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Monthly Update

February 3, 2025

US High Yield

US high yield returned 1.38% in January, according to the ICE BofA US High Yield Constrained Index (HUC0). The US high yield market had a bullish tone to start the year as investors took comfort in solid growth trends and Core PCE inflation heading down towards a 2% annualized rate in Q4. In addition, hopes for tax cuts and deregulation from the Trump administration exceeded fears about disruption, and positive sentiment about investment helped the S&P 500 hit an all-time high. US Treasuries rallied modestly from 4.57% to 4.54% on the 10-year, while high yield performed well across the ratings spectrum, and spreads tightened. Telecom, Broadcasting, and Cable TV were among the best performing sectors in the market overall, while Entertainment and Containers lagged. Utilities, the sector most tied to AI in high yield, also lagged as the Chinese AI model DeepSeek threatened to reduce expected power needs for AI. US high yield ended the month with a yield of 7.17% and spread of 268 bps.

At this time, the Trump administration is only two weeks old, there is clearly a large appetite for change, and the full impact is difficult to determine. Over the weekend, Trump announced tariffs on Mexico, Canada, and China which in the near term will disrupt sectors including food and autos. There remains uncertainty about the milestones Trump requires to rescind tariffs, as well as future tariffs. The administration is also taking a close look at domestic and foreign spending, immigration, and other areas. Some actions can be taken by the executive branch, but some will require Congress, and some may face court scrutiny. We will actively parse the various initiatives as they emerge.

European High Yield

The European high yield market returned 0.55% (EUR, unhedged) in January, as measured by the ICE BofA European Currency High Yield Constrained Index (HPC0). The European high yield market started the year softly, while the Bund also continued its sell-off, peaking at 2.46%. However, as the inauguration of President Trump passed with no immediate tariffs applicable to Europe, and the credit markets remained resilient even during the DeepSeek-inspired equity sell-off, European high yield quickly gained traction, and we saw a very strong rally going into the end of January. Additionally, the ECB remained somewhat dovish as they cut rates another 25 bps, citing progress with inflation and weaker economic expectations in major regions of the Eurozone. The market expects three to four more cuts in 2025, with the bulk coming in the first half. The European high yield rally was broad-based, and even included some out-of-favor sectors such as autos. The new issue market saw only a handful of names come to the market to refinance their debt. As a result, demand was strong, and final pricing tightened meaningfully versus initial expectations, as most new issues traded higher. Spreads tightened by 6 bps during the month, with CCCs outperforming. The outlook for European high yield remains solid, as default rates are expected to stay low in 2025, and rates should act as a tailwind for high yield returns, even as spreads remain relatively tight.

Emerging Markets

EM hard currency debt markets posted returns of roughly 1% in January, with high yield credits outperforming. EM Sovereign bonds, as measured by the JPM Emerging Markets Bond Index Global (EMBIG), gained 1.23% in January, with high yield credits up 1.94% while investment grade credits gained 0.67%. A similar trend was seen in EM Corporates, which gained 80 bps during the month, according to the JPM Corporate Emerging Market Bond Index Broad Diversified (CEMBI BD), with high yield credits outperforming with a 1.03% gain, while investment grade corporates lagged at 63 bps. New supply in January was dominated by investment grade credits, but capital markets were open for high yield issuers absent from the primary market for a while, such as Egypt. Technical factors should continue to be supportive for EM hard currency bonds in 2025 on relatively low net new issuance and prospects for a low default rate.

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