primary market and growth outlook, disinflation, IMF programs. ▪ Headwinds: US trade policy & USD strength, variation in monetary policy paths, Middle East tensions, higher debt to GDP ratios, wider fiscal deficits, slow restructurings.	▪ US trade policy aggression strengthens USD against EM currencies. ▪ EM policy makers constrained by currency pressure; rates remain tight. ▪ Fiscal concerns leak into local risk premia.
Investment Grade Credit		▪ Spreads are at the tightest levels since 1998. Current valuations limit spread compression upside and provide little compensation for taking additional risk. ▪ 2024 earnings and upgrades have been above expectations. Results and commentary from issuers do not indicate fundamental deterioration. ▪ IG analysts expect strong fundamentals and decade-low leverage for 2024 / 2025. ▪ The Group is keeping an eye on post-election industry differentiation.	▪ Tighter financial conditions lead to European slowdown, corporate impact. ▪ Lending standards continue tightening, even after Fed pauses hiking cycle. ▪ Rate environment remains volatile. ▪ Consumer profile deteriorates. ▪ Geopolitical conflicts worsen operating environment globally.
High Yield Bonds and Bank Loans		▪ The current rich valuations are misaligned with a cautious fundamental outlook. ▪ Earnings season performed within expectations; however, the group still has a cautious view of fundamentals given management guidance, CTI default forecasts, and the increase in lender-on-lender violence and liability management exercises. ▪ Weaker outlook for cyclical industrial and consumer sectors. ▪ The Group is conservatively positioned but remains open to attractive high quality relval opportunities, particularly sectors experiencing near-term volatility. Prefer loans due to cheaper relative valuations and strong market technicals.	▪ Lending standards continue tightening, increasing the cost of funding. ▪ Default concerns are revised higher on greater demand destruction, margin pressure and macro risks ▪ Rally in distressed credits, leads to relative underperformance ▪ Volatility in the short end of the curve, eroding potential upside where we are positioned for carry.
Agency MBS		▪ Agency MBS ended 2024 with positive excess return and spreads 11bps tighter YoY. ▪ The Group remains positive on Agency MBS because the carry and convexity are still attractive, and prepayment risk is low because of elevated mortgage rates. Valuations are still cheap relative to longer term averages. ▪ Prefer call-protected Inverse IO CMOs, a large beneficiary of aggressive cutting cycle. Difficult to increase position sizing as few holders are willing to sell into the current rate environment.	▪ Lending standards continue tightening even after Fed pauses hiking cycle. ▪ Fed fully liquidates position. ▪ Market volatility erodes value from carrying. ▪ More regional bank turmoil leads to lower coupons to underperform.
Structured Credit Non-Agency MBS & CMBS		▪ Neutral outlook because of decent fundamentals and relval in select high quality issues. ▪ RMBS: Spreads near 2024 tights. Fundamental metrics, such as delinquencies, prepayments, and foreclosures remain solid overall. Pockets of weakness emerging. ▪ CMBS: Spreads tighter MoM. Stress continues, particularly in office, floaters, and near-term maturities. SASB delinquencies are rising and there are pockets of opportunity in SFR. ▪ CLOs: Demand remains high given relative spread to other asset classes; strong technicals. Defaults remain low, but CCC buckets are rising with lower recoveries. ▪ ABS: 60+ Day delinquencies are elevated, driven by inflation and credit score drift. Spreads tighter over the past month; the group prefers higher quality, liquid securities.	▪ Weakness in labour market ▪ Consumer fundamental position (especially lower income) weakens with inflation and Fed tightening. Consumer (retail/travel) behaviour fails to return to pre-covid levels ▪ Student loan repayments weaken consumer profile more than anticipated, affecting spreads on a secular level. ▪ High interest rates turn home prices negative, punishing housing market. ▪ Cross sector contagion from CRE weakness.

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