In Credit

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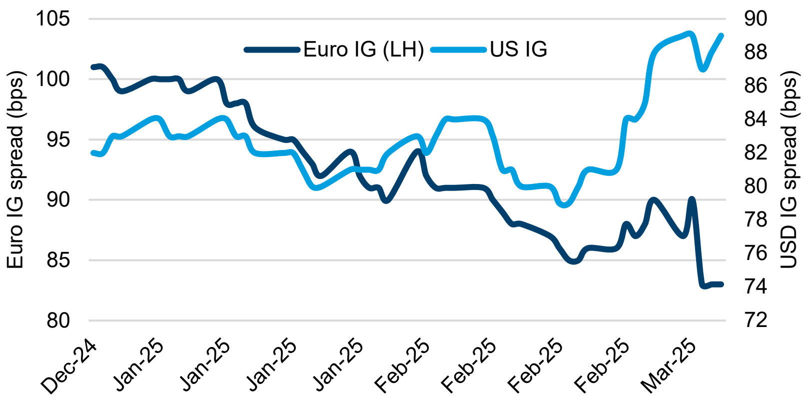
A week of divergence

Markets at a glance

	Price / Yield / Spread	Change 1 week	Index QTD return*	Index YTD return
US Treasury 10 year	4.24%	3 bps	2.2%	2.2%
German Bund 10 year	2.81%	41 bps	-2.6%	-2.6%
UK Gilt 10 year	4.63%	15 bps	0.6%	0.6%
Japan 10 year	1.58%	20 bps	-2.7%	-2.7%
Global Investment Grade	88 bps	-1 bps	1.3%	1.3%
Euro Investment Grade	83 bps	-7 bps	-0.2%	-0.2%
US Investment Grade	89 bps	1 bps	2.0%	2.0%
UK Investment Grade	81 bps	1 bps	1.0%	1.0%
Asia Investment Grade	119 bps	3 bps	2.2%	2.2%
Euro High Yield	308 bps	2 bps	1.3%	1.3%
US High Yield	297 bps	10 bps	1.7%	1.7%
Asia High Yield	520 bps	-11 bps	3.2%	3.2%
EM Sovereign	297 bps	-2 bps	2.7%	2.7%
EM Local	6.4%	2 bps	4.7%	4.7%
EM Corporate	251 bps	-3 bps	2.3%	2.3%
Bloomberg Barclays US Munis	3.6%	9 bps	1.0%	1.0%
Taxable Munis	5.0%	10 bps	2.4%	2.4%
Bloomberg Barclays US MBS	33 bps	2 bps	2.4%	2.4%
Bloomberg Commodity Index	256.42	2.1%	6.9%	6.9%
EUR	1.0846	4.4%	4.6%	4.6%
JPY	146.91	1.7%	6.2%	6.2%
GBP	1.2940	2.7%	3.2%	3.2%

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

Chart of the week: Euro IG versus US IG Spreads YTD



Source: ICE BofAML and Bloomberg, as of 7 March 2025

Macro/government bonds

Events in Europe were the principal bond market driver over the past week. The cracking of the Transatlantic Alliance in the new Trump era of transactional politics has led to a turning point in European politics. Germany's chancellor-elect, Friedrich Merz, from the conservative CDU party, announced a €500 billion infrastructure fund, which will include an allocation for defence. This built on comments he previously made on amending Germany's debt brake, arguing that defence spending could be specifically excluded. The realisation in the market that an abrupt shift in European fiscal policy would likely result in higher structural deficits led to a jump in longer-dated bond yields, with the German 10-year finishing the week 43bps higher. Alongside Germany, the European Union (EU) agreed to an €800 billion plan to bolster defence capabilities across member states, while Poland announced plans to provide military training to all adult males. Mirroring the German rise, the yield on the UK 10-year rose 16bps as the country committed to spending more on defence. The once unthinkable prospect of Europe being solely responsible for its own defence has became a more concrete prospect.

We also had the European Central Bank (ECB) decision on interest rates, which reduced its deposit rate by 0.25% to 2.5%. Bank president, Christina Lagarde, provided context for the debate around the monetary policy decision: first, disinflation remains on track; second, monetary policy has become increasingly less restrictive; and third, the EU faces significant uncertainty in terms of geopolitical risk and trade policy uncertainty. She also emphasised that rates had come down by 150bps since the ECB began the process of easing monetary policy. The headwinds of uncertainty and sticky services inflation meant the bank remained firmly in 'data dependent' mode.

The steepening that took place in Europe and the UK was also reflected in the US. Perhaps another word for steepening over the past week could simply have been uncertainty, with Trump delaying the implementation of tariffs on Canada and Mexico until 2 April. Treasury secretary, Scott Bessent, pitched the tariffs as a one-time price adjustment. Jay Powell, Chairman of the Federal Reserve, however, was more circumspect. He stated that the Fed was well positioned to wait for greater clarity on changes to fiscal, trade and immigration policy before they would factor such changes into monetary policy. The dominant narrative in the US Treasury market is that policy uncertainty and tariffs will result in cooling economic growth. Although the current economic backdrop remains healthy enough, there has been a continued drip-drip of less constructive economic data. Readings on the manufacturing sector, unemployment and underemployment came in weaker than expected. Although Trump tried to dismiss the prospect of any downturn as short-term turbulence, market price action suggested he is not winning the debate for now.

Investment grade credit

Amid the volaility seen in equities, foreign exchange and government bonds (see above), the IG credit market was a somewhat calmer place. What has been notable is that euro credit continues to outperform – at least when measured on a spread-to-government basis. Looking at the year-to-date, euro credit spreads are 18% tighter while the US dollar market has seen spreads widen by around 9%, according to data from ICE indices (**see Chart of the week**). This move also reflects the on-going tightening of euro swap spreads, which are now trading more than 10bps through German government bonds at the 10-year tenor. Why has this happened? Our suspicion is that German government bonds are cheapening relative to swaps and credit markets, as investors worry about the supply implications of the policy shift outlined in the country.

Higher European yields, driven by higher government bond yields, are attracting yield/income buyers, which continues to support the market. However, these higher yields have led to some weakness in European real estate, which is seen as exposed to these higher borrowing costs.

High yield credit and leveraged loans

US high yield bond spreads widened for the third consecutive week to year-to-date highs of +316bps, as oscillating trade war rhetoric and rising growth concerns weighed on sentiment.

The ICE BofA US HY CP Constrained Index returned -0.3% and spreads were 10bps wider on the week. The index yield-to-worst increased 14bps to 7.27%. According to Lipper, US high yield bond retail funds saw a $1.8 billion inflow over the week. This marked a seventh consecutive weekly inflow and the largest in three months. Leveraged loan prices declined $0.3 over the week amid ETF outflows and rising US growth risks, as well as potential associated Fed easing. Retail floating rate funds overall saw just $60 million contributed – the second lowest net flow over the past three months. Floating rate ETFs, however, saw $841 million of outflows.

European HY proved relatively resilient over the past week, in spite of the sharp rise in underlying government yields – the largest one-week move in 25 years – returning -0.48% for the first week of March, with spreads widening only +2bps to 308bps. This compared to a -1.15% return for Euro IG.

Due to higher government bond yields, HY yields ended 20bps higher at 6.21%. Flows into the asset class continued, although slowed to only €91 million. Again, this was due to managed accounts as ETFs continued to experience outflows. After a very quiet February, the primary market picked up with three deals (Aramark, Celanese and Sappi) totalling €1.2 billion. More deals are waiting in the wings with at least six new issues expected in the coming week.

There was good news for the European auto industry, as European Commission president, Ursula von der Leyen, said the bloc would grant carmakers a three-year window in which to hit carbon dioxide emissions targets. These targets were originally set for this year. In more specific auto news, Forvia announced more asset disposals in an effort to slash debt.

In credit rating news, Very Group (SHODFP) was downgraded to CCC+ from B- by Fitch with a negative outlook, due to a portion of the working cap facility having gone with refinancing of the group’s debt still unresolved.

Earnings reports for the leisure sector continue to come in ahead of expected – for example, Lottomatica and Flutter Entertainment – accompanied by strong FY25 guidance.

Asian credit

The JACI index posted 13bps of returns for the week (IG was +5bps and HY +65bps), thanks to the strong performance of Asia HY. The NWDEVL (New World Development bonds) were among the outperformers for the week.

The National People’s Congress (NPC) in China has concluded and, in-line with consensus, the Government Work Report (GWR) revealed a growth target of around 5% for 2025. This is similar to 2023 and 2024. There were limited surprises in other economic targets for the year, such as the 2% inflation target (in 2024 it was around 3%), a 4% fiscal deficit target (2024 was again around 3%) and more special treasury bond issuance. Specifically, the quota for the Central Government Special Bonds (CGSBs) has been increased to CNY1,300 billion in 2025 (up from CNY1,000 billion in 2024). The CGSBs will cover the trade-in programs (CNY500 billion) and major strategic projects (CNY800 billion related to railways, highways and airports). Additionally, another CNY500 billion of special treasury bonds will be issued to recapitalise banks.

The NPC also called for tech innovation and the development of AI models and next-generation intelligent products (edge computing). In terms of the property sector, a quota of CNY4,400 billion is set for the issuance of local government special bonds (LGSBs). Local governments can access the LGSB funding to finance inventory purchase and land, either undeveloped and/or idle land from property developers.

Baidu issued US$2 billion of bonds (a zero-coupon maturing in 2032) that are exchangeable to the ordinary shares of Trip.com, which are listed on the HKSE. However, the bonds are not exchangeable for the American Depositary Shares of Trip.com. The issuance allows Baidu to potentially reduce its stake in Trip.com from 7.1%. Additionally, Baidu issued CNY10 billion of domestic bonds (CNY7.5 billion of 2030 notes and CNY2.5 billion of 2035 notes). It will use the net proceeds for debt refinancing – around US$1.1 billion of near-term US dollar bond maturities – interest payments and general corporate purposes.

Fitch has affirmed the BBB- ratings for both Adani Energy Solutions Ltd (AESL) and Adani Electricity Mumbai Ltd (AEML) and moved their respective ratings outlooks from ‘Watch Negative’ to ‘Negative’. Fitch had put the two companies on ‘Watch Negative’ in December 2024 to reflect the potential for a material deterioration in their near- to medium-term funding access due to the US Department of Justice probe on Adani Green Energy Ltd. In removing the ‘Watch Negative’, Fitch stated that both companies continue to benefit from adequate access to funding since the US indictment of Gautam Adani and Sagar Adani.

In the primary market, Hysan issued US$750 million of subordinated perpetual debt to fund the tender offer of its old 4.1% perpetual. Cikarang Listrindo also successfully issued US$350 million of 10-year bonds to redeem the 2026 notes.

Emerging markets

Geopolitical tensions continue to set the tone for emerging markets (Ems). Last week saw an outperformance for local currency in EMs, adding 1.85%. EM sovereigns returned -0.34% on the week in US dollar terms.

A potential ceasefire in Ukraine remains a key story in EM. EU leaders gathered in Brussels last week to reaffirm support for Ukrainian president, Volodymyr Zelenskyy, following US president Trump's pause in US military aid to Ukraine.

Elsewhere, the first wave of Trump's tariffs came into effect on 4 March. Goods from Mexico, Canada and China were hit with 25% tariffs, as well as an additional 10% on Chinese goods. Within 24 hours, however, the US had issued a 30-day exemption on auto imports from Mexico and Canada. Markets expect tariff uncertainty to persist. Mexico's 2037 dollar bonds lost 1.2% following the tariff implementation but recovered the losses following the exemption news.

As reported in Asian credit, China's annual National People's Congress (NPC) met last week. The Government Work Report was published on 5 March and set China's 2025 GDP growth target at 5% and increased the official fiscal deficit from 3% to 4% of GDP. Yields on China's 10-year government bond jumped by 6bps on Friday 7 March to 1.83% as the People's Bank of China appeared hesitant to cut interest rates further.

Panama's bonds rallied last week after CK Hutchison Holdings handed over the control of ports near the Panama Canal to a consortium led by BlackRock. Dollar bonds due in 2035 gained 0.6% following the news. Despite this, Trump remains committed to ‘taking back’ the canal.

As expected, the Central Bank of the Republic of Turkey delivered its third consecutive rate cut of 250bps, continuing its path of measured monetary policy easing. In terms of new issues, Armenia came to market.

Looking to the week ahead, markets await more monetary policy news from the NPC meeting in China. Central bank policy rate meetings will be held in Poland and Peru.

Responsible investments

Last week, Wells Fargo announced they would no longer pursue a number of net zero-related goals. This comes after a number of months of increasing pressure from the Republican party in the US to steer away from strict climate policies in favour of energy security. The company announced it would discontinue their goal to achieve net zero carbon emissions by 2050 for financed emissions, along with a handful of interim targets. Sustainable finance from the bank will continue, for now, with a target of $500 billion deployed by 2030. So far it has issued $178 billion, according to Bloomberg.

Fixed Income Asset Allocation Views

10th March 2025

COLUMBIA THREADNEEDLE INVESTMENTS

Strategy and positioning (relative to risk free rate)		Views	Risks to our views
Overall Fixed Income Spread Risk	Under-weight -2 -1 0 +1 +2 Over-weight	▪ Spreads remain near generational tights. Volatility has continued to fall so far this year, and fundamentals remain stable. ▪ The meeting focussed on strategies to navigate tight spreads without a clear catalyst for widening. The group refers higher quality and shorter duration assets. ▪ **The group improved the outlook for High Yield and Emerging Market credit but remains negative on credit risk overall.** ▪ The Federal Reserve paused their rate cutting cycle in January. 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.	▪ 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)	¥ £ Short -2 -1 0 +1 +2 Long P $ €	▪ 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)	EM A$ ¥ Short -2 -1 0 +1 +2 Long € £ $	▪ 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))	R Under-weight -2 -1 0 +1 +2 Over-weight 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)	Under-weight -2 -1 0 +1 +2 Over-weight	▪ The group upgraded the outlook to neutral due to improved fundamentals, as technical remain healthy and valutations remain rich. ▪ The group has a neutral position in the sector, reducing exposure where risk premium has compressed materially and switching into compelling high yield opportunities. ▪ Tailwinds: Strong primary market and growth outlook, ratings trends, 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	Under-weight -2 -1 0 +1 +2 Over-weight	▪ Spreads remain near tights of this cycle. Current valuations limit spread compression upside and provide little compensation for taking on additional risk. ▪ 2024 earnings are within expectations. Results and commentary from issuers do not indicate fundamental deterioration. ▪ IG analysts expect strong fundamentals and decade-low leverage for 2025. ▪ Most global portfolios prefer Euro IG	▪ 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	Under-weight -2 -1 0 +1 +2 Over-weight	▪ The group upgraded the outlook because of a strong start to the earnings season, however they remain cautious on high yield given rich valuations, tariff risks, and the lingering threats of lender-on-lender violence and LME. ▪ Weaker outlook for cyclical industrial and consumer sectors. ▪ The Group is conservatively positioned but remains open to attractive high quality relval opportunities, particularly in 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	Under-weight -2 -1 0 +1 +2 Over-weight	▪ Agency MBS has had a positive start to the year, with spreads modestly tighter MoM. ▪ 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	Under-weight -2 -1 0 +1 +2 Over-weight	▪ Valuations are rich; the group prefers higher quality, liquid securities with good carry. ▪ RMBS: Spreads near YTD tights.. Fundamental metrics, such as delinquencies, prepayments, and foreclosures remain solid overall. Pockets of weakness emerging. ▪ CMBS: Spreads tighter YTD. Technicals are better with strong issuance. Stress continues, particularly in office, floaters, and near-term maturities. ▪ CLOs: Strong ETF inflows keep pushing spreads tighter. 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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