Global Credit Perspectives

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Global Credit: An Attractive De-Risking Asset Class That Offers Global Diversification

Author

Owen Murfin, CFA
Institutional Portfolio Manager

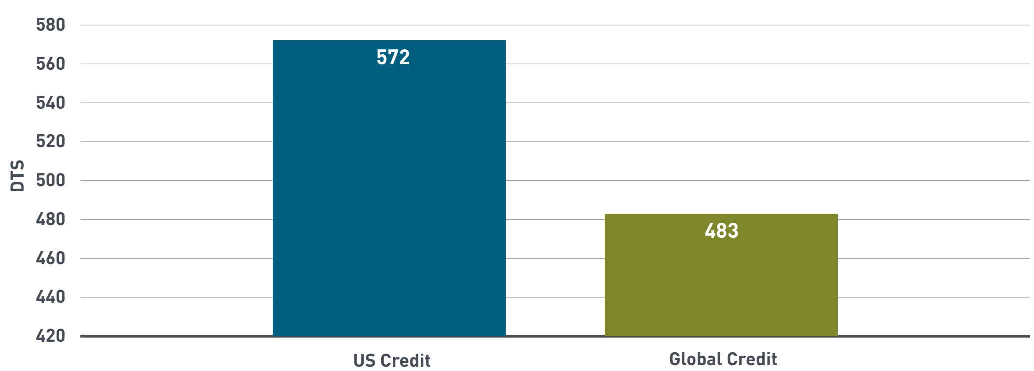
Key Takeaways

- We believe that global credit is well positioned in the period ahead as an asset class that may deliver attractive defensive characteristics, regional diversification and interesting alpha opportunities.
- Despite the challenging global environment, there are a number of factors that may help support the asset class. Global credit may benefit from investors needing to de-risk their multi-asset portfolios. In addition, we believe that the global macro backdrop will remain supportive, reflecting positive macro developments, including a more stable growth outlook for China, ongoing global monetary policy easing and planned fiscal expansion in Germany.
- The asset class is supported by solid fundamentals, attractive all-in yield valuations and strong inflows.
- Overall, our view is global credit is likely to display strong resilience, thereby offering an attractive de-risking opportunity in the face of elevated market uncertainty.

Global credit exhibits attractive defensive characteristics

Looking at the two sources of fixed income risk — duration and credit risk — global credit carries less risk than its US counterpart, as illustrated by the lower duration times spread or DTS. In particular, at around 5.9 years, the duration of the global credit index is shorter than US investment grade. It's worth highlighting that, in our view, the duration of the global credit index is adequately positioned — meaning that it's not as long as typical government bond indices, but long enough to provide some potential hedge against rising recession risks.

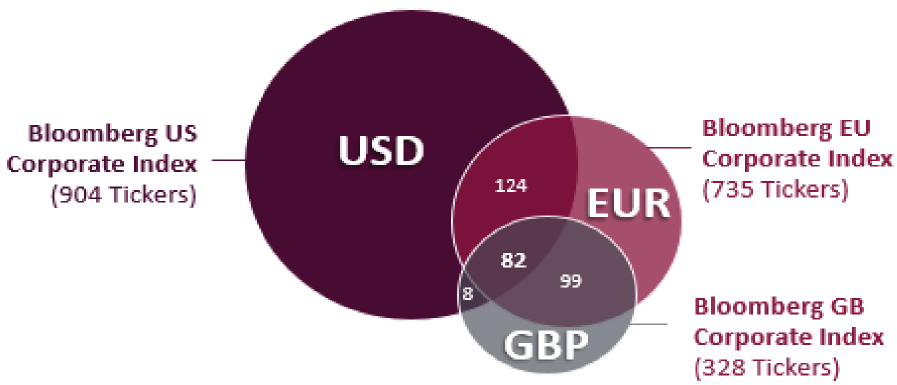
Exhibit 1: Based on DTS, Global Credit Is Markedly Less Risky Than US Credit



Sources: Bloomberg. US credit = Bloomberg US IG credit index. Global credit = Bloomberg global IG index. DTS = duration x spread. The DTS does not have a unit, being the product of two different dimensions (years and basis points), but it provides a measure of total fixed income risk. Data as of 2 June 2025.

We believe global diversification has proven to be a valuable investment approach. With so much focus this year on policy credibility risks, especially in the United States, adopting a diversified strategy at the global level has been beneficial. By construction, global credit offers a larger investable universe and a much broader source of country risk exposures, ranging from the US to Europe to other developed markets and emerging markets. In addition, global credit also offers some diversification away from governments' rising fiscal risks, a major item on radars of global investors. As we have observed over the past few months, over-exposure to the US has created challenges for the global investor, especially in view of the declining US dollar. Finally, the broader the investable universe, the larger the potential for security selection alpha opportunities, given the greater breadth of idiosyncratic credit stories. As illustrated by Exhibit 2, the global credit index offers a wide opportunity set, with an index including well over 2,000 tickers, representing a market value of nearly $13 trillion. It's also worth pointing out that a large number of single-name issuers have debt strategies that involve issuing debt across multiple currencies, thereby offering potential cross-currency relative value opportunities for investors.

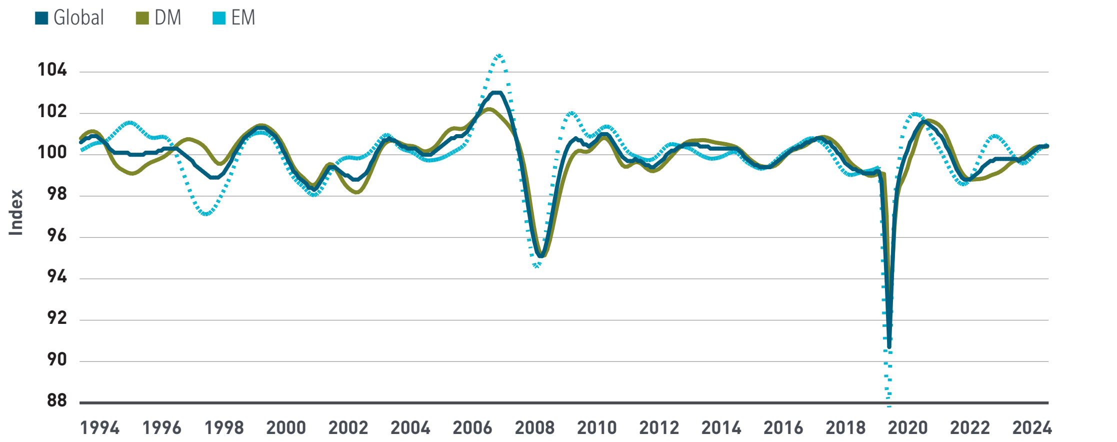
Exhibit 2: The Broad Opportunity Set of Global Credit



Source: Bloomberg. Data as of 22 May 2025. US = Bloomberg US Aggregate Corporate Index. Euro = Bloomberg European Corporate Index. GBP = Bloomberg Sterling Corporate Index.

Despite a challenging macro environment, global credit should remain well supported in the period ahead. While it's true that the ongoing trade war has triggered a downgrade in growth expectations, we don't believe that the global economy is subject to elevated recession risks. In the US, the growth shock is unlikely to tip the country into recession, given the resilience displayed by the consumer. Elsewhere, we believe the recently announced government spending package in Germany should help boost the growth outlook for Europe. Finally, we are encouraged by the significant stimulus measures undertaken by Chinese policymakers — both on the fiscal and monetary policy fronts — which are beginning to bear fruit and provide a foundation for a more positive growth outlook. Overall, the global macro backdrop is likely to remain supportive of the asset class.

Exhibit 3: Global Growth Expectations Remain Healthy

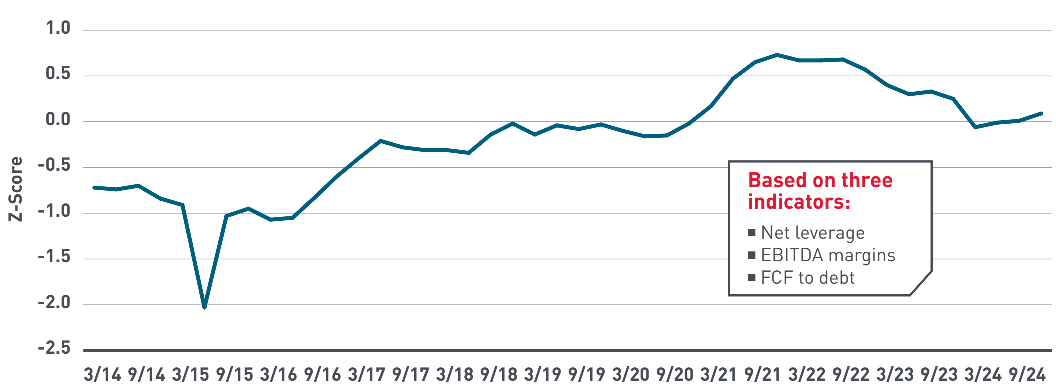


Sources: Organization for Economic Cooperation and Development (OECD). Monthly data from January 1994 to April 2025. The Composite Leading Indicators (CLIs) are designed to anticipate turning points in economic activity relative to trend six to nine months ahead. A CLI for any given month provides an indication of whether GDP levels are expected to be above or below long-term trends. Trend GDP estimates are set at 100 in the system for all economies and all months. A CLI above 100 anticipates that GDP levels will be above trend levels in six to nine months, while a CLI below 100 anticipates that GDP levels will be below long trend levels in six to nine months. A reading above 100 that is rising predicts expansion, above 100 and falling a downturn, below 100 and falling a slowdown, and below 100 and rising a recovery.

What Does This Mean For Investors

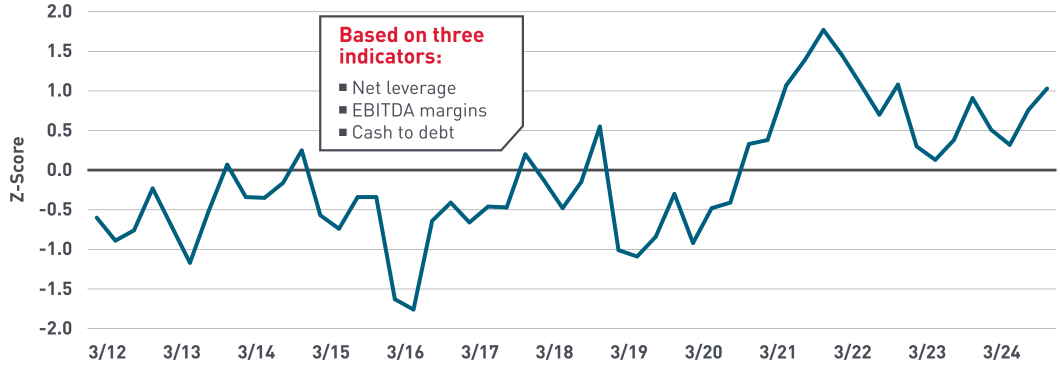
The asset class is supported by solid fundamentals, attractive yield valuations and healthy technicals. In the US, IG fundamentals remain supportive despite a more challenging macro environment. Meanwhile in Europe, euro IG fundamentals continue to show remarkable strength, helped in particular by strong earnings and cash positions.

Exhibit 4: US IG fundamentals



Sources: J.P. Morgan, US IG credit, quarterly data up to Q4-2024. Indicator based on the average of the three individual z-scores for net leverage, EBITDA margins and FCF to debt.

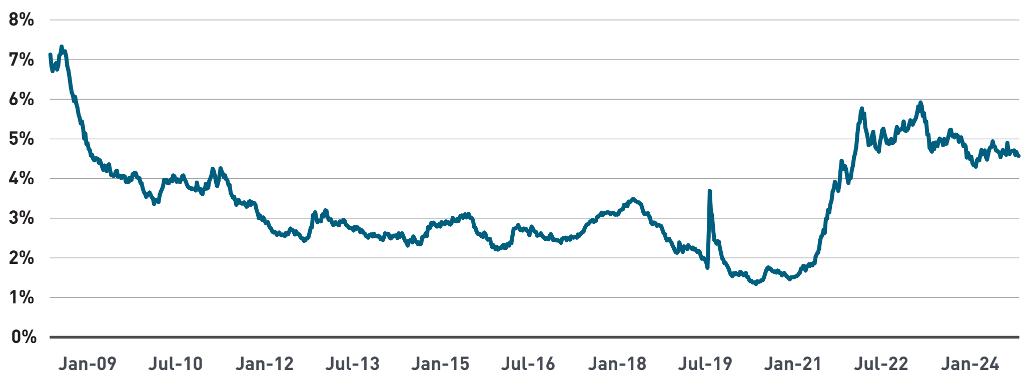
Exhibit 5: EUR IG Fundamentals



Sources: J.P. Morgan, EUR IG credit, quarterly data from Q1 2012 to Q4 2024. Indicator based on the average of the three individual z-scores for net leverage, EBITDA margins and Cash to debt.

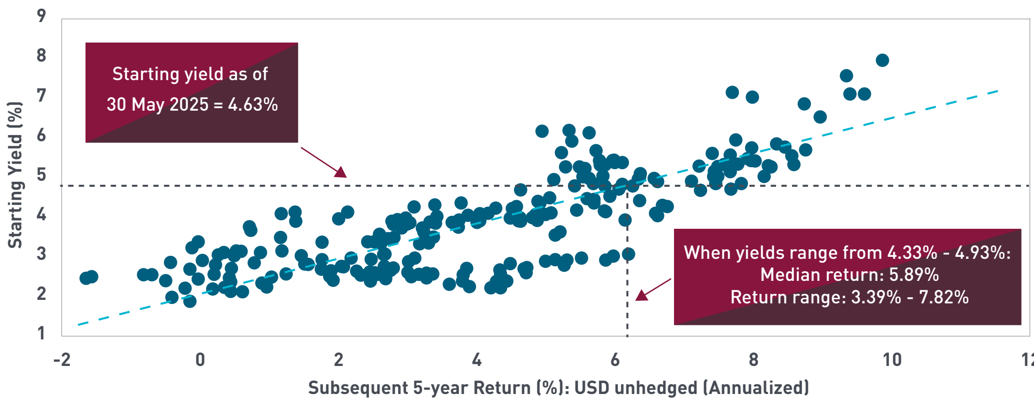
Elsewhere, our EM team is of the view that EM fundamentals remain resilient. On the valuation front, we believe that the total yield valuation backdrop looks compelling, with yields currently trading at about 4.6%, corresponding to a 78% 10-year percentile. Finally, flows over the past few months have been robust, especially in Europe, boosted by the lowering of policy rates in the region. Meanwhile, even though market rates have stayed on the higher side, the strong issuance pipeline, which has been met by robust demand for yield, has helped manage funding needs and refinancing risks.

Exhibit 6: Global Credit Total Yields



Source: Bloomberg. Bloomberg Global Aggregate Credit Total Return Index Value Unhedged USD, yield to worst, daily data up to 30 May 2025.

Exhibit 7: The Strategic Power of Entry Points
Starting Yields versus Subsequent Returns



Sources: Bloomberg. Global Credit = Bloomberg Global Aggregate Credit Total Return Index Value Unhedged USD. Yield = yield to worst. Monthly data from September 2000 through May 2025. Dashed light blue line represents regression trend-line to highlight the relationship between starting yield and subsequent return. Returns are gross and in USD. Past performance is no guarantee of future results.

Our Global Credit investment team favors a prudent portfolio risk bias, given the high level of uncertainty and insufficient risk premia in credit markets. While global credit spreads have widened somewhat because of heightened global market volatility, they remain fairly tight by historical standards. The investment team remains focused on avoiding companies and industries at fundamental risk, either from idiosyncratic factors, secular challenges or increased management aggressiveness. Active shifts in global asset allocation are also an important part of the global credit investment process. While the team has, in the recent past, expressed a bias in favor of greater euro IG exposure, the recent tariff-related dislocation has offered a tactical opportunity to rebalance allocations back to the US and, to a lesser extent, Canada where we see opportunities across sectors such as utilities and REITs. In terms of sector exposure, the team favors allocations to financials, energy and utilities and basic industries. Within each sector, the bias tends to favor the most defensive segments like midstream and E&Ps in energy, insurance in financials, or industrial chemicals in basic industry.

Potential Opportunities

The resilient global consumer represents an interesting investment theme

- In the US, we don't believe that the expected slowdown in consumer spending will be severe enough to trigger a recession.
- Some recent dislocation in the face of higher global recession pricing may offer attractive security selection opportunities, for instance, in autos.
- Some consumer sub-sectors such as gaming are less exposed to tariffs and may present attractive defensive characteristics.

Spread dispersion remains tight, increasing focus on security selection

- Tight spread dispersion is often a symptom of mispriced fundamentals at the sub-index level.
- Fundamental analysis therefore plays an even bigger role, given the elevated market uncertainty as the re-underwriting of credit exposures becomes a core part of active portfolio and risk management.
- The higher the dislocations and the mis-pricing of credit fundamentals, the greater the opportunity to generate alpha through a robust security selection process.

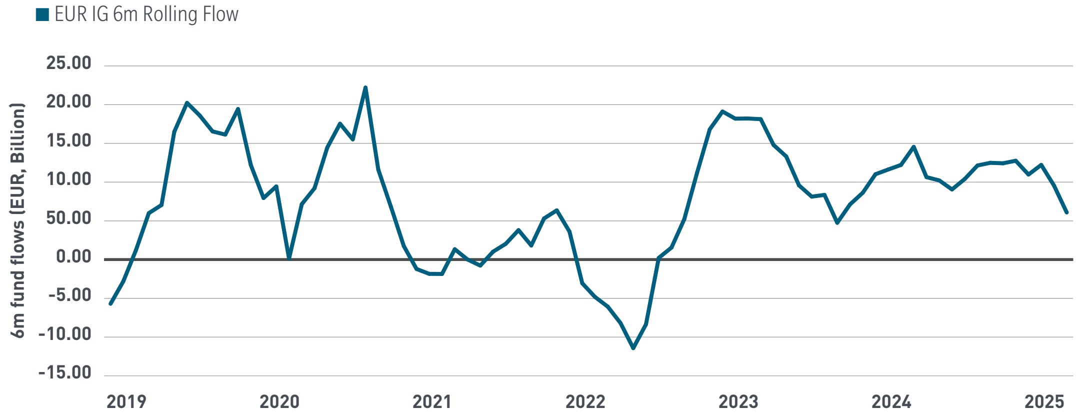
The attractiveness of going global

- A more pronounced decoupling at the macro and sector levels has occurred between the US and the rest of the world.
- Exposure to non-US assets may make sense in the context of a persistently weaker dollar.
- The broadening of the investible universe paves the way for more alpha generation opportunities.

Market technicals are supportive

- Net new issuance has been low, with higher rates encouraging de-leveraging.
- The flows to credit have been robust, particularly into Europe, boosted by the lowering of policy rates.

Exhibit 8: EUR Corporate Fund Flows



Source: Morningstar. 6-month rolling flows based on monthly data from 30 June 2019 through 30 April 2025. Flows are in EUR billion.

- Global credit is well positioned to offer a de-risking option to global investors who want to scale down their equity exposure, especially in view of attractive all-in yields. In addition, global credit offers an attractive de-risking alternative for investors with large private credit allocations, given that private credit may now face some headwinds.
- The appetite for yield remains strong, as illustrated by the demand for opportunities in primary markets.

Potential Risks

There are important global tail risks

- There are macro risks such as the US and a possible global recession.
- The geopolitical risks include Russia/Ukraine, Iran, and Taiwan.
- Europe's spending ambitions may disappoint, thereby hurting growth prospects for the region.

How much growth slows depends on size and breadth of tariff hikes

- US growth will slow and inflation will increase.
- Outside the US, growth will slow and inflation will fall.

Fed response will depend on the relative size of inflation/growth impacts

- Tariff policy uncertainty will also slow growth.

These global risks are yet to be fully reflected in global credit valuations

- Given the uncertainty, and with little cushion from spread valuations, a sound credit selection process is paramount.
- At the other end of the spectrum, a major recovery in global risk sentiment may undermine the appetite for more defensive asset classes, such as IG credit.

Important Risk Considerations:

Investments in debt instruments may decline in value as the result of, or perception of, declines in the credit quality of the issuer, borrower, counterparty, or other entity responsible for payment, underlying collateral, or changes in economic, political, issuer-specific, or other conditions. Certain types of debt instruments can be more sensitive to these factors and therefore more volatile.In addition, debt instruments entail interest rate risk (as interest rates rise, prices usually fall). Therefore, the portfolio's value may decline during rising rates.

Emerging markets can have less market structure, depth, and regulatory, custodial or operational oversight and greater political, social, geopolitical and economic instability than developed markets.

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