Information for investment professionals

In Credit

20 January 2025

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Markets at a glance

	Price / Yield / Spread	Change 1 week	Index QTD return*	Index YTD return
US Treasury 10 year	4.58%	-17 bps	0.0%	0.0%
German Bund 10 year	2.53%	-7 bps	-1.0%	-1.0%
UK Gilt 10 year	4.66%	-17 bps	-0.2%	-0.2%
Japan 10 year	1.19%	-1 bps	-0.6%	-0.6%
Global Investment Grade	86 bps	-2 bps	-0.1%	-0.1%
Euro Investment Grade	95 bps	-4 bps	-0.3%	-0.3%
US Investment Grade	82 bps	-1 bps	0.0%	0.0%
UK Investment Grade	79 bps	-2 bps	0.0%	0.0%
Asia Investment Grade	117 bps	11 bps	0.2%	0.2%
Euro High Yield	320 bps	-5 bps	-0.1%	-0.1%
US High Yield	264 bps	-17 bps	0.9%	0.9%
Asia High Yield	547 bps	22 bps	-0.4%	-0.4%
EM Sovereign	295 bps	3 bps	0.2%	0.2%
EM Local	6.4%	-1 bps	0.0%	0.0%
EM Corporate	242 bps	8 bps	0.2%	0.2%
Bloomberg Barclays US Munis	3.8%	-3 bps	-0.3%	-0.3%
Taxable Munis	5.2%	-14 bps	-0.2%	-0.2%
Bloomberg Barclays US MBS	42 bps	-4 bps	0.0%	0.0%
Bloomberg Commodity Index	249.53	1.3%	5.2%	5.2%
EUR	1.0350	0.3%	-0.8%	-0.8%
JPY	155.94	0.9%	0.6%	0.6%
GBP	1.2237	-0.3%	-2.8%	-2.8%

Source: Bloomberg, ICE Indices, as of 17 January 2025. *QTD denotes returns from 31 December 2024

Chart of the week: Gilt Yields

Source: Bloomberg, as of 20 January 2025

Macro/government bonds

The momentum to higher US Treasury yields last week was arrested by a mix of weaker than expected economic data and dovish comments from leading policy makers at the Federal Reserve. The catalyst for the break in yields was core CPI data, which came in weaker than expected at 0.2% for December, translating into an annualised rate of 3.2%. In addition, headline retail sales also surprised to the downside. Positive sentiment towards US Treasuries was helped by comments from New York Fed president, John Williams, and Fed governor, Chris Waller; both men delivered a message that the process of disinflation remained on track, with Waller also making the point that 2% inflation could be reached faster than many in the market were anticipating. The shadow in the background remained President Trump and what his policies would mean in practice for inflation and the fiscal deficit. Over the course of the week, the yield on the US 10-year fell 13bps to 4.63%, while the broader yield curve experienced a gentle flattening.

The high level of correlation between the US Treasury market and other core bond markets meant that renewed strength in the US was replicated globally. In the UK, the yield on the 10-year gilt fell 18bps to 4.67%. The driver behind this outperformance was an expected slowdown in UK inflation to 2.5% versus expectations of 2.6%. In addition, UK growth for November effectively continued to flatline at 0.1%, while growth in the three months to the end of November was zero. The news on inflation was widely welcomed in the bond market, news on the economy less so as it implied lower revenues for the government, which might necessitate higher gilt issuance. The combination of weaker data and lower inflation meant the market nudged forward its rate cut expectations, pricing in the greater probability of two quarter point rate cuts by mid-June.

Yields in Europe were also lower, but the magnitude less so. The German 10-year fell 6bps to end the period at 2.5%. Just as in the US, policy makers at the European Central Bank helped channel investors' views on monetary policy. Luis de Guindos, ECB vice president, affirmed that the balance of risks had shifted from high inflation to low growth, while Isabel Schnabel, a senior policy maker widely regarded as being in the more hawkish wing of ECB policy makers, could not see any major risks that would prevent the ECB from reaching its 2% inflation target. This reflects the widespread unanimity in the market that a quarter point rate cut at the bank's January meeting in just under two weeks is effectively a done deal.

Investment grade credit

It has been an interesting year thus far in investment grade credit, in that nothing has yet really happened! The government bond market continues to exhibit volatility as investors search for clues about inflation, interest rates and the direction of 'Trumponomics'. All the while, the credit market has undergone its usual seasonal pattern of high levels on new issuance after a festive lull and the start of earnings season. So far, there has been around €45 billion and $47 billion of issuance against a backdrop of our estimates of circa €150 billion and $600 billion of net supply in 2025 as a whole. This would be a 5%-6% increase in market size, which would be running ahead of nominal GDP and a similar amount to 2024. The issuance thus far has been met with strong investor demand and a consequent low level of new issue premia.

Last week, the large US banks released strong results. Profits were impressive, Citibank aside, and margins have crept higher at a time of robust markets business and high levels of capital all round. Asset quality remains less strong than normal and write-offs rose – albeit marginally and after a decline in the prior quarter. The banking sector was one of the strongest in 2024 and remains a focus of the primary market.

In conclusion, market spreads remain unattractive and it seems most likely that inflows into the market are yield-driven and aided, ironically, by some of the recent rise in government bond yields.

High yield credit & leveraged loans

US high yield bond valuations tightened sharply over the week as the mid-week CPI report showed easing inflation resulting in lower interest rates. Meanwhile, there was little fundamental concern at the start of earning season from early reporters, while new issuance was relatively subdued over the week. The ICE BofA US HY CP Constrained Index returned 0.86%, while spreads were 16bps tighter ending at +282bps. Despite lower rates, BB issues underperformed the lower quality portions of the market. According to Lipper, US high yield bond retail funds saw a sixth consecutive – albeit modest – weekly outflow of $60 million.

Leveraged loans remained stable despite the decline in rates and slight shift in Fed expectations for the year following the week's CPI data. The average price of the S&P UBS Leveraged Loan Index was stable at $96.5 over the week. Retail loan funds saw a $1.4 billion inflow with actively managed funds continuing to benefit.

European HY returned +0.26% as spreads tightened 3bps to 322bps and yields fell 7bps to 6.23%. Spread compression was back as CCCs outperformed lower beta credits and GBP HY outperformed Euro HY.

The theme seen so far in 2025 of outflows for ETFs but inflows for managed accounts continued. This resulted in net outflows of €302 million for last week. The primary market was subdued with only three deals totalling €1.35 billion. The pipeline suggests that the pace of issuance should pick up with four or five new offerings in the next seven to 10 days. As such, technicals continue to provide underlying support for the market given the low new issuance and the high available cash balances.

Good news in the gaming sector with Evoke (888) reporting a strong Q4 2024 and raising EBITDA guidance by mid-single digits. The company saw positive trends with revenue up 13 points to 14%. The chemicals sector fared less well with Kemone bonds down 7 points on reports the company has hired advisers to look at liquidity options following weak Q3 results.

On the rating changes front, 2024 saw rising stars dominate the crossover between IG and HY. Overall, the year saw €47 billion of rising stars versus €14.9 billion of falling angels. This was a surprise as 2024 was supposed to see a switch from the previous two years of rising star dominance.

Asian credit

The JACI delivered positive returns of 37bps for the week thanks to tighter core rates (+88bps), which offset spread decompression (-50bps).

In China, the trade-in program has been expanded to four categories of digital products: smartphones, tablets, smartwatches and wristwatches. According to the Ministry of Commerce of China, both domestic and foreign brands should get equal treatment in subsidies. That said, the trade-in program will largely benefit local brands as only those items priced below CNY6,000 (around $822) are eligible for a 15% subsidy.

Last week, the outgoing Biden administration announced additional restrictions on the exports of chips and AI technology. The 'Regulatory Framework for the Responsible Diffusion of Advanced Artificial Intelligence Technology' aims to control the amount of computational power that different categories of end-users can purchase, based on the tiering of countries. This complex framework seeks to create a licensing structure for the export of advanced AI chips and to position the US, as well as 18 allied nations in Tier One friendly jurisdictions, as the major base of data centre developments. For the majority of countries that fall into Tier Two, caps will be imposed on the levels of computing power that they can own and operate. At the other extreme, countries in Tier Three (US embargoed countries) are blocked from importing advanced chips. Additionally, on 15 January the Bureau of Industry and Security released additional rules on the export controls and added more Chinese entities to the list.

Meanwhile, TSMC reported a set of solid Q4 2024 results with bullish guidance on its 2025 and longer-term outlook The company expects FY25 revenue to grow by close to mid-20% year-on-year and its longer-term revenue growth will be around 20%, driven by its four platforms (smartphones, high performance computing, automotive and IoT). It maintains its long-term margin guidance at 53% or higher. TSMC expects AI revenue to increase by mid-40% over the next five years. With respect to the potential impact of the tightening of chip exports, TSMC views this as manageable and says it will help its affected customers to apply for special permits to purchase the restricted chips.

Emerging markets

Emerging market sovereigns returned 0.83% in US dollar terms on the week, with little change in spreads. EM local markets were also little changed, returning 0.38% in US dollar terms on the week.

Last week's ceasefire agreement between Israel and Hamas boosted sentiment towards the Middle East, with Egypt's international bonds jumping to more than a cent, up from the previous bid of $0.75. Jordan's 2047 bond jumped by two cents to $0.89. Lebanon continued to be an idiosyncratic story. Its bonds, which have been in default since 2020, rallied following the election of Joseph Aoun as president. This outperformance has continued as some bondholders are reportedly looking to engage with the government to restructure $30 billion in defaulted bonds.

Argentina delivered its first fiscal surplus in over a decade at 0.3% of GDP. President Milei achieved this through drastic cuts including reducing government jobs and slashing pension expenditures after taking office in December 2023. Bond prices remain little changed.

China hit its 5% growth target for Q4 2024, exceeding expectations and marking the fastest pace of growth in six quarters. This was largely attributed to a policy pivot and export boom as tariff threats caused global businesses to frontload shipments. Despite this, annual consumption growth (both CPI and PPI) remained below pre-pandemic levels and deflation persisted for a second year. As tariffs loom, China's fragile recovery hangs in the balance with the government set to announce its annual growth targets in March.

Last week, Poland, Romania and Korea held interest rates, but Indonesia delivered a surprise 25bps cut to support domestic growth. Markets expect a 250bps cut from Turkey this week.

In terms of new issues, Benin entered the market as the first issuer from Africa and the first high-yield issuer this year.

In the week ahead, all eyes will be on the Trump inauguration and the pace of change in geopolitical, trade and economic policies.

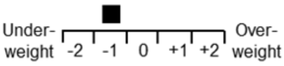
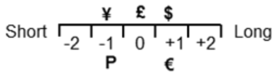
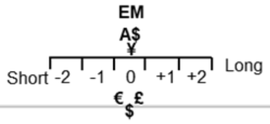
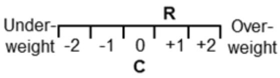
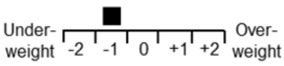
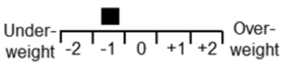
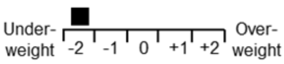
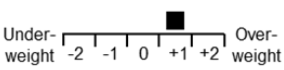
Responsible investments

An internal review of the Net Zero Asset Managers Initiative (NZAM) is taking place, with all ongoing activities and reporting removed from the website until the review is complete. Larger asset managers have in recent months been calling on the organisation to assess its suitability in current markets given the initiative started nearly five years ago. Current signatories will be updated once decisions have been made.

Around $92 billion of ESG-labelled debt has been raised so far in 2025. This is a similar level as this time last year, showing an ongoing strong appetite for ringfenced use-of-proceeds bonds. In contrast, however, of the total so far raised a much lower portion is attributed to green bonds ($32 billion) than at the same stage last year ($48 billion). Last week we saw a $2 billion social bond issue from International Finance Corp, with use of proceeds targeting emerging market nations and those most deprived.

Fixed Income Asset Allocation Views

20th January 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.	▪ Global election calendar (US, LATAM) ▪ Weak action from Chinese govt, no additional support for property and commercial sectors ▪ China/US relations deteriorate. ▪ Spill over from Russian invasion and Israel-Hamas war: local inflation (esp. food & commodity), slow global growth. ▪ Potential for the start of a new war in the conflict between Israel and Iran.
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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