NCRAM

Monthly Update

January 2, 2025

US High Yield

US high yield returned -0.43% in December, bringing the YTD return to 8.20%, according to the ICE BofA US High Yield Constrained Index (HUC0). As markets continued to digest expectations for growth, inflation, Fed policy and the incoming Trump administration, Treasuries sold off during the month and spreads widened modestly. The Fed cut their overnight rate in mid-December, bringing the rate to 4.25% to 4.5%, but tempered expectations for further cuts next year as growth remains stable in the 3% area, and inflation remains above their target at 2.82% for Core CPE on a LTM basis. In addition, the Fed may be quietly viewing Trump policies as potentially inflationary, though they deny putting weight on unknown future policy actions. Overall, a somewhat less dovish Fed led markets to pull back, and the 10-year Treasury increased by 40 bps to 4.57%, while US high yield spreads widened by 18 bps. BBs were the worst performing rating category on Treasury sensitivity, while CCC's were the best, continuing the pattern of 2024. Broadcasting and Insurance were the best performing sectors, while Cable TV and Building Materials were the worst.

For 2024 overall, growth exceeded market expectations thanks to steady consumer spending and business investment across many sectors including healthcare, utility output, energy production, and demand for IT equipment and Artificial Intelligence capabilities. Inflation fell, but progress has stalled, and expectations for Fed cuts were pared back. The 10-year Treasury increased 69 bps for the year overall, while high yield spreads tightened 47 bps. US high yield ended the year with a yield of 7.47% and spread of 292.

Looking forward, NCRAM expects US economic activity to slow modestly in 2025, from near 3% real GDP growth in both 2023 and 2024, to the mid-2% range in the coming year, with some risk to the upside. Higher interest rates will impact some consumer spending, and growth is generally slow outside of the US. The policy impact of the Trump administration will be a key factor but is somewhat unknown. We continue to feel the incoming administration has a fairly large appetite for change, and aggressive ideas have been floated in the areas of taxes, deregulation, immigration, tariffs, and geopolitics. While Trump can undertake some executive action, there remains uncertainty about what will pass Congress with small Republican majorities. Overall, we're hopeful that growth remains supportive for high yield. Deregulation, extending the 2017 tax cuts, and further initiatives to reduce the tax burden on companies and individuals would support stronger growth and higher profits. Lighter-touch regulation would also create a more favorable environment for mergers & acquisitions, supporting asset prices. On the other hand, protectionist trade policy and amplified diplomatic tensions are anti-growth and inflationary. Overall, NCRAM maintains a constructive outlook for high yield, driven by resilient fundamentals underpinned by continued earnings growth, supportive technicals, and attractive yields.

European High Yield

The European high yield market returned 0.69% in December and 9.39% for the YTD period, as measured by the ICE BofA European Currency High Yield Constrained Index (HPC0 in EUR, unhedged). December capped off a strong year for European high yield even as the Bund sold off in sympathy with US Treasuries, as spreads tightened 23 bps during the month. The main driver for positive performance continued to be recent new issues, particularly single-Bs that priced wide of index levels and also retain some convexity with trading prices below the call price. BBs also performed well, while CCCs struggled due to idiosyncratic issues. Technicals remained strong as new supply to the market was low due to the holiday period. European high yield ended the year with a yield of 5.77% and spread of 316.

As we look forward to 2025, we expect stable growth in the European economy, although we are watching risks that include geopolitical instability in Ukraine, political instability in Germany and France, energy prices, and the threat of Trump tariffs. We do expect inflation to continue to march lower and the ECB should steadily decrease their benchmark rate in the first half of the year. We see some policy divergence between US and European central banks as a key theme for the upcoming year, which could favor European fixed income assets. Default rates should continue to be low, excluding several large well telegraphed capital structures where restructuring is expected in 2025. As a result, while we do think European spreads are somewhat tight and could widen marginally over 2025, lower rates should offset a portion of that leading to another year of positive total return in the European high yield market.

Emerging Markets

EM hard currency bonds delivered strong returns during 2024 thanks to the high-yield issuers which represent about 40% of the benchmarks, and our flagship EM strategies tended to tilt towards the high-yield credits. EM Corporate bonds, as measured by the JPMorgan Corporate Emerging Markets Broad Diversified Index (CEMBI BD) posted a -0.54% return in December and a +7.63% return in 2024. The high yield portion of the corporate index earned +11.67% return in 2024. Real estate, Transportation and Metals and Mining were the best performing corporate sectors in EM for the year. Technical factors remained supportive for EM Corporates with low default rates and moderate net new issuance. EM Sovereign bonds, as measured by the JPMorgan Emerging Markets Bond Index Global (EMBIG), declined -1.50% in December due to higher US Treasury yields but delivered a +5.73% return for the full year 2024. EM Sovereigns were also led by high yield credits which delivered +13.49% in 2024 driven by some CCC and B-rated restructured credits (Argentina, Ecuador, Ukraine) and defaulted countries (Lebanon). There were no EM sovereign defaults in 2024 and most of the small countries that defaulted during post-COVID years with rising US interest rates managed to restructure their bonds in 2024.

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