In Credit

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David Oliphant
Executive Director,
Fixed Income

Contributors

David Oliphant
Investment Grade Credit

Simon Roberts
Macro/Government Bonds

Angelina Chueh
Euro High Yield Credit

Chris Jorel
US High Yield Credit,
US Leveraged Loans

Kris Moreton
Structured Credit

Justin Ong
Asian Fixed Income

Charlotte Finch
Responsible Investments
Investment Grade Credit

Gary Smith
General Fixed Income

Priyanka Prasher
Emerging Markets

Sarah McDougall
General Fixed Income

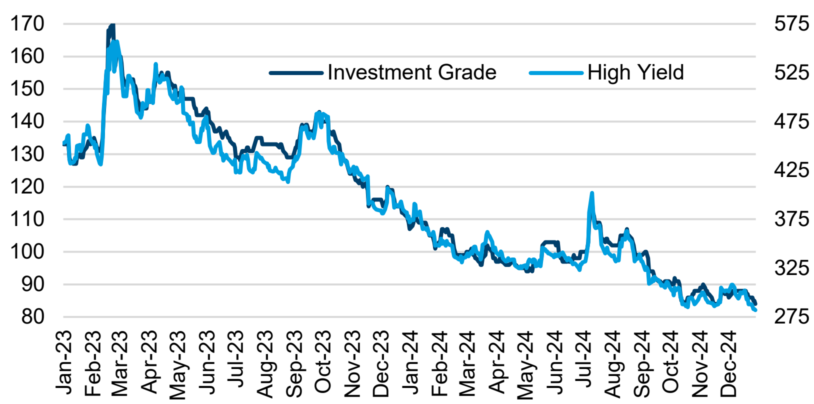
Long rally runnin'

Markets at a glance

	Price / Yield / Spread	Change 1 week	Index QTD return*	Index YTD return
US Treasury 10 year	4.53%	-10 bps	0.1%	0.1%
German Bund 10 year	2.53%	0 bps	-1.3%	-1.3%
UK Gilt 10 year	4.59%	-8 bps	0.0%	0.0%
Japan 10 year	1.21%	1 bps	-0.6%	-0.6%
Global Investment Grade	84 bps	-2 bps	0.1%	0.1%
Euro Investment Grade	94 bps	-2 bps	-0.3%	-0.3%
US Investment Grade	80 bps	-2 bps	0.2%	0.2%
UK Investment Grade	79 bps	-1 bps	0.3%	0.3%
Asia Investment Grade	117 bps	-1 bps	0.2%	0.2%
Euro High Yield	311 bps	-11 bps	0.2%	0.2%
US High Yield	260 bps	-4 bps	1.2%	1.2%
Asia High Yield	552 bps	6 bps	-0.7%	-0.7%
EM Sovereign	290 bps	-5 bps	0.7%	0.7%
EM Local	6.3%	-9 bps	2.8%	2.8%
EM Corporate	240 bps	-2 bps	0.5%	0.5%
Bloomberg Barclays US Munis	3.8%	-4 bps	-0.1%	-0.1%
Taxable Munis	5.2%	0 bps	-0.1%	-0.1%
Bloomberg Barclays US MBS	35 bps	-7 bps	0.0%	0.0%
Bloomberg Commodity Index	246.79	-0.2%	5.0%	5.0%
EUR	1.0490	2.2%	1.4%	1.4%
JPY	154.61	0.2%	0.8%	0.8%
GBP	1.2496	2.6%	-0.3%	-0.3%

Source: Bloomberg, ICE Indices, as of 24 January 2025. *QTD denotes returns from 31 December 2024

Chart of the week: Spread levels in IG and HY since 2023



Source: Bloomberg, as of 27 January 2025

Macro/government bonds

US Treasury yields were marginally unchanged on the week with the US 10-year closing at 4.62%. The market was relatively stable after recent weeks, as President Trump continued to outline his programme. The tone has been “America First” with tariffs presented as bargaining chips that can be used to improve the US’s terms of trade and her ability to draw in foreign direct investment (FDI). On tariffs, Trump suggested 10% might be appropriate for China, while he threatened to levy 25% on Columbia after its government initially refused to accept illegal migrants on a US military jet (see Emerging markets). Trump’s power to shock has diminished, with the market learning to live a little easier with policy uncertainty. The market regards Trump’s pro-growth agenda as broadly inflationary, while economic data also remains buoyant. The US manufacturing PMI edged across the 50 demarcation point that separates expansion from contraction. There was no change to US interest rate expectations, with the market continuing to price in two quarter-point rate cuts by the end of December.

In Europe, eurozone bond yields were broadly unchanged with the German 10-year finishing the week at 2.53%. Policy makers met at Davos for the World Economic Forum. Christine Lagarde, president of the European Central Bank, told her audience that inflation is still primed to hit 2% this year. Despite the headwinds facing the eurozone economy, however, the ECB remains in hawkish cutting mode, not wishing to step too far out of line with the Fed for fear of putting downward pressure on the exchange rate, while keeping one eye on uncertainty surrounding the ongoing tariff “dance”. The market continues to price in three rate cuts by year-end for the ECB.

In the UK there was more stability to the UK gilt market. The market remains sceptical as to the UK government’s growth plan, but inflation is expected to fall as economic slack increasingly opens up. The Bank of England is expected to cut interest rates by a quarter point at its next meeting in February, with another two quarter-point cuts expected by end of December. Alongside a more stable gilt market, we also saw recovery in the sterling exchange rate against the US dollar.

In a widely expected move, the Bank of Japan raised interest rates by 0.25% to 0.5%, as policy makers seek to combat sticky inflation pressures in the economy. The process of monetary policy tightening is not yet over, with the market currently pricing in one more quarter-point rate hike by October.

Investment grade credit

Another week, another grind tighter in spreads (see **Chart of the Week**), which ended last week 2bps better for the global index, according to data from ICE indices. The lack of an immediate introduction of trade tariffs from the new US administration seems to have supported all ‘risk’ assets, including investment grade credit.

So far in 2025 global IG spreads are 5% tighter, led by the euro market which is 9% better while its US dollar cousin is ‘only’ 2% better. Looking at industry sectors globally, all are tighter this year aside from utilities which are flat. Other laggards include insurance and telecoms. The ‘winners’ have been banking (-8%) after a strong US earnings season, autos and capital goods. Notably, corporate hybrids and AT1s have performed very well in this ‘risk-on’ environment.

This week will see a ramping up of earnings season. In specific news, Italian bank Monte Dei Paschi made an all-share approach to acquire rival Mediobanca.

High yield credit & leveraged loans

US high yield bond spreads tightened to a new post-global financial crisis low over the week as valuations benefited from light new issuance, fund inflows and supportive macroeconomic data.

The ICE BofA US HY CP Constrained Index returned 0.34% while spreads were 5bps tighter, ending at +278bps. According to Lipper, US high yield bond retail funds saw inflows following six consecutive weekly outflows, with $1.4 billion contributed, largely via ETFs. Leveraged loans remained stable amid light new issuance and ongoing inflows. The average price of the S&P UBS Leveraged Loan Index was stable at $96.6 over the week. Retail loan funds saw a $1.6 billion inflow with the asset class seeing $13.4 billion of inflows over the past 11 weeks.

European HY repeated last week's performance with another +0.26% return, as spreads tightened 11bps to 311bps and yields fell 4bps to 6.19%. Spreads have now tightened to levels not seen since the end of September 2021. It was also another week of spread compression as CCCs outperformed BBs by three times and Bs by two times, in terms of return. GBP HY also outperformed Euro HY.

Since the start of the year, EHY ETFs have experienced net outflows while managed accounts saw inflows. On the week, EHY saw net outflows of €143 million with ETF flows dominating. Primary market issuance picked up with four deals amounting to the equivalent of €2 billion. All offerings were well received, coming inside of initial price talk, with the majority of bonds rated in the broad B range.

There were more worries in the auto sector space as German auto parts supplier Schaeffler cut its guidance. However, the weakness is coming from their bearings and industrial solutions divisions rather than from the auto sector.

On the credit rating front, French satellite operator Eutelsat was downgraded two notches to B1 by Moody's. Weakness looks likely to continue for the firm and for European satellite businesses in general, with competition from Elon Musk's Starlink continuing to be a big challenge. Thames Water's rating also continues to deteriorate with Moody's dropping the issuer two notches to Caa3. The business is already rated CC at S&P. The downgrade came on the back of regulator Ofwat's decision to not accept the utility firm's spending allowance request, instead reducing it by 16.4%. Thames Water will also continue to be at risk of heavy penalties under the outcome delivery incentives (ODI) framework.

Asian credit

The JACI posted a marginal positive return of 2bps for the week, with IG at +5bps and HY at -13bps. Spread return was 19bps, which was slightly above the Treasury loss of -17bps.

In the China property sector, Vanke's liquidity distress has led to further talks among the Shenzhen government, the Shenzhen Metro Group and Vanke itself to lay out further steps to stabilise its operations. Shenzhen Metro Group, a local state-owned enterprise, is the largest shareholder in Vanke with around a 27% stake. There are plans to bring in new auditors and financial advisors to assess Vanke's financial situation and property projects.

South Korean chip manufacturer SK Hynix reported positive momentum in AI demand for its premium high bandwidth memory (HBM) chips in Q4 2024, which compensated for the softer demand for its conventional chips. For 2025, SK Hynix expects its HBM revenue to increase more than 100% year-on-year, boosted by demand from customers for ASICs (Application Specific Integrated Circuits). However, the company expects the inventory adjustments in PCs and smartphones to be a drag on demand for conventional memory chips.

In India, Moody's revised the outlook of Bharti Enterprises' Baa3 rating to positive from stable thanks to improvement in its financial profile and growth in its market share, which was up to 37% in September 2024 from 33% in March 2020.

Panama Ports Company (PPC), which is owned by Hutchison Ports, operates the Cristobal and Balboa ports that sit at each end of the Panama Canal. Hutchison Ports' concession for the two ports was renewed for 25 years in 2021. President Trump, during his inauguration speech, mentioned taking back the Panama Canal from China, alluding to the latter's influence over the canal. However, the Panamanian government rejected Trump's statement on the sovereignty issue of the canal. On a related note, the Panamanian Comptroller's Office announced the launch of a review and audit to ensure transparency. PPC stated it remains committed to port operations in Panama and will cooperate with the audit.

Emerging markets

Uncertainty around US president Trump's policy action led to a risk-off across emerging markets. EM sovereign credits ended the week up 0.3% with credit spreads 5bps tighter overall. EM local returned 2.81% in US dollar terms on the week.

Colombia narrowly averted a diplomatic crisis with the US on Sunday night. Trump announced via social media that he would set 25% emergency tariffs on all Colombian goods after Colombian president, Gustavo Petro, revoked authorisation for two military planes carrying deported migrants to land. Trump called for a travel ban and immediate visa revocations on Colombian government officials, as well as visa sanctions on supporters and family of Petro. Three hours later, Petro announced retaliatory tariffs of 25% on US goods. After reaching a deal on the return of the migrants, Trump pulled his threat. The US is Colombia's main trading partner, while Colombian trade accounts for less than 1% of US exports and imports. The Colombian peso is expected to weaken against the dollar as traders brace for a volatile session.

Tariffs had previously been expected for Canada, Mexico and China but also appear to be an all-purpose vehicle for foreign policy.

Across EMs ratings have trended positive over the past 12 months. Moody's upgraded Kenya to positive, citing reduced liquidity risks and a better ability to manage fiscal challenges.

However, last week S&P downgraded Romania from "stable" to "negative" as the government's fiscal consolidation plan is likely to be delayed by increased parliamentary fragmentation. A rescheduled presidential election will take place in May. Gabon was also downloaded to CCC by Fitch, citing the country's liquidity strain and the tight local debt market. Despite this, Gabon's sovereign dollar bonds rallied after the announcement of a presidential election to take place on 12 April. So far, bonds have returned 8.2% in January, driven by speculation about the upcoming vote.

Key new issues last week came from the Philippines. This week, Sri Lanka, India, South Africa, Ukraine and Mexico will tap the market. Bahrain is expected to issue US$2-US$3 billion of bonds in 2025. Last week, the central bank's BD70 million (US$186 million) issue of 91-day Treasury bills was oversubscribed by 261%.

Fixed Income Asset Allocation Views

27th January 2025

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 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)	¥ £ $ 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	■ 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	Under-weight -2 -1 0 +1 +2 Over-weight	■ 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 ungrades 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	Under-weight -2 -1 0 +1 +2 Over-weight	■ 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	Under-weight -2 -1 0 +1 +2 Over-weight	■ 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	Under-weight -2 -1 0 +1 +2 Over-weight	■ 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.

Important Information

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