2025: Quarter 2

Credit Chronicle

Market review from Ninety One's
Developed Market Credit team

Second quarter market review

In the US, an eventful second quarter for the US Treasury market resulted in the yield curve steepening: longer-dated bond yields rose in reflection of investor concerns over the outlook for public finances; while short-dated bond yields fell as softer economic data led some members of the Federal Reserve's rate-setting committee to become more dovish. In Europe, sovereign bond yields fell, particularly in shorter-dated bonds. Driving factors included a weaker growth outlook following Trump's tariff announcements and falling inflation.

The global credit market had another strong quarter overall, with significant dispersion in returns again a feature. The high-yield corporate bond market was one of the top-performing segments, particularly in the US. It benefited from tightening credit spreads following the 'Liberation Day' spike, as markets gained confidence from the pause in trade tariffs. European high-yield debt also benefited from a tightening of credit spreads.

The bank capital market (additional Tier 1 and Tier 2 instruments) also performed well, as a recovery in investor risk appetite helped spreads tighten further. In the loans market, returns diverged between the US and Europe, with the former seeing more spread tightening than the latter. The regional picture was more balanced in the investment-grade credit market: US and European markets were boosted by the fall in sovereign bond yields and slightly lower credit spreads. A healthier appetite for risk was also in evidence in the collateralised loan obligation (CLO) market, where riskier (lower-rated) tranches outperformed, partly thanks to tightening credit spreads.

Current snapshot

We believe that credit markets are driven by three Compelling Forces and that a careful assessment of each of these is essential for exploiting evolving market inefficiencies and building a robust credit portfolio. Here's our current view:

Compelling force	**Fundamentals** Fundamental strength	**Valuations** Attractiveness of valuations	**Technicals** Supply/demand dynamics
US high yield	Orange	Red	Grey
European high yield	Orange	Orange	Grey
US investment grade	Grey	Red	Light green
European investment grade	Grey	Orange	Light green
US loans	Orange	Orange	Grey
European loans	Orange	Orange	Grey
Bank capital	Grey	Red	Grey
Corporate hybrids	Grey	Red	Grey
EM corporate credit	Grey	Red	Grey
Short-duration high yield	Orange	Red	Grey

Key: Worst ← Red, Orange, Grey, Light green, Dark green → Best

For illustrative purposes only. For further information on the investment process, please see the important information section.

Where to focus and what to avoid

- Higher-carry (higher-income) holdings – such as structured credit (including agency mortgage-backed securities), loans, and selective parts of the short-duration high-yield and bank capital markets – offer an attractive income profile and favourable downside characteristics.
- In more traditional markets – such as US high-yield debt and US investment grade – credit spreads remain near the tightest (most expensive) levels seen over previous cycles; we see limited potential here for further price appreciation or attractive income.
- Our sector positioning favours areas such as utilities and financials, which are domestically oriented and therefore less likely to be impacted by trade tariffs.

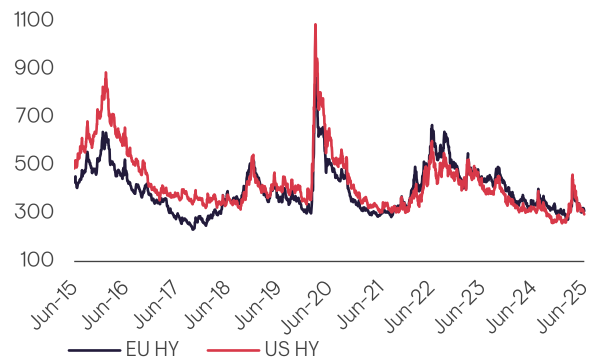
Sector by sector

High yield

US	--	-	0	+	++
Fundamentals		●			
Valuations	●		◌		
Technicals			●		
EUR	**--**	**-**	**0**	**+**	**++**
Fundamentals		●			
Valuations		●			
Technicals			●		

An empty circle denotes our view in the previous quarter, if it differs.

Spreads are close to the tightest they've been in 10 years



Source: ICE BofA, Bloomberg, 30 June 2025. EU HY = ICE BofA European High Yield index; US HY = ICE BofA US High Yield Constrained index.

High-yield debt continued to perform strongly – notably the US market, which posted a total return of 3.6% in Q2; the European high-yield market returned 2.7%. However, these total returns masked significant intra-quarter volatility. In the US market, credit spreads began the quarter at around 350bps, before rapidly climbing to above 450bps in early April following President Trump's sweeping tariff announcements. Since 8 April, spreads have been on a tightening trend – driven by reduced tariff uncertainty and the subsequent improved appetite for risk; they ended the quarter at just under 300bps, which is near the tightest level they have been in the past decade (within the 4th percentile). It was a similar story in European high-yield markets, with spreads heading into Q2 at c.330bps, spiking to c.430bps and then tightening to end the quarter at c.310bps. This also leaves European high-yield spreads at tight levels in the historical context (around the 18th percentile over the past decade). Primary issuance ramped up in both the US and Europe once markets recovered: June was the most active month for new European high-yield issuance since 2021, with more than €23 billion in new supply. Investors remain hungry for yield and this supply was well absorbed.

Global loans

US	--	-	0	+	++
Fundamentals		●			
Valuations		●	◌		
Technicals			●		
EUR	**--**	**-**	**0**	**+**	**++**
Fundamentals		●			
Valuations		●	◌		
Technicals			●		

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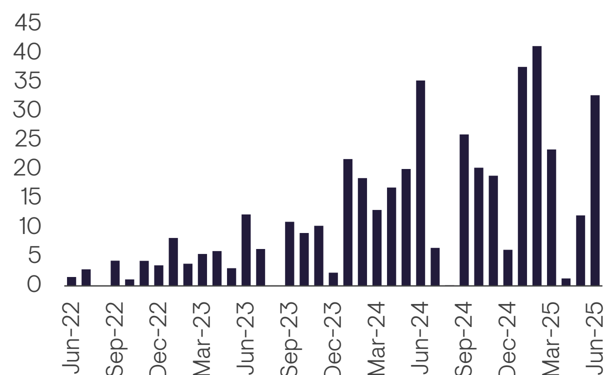
Loan issuance has ramped up over the past few years



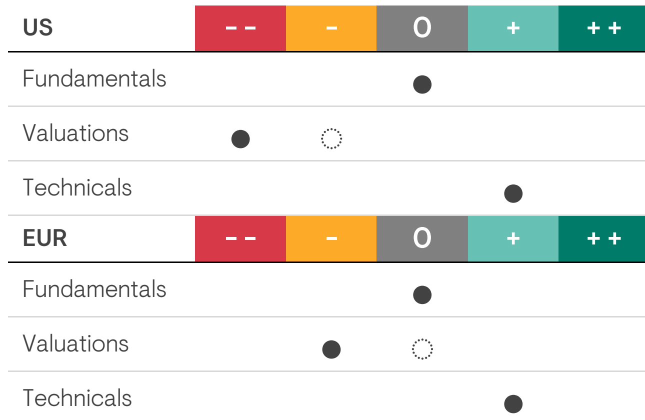
Source: Credit Sights, June 2025.

Loans delivered solid performance in Q2, quickly shrugging off the tariff-induced volatility seen in early April: the US loans market was down 2.6% in the first 11 days of April, only to end the month flat; subsequently, May and June performance was much stronger as the macroeconomic backdrop improved after Trump paused tariffs. For the quarter overall, US loans delivered +2.4% returns, outpacing European loans, which delivered +1.3%. Even so, returns seen in the US high-yield market were stronger (+3.6% in Q2, +4.7% over the year-to-date) with the rally in US Treasuries reinforcing performance.

A similar story unfolded in the new-issue market, which went from being effectively frozen in early April to roaring back in May and June, with record-setting volumes in both the US and Europe as deals shelved in April came back to market. In Europe, €152 billion in new loans have been issued so far this year, which is 75% of the 2024 total volume, with 2024 itself having been a record-setting year for issuance in Europe. Such a receptive new-issue market has also driven a resurgence in loan repricing*, with US$28 billion repricing in June in the US, up from just US$10 billion over the prior three months combined. This looks set to continue, with 39% of US loans now trading above par. With such strong new issuance volumes, the very favourable technical backdrop seen in April and May (light market positioning, high cash balances, continued inflows) has shifted somewhat, with elevated cash balances having been increasingly absorbed by the deluge of new deals as the quarter progressed. The slight softening of the technical picture is something to monitor over Q3.

*Repricing is when issuers reduce the margin on their existing debt by effectively re-issuing the existing facility.

Developed market credit indicator: Credit Chronicle



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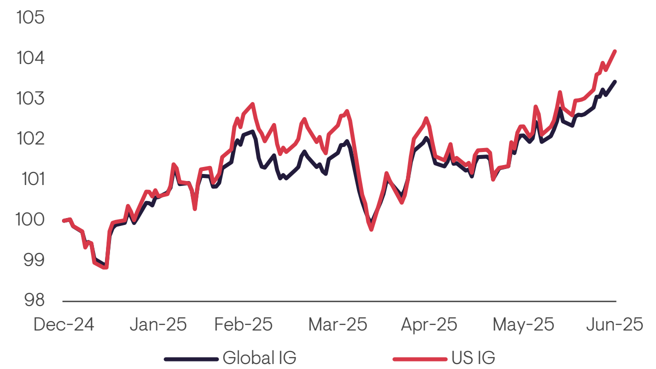
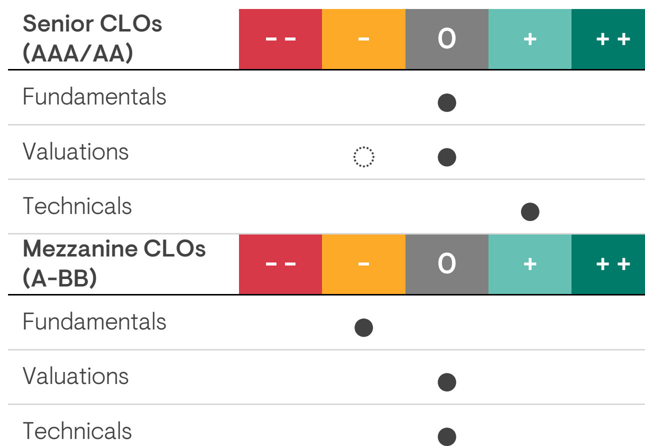


Source: ICE BofA, Bloomberg, 30 June 2025. US IG = ICE BofA US IG index, Global IG = ICE BofA Global Corporate index.

The global investment-grade (IG) market had another strong quarter, achieving a +1.7% total return. This return was driven primarily by credit-spread moves, which tightened by 8bps to end the quarter at just 88bps – close to the tightest levels seen since the GFC. However, yields remain elevated and near the high end of the historical range, particularly in the US market, which still has a yield of over 5%. BBB rated debt drove much of the spread tightening seen over the quarter, which has resulted in the BBB/A spread ratio approaching the lows of the year (i.e., investors getting limited compensation for taking additional risk). By sector, financials outperformed industrials, with spreads on bank issuers now tighter than industrials as investors expect bank fundamentals to remain resilient even in an environment of tariff-driven uncertainty.

With IG markets up +3.4% globally and +4.2% in the US through the first half of 2025, and with spreads near their tightest levels of recent months, the IG credit asset class is arguably unenticing for investors. Foreign demand for IG has recently weakened as FX-hedge adjusted yields for European and Asian investors have declined over the quarter. However, broad demand for high-quality credit will likely continue to support IG credit spreads through the rest of the year.



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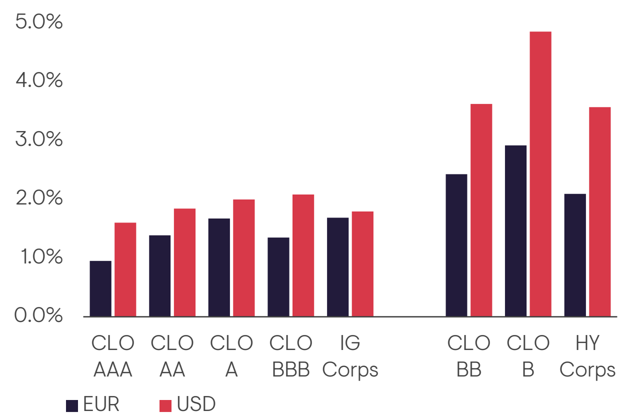

Source: JP Morgan, BofA, 30 June 2025. JP Morgan for CLOs and ICE BofA Indices for corporate bonds.

Collateralised loan obligation (CLO) spreads moved sharply wider at the start of the quarter in response to the trade policy announcements from the Trump Administration. However, the magnitude of spread moves across CLO tranches was broadly in line with historical norms relative to other corporate credit asset classes, such as corporate bonds and loans. Secondary trading volumes remained healthy through the worst of the market weakness, with little sign of stressed selling. We also saw a high rate of bonds failing to trade on CLO auctions, indicating to us that sellers remained selective on pricing. In contrast, activity in primary markets slowed in the US and ground to a halt in Europe for several weeks as managers awaited some price stability before bringing deals to market.

Despite the weak start to the quarter, CLOs delivered positive returns across ratings and regions, with lower-rated tranches outperforming higher-rated tranches. Spreads in most categories ended the quarter at tighter levels than they started. Price tiering across deals now looks relatively compressed in our view, and with a number of macro and geopolitical risks hanging over the market, we think a focus on stronger managers, better quality loan portfolios, and more robust deal structures is key going into the second half of the year.

Specialist credit

Bank capital	- -	-	0	+	+ +
Fundamentals			●		
Valuations	●	○			
Technicals			●		

EM corporate debt	- -	-	0	+	+ +
Fundamentals			●		
Valuations	●	○			
Technicals			●		

Corporate hybrids	- -	-	0	+	+ +
Fundamentals			●		
Valuations	●	○			
Technicals			●		

Short-duration high yield	- -	-	0	+	+ +
Fundamentals		●			
Valuations	●	○			
Technicals			●		

An empty circle denotes our view in the previous quarter, if it differs.

Corporate hybrids (perps) performed well over the quarter, largely keeping pace with the high-yield market. The drawdown in March–April was shallower than in parts of the high-yield market and in other subordinated products such as AT1s, underscoring the defensive structure of the corporate-hybrids market. Primary markets were active, with gross supply now at c.€20 billion year to date (+10% year on year); utilities accounted for the largest share of issuance. Given the wider absence of mergers & acquisitions, most deals have simply refinanced existing hybrid capital, keeping net supply comparatively limited. While overall valuations remain uninspiring, we see value in defensive utility hybrids and select real-estate hybrid securities.

The **bank capital** market, or AT1s, posted a strong second quarter, with a US hedged return of 3.2% in Q2 (Q1: 1.7%) and bringing year-to-date total returns to 5%. Q2 started off on a weak footing with the macro environment providing a challenging backdrop in April (US Liberation Day) and inducing volatility, which impacted risk assets. However, the AT1 sector was able to move past this quickly, with strong performance in both May and June driving the returns in Q2. Returns were driven both by price (c.+1.4%) and carry (c.+1.6%). The primary market remained robust and resilient despite the volatility, and market dynamics remained conducive – with Q2 seeing 15 new AT1s issued by European banks (Q1: 18) across EUR/USD/GBP. Demand for these new issues remained very strong. Furthermore, banks have continued to call their bonds, and we expect this to continue in Q3. Fundamentals continue to provide a positive backdrop for the sector and AT1 investors. In our previous Credit Chronicle, we highlighted the increasing importance of selectivity within this asset class; we still believe this to be the case looking ahead given where valuations are.

The **emerging market (EM) corporate debt** asset class (JPMorgan CEMBI BD) gained 1.6% over the quarter, with both the high-yield and investment-grade parts of the market boosting overall index returns. Both markets benefited from the fall in US Treasury yields, while credit spreads were broadly unchanged in both segments. With the exception of real estate, all sectors posted positive total returns, while top-performing countries included Panama and Indonesia.

Developed market credit indicator: Credit Chronicle

Credit market performance	Q2 2025 return (US$ hedged) %	Yield-to-worst %	Spread*	Duration
US high yield	3.6	7.1	296	3.1
European high yield	2.7	5.4	310	2.9
US investment grade	1.8	5.0	86	6.5
European investment grade	2.3	3.1	91	4.5
US loans	2.4	7.7	435	0.1
European loans	1.3	7.0	477	0.2
Short duration high yield	2.3	6.9	332	1.7
CoCo's	3.2	6.2	281	3.4
Emerging market corporate debt	1.6	6.3	221	4.1

Past performance is not a reliable indicator of future results, losses may be made. Please see important information section for information on indices.

*OAS spread. Sources: US high yield = BofA US High Yield (HUC0); European high yield = BofA EUR High Yield (HE00); US investment grade = BofA US Investment Grade (C0A0); European investment grade = BofA EUR Investment Grade (ER00); US Loans = JP Morgan US Loans Index; European Loans = JP Morgan European Loans Index; Short Duration High Yield = BofA 1-3yr Global High Yield (H1WN); CoCo's = BofA Contingent Capital Index (COCO); EMCD = JPM CEMBI BD. All as of 30 June 2025.

General risks

The value of investments, and any income generated from them, can fall as well as rise. Where charges are taken from capital, this may constrain future growth.

Past performance is not a reliable indicator of future results. If any currency differs from the investor's home currency, returns may increase or decrease as a result of currency fluctuations.

Specific Risk(s)

Default: There is a risk that the issuers of fixed income investments (e.g. bonds) may not be able to meet interest payments nor repay the money they have borrowed. The worse the credit quality of the issuer, the greater the risk of default and therefore investment loss. **Derivatives:** The use of derivatives may increase overall risk by magnifying the effect of both gains and losses leading to large changes in value and potentially large financial loss. A counterparty to a derivative transaction may fail to meet its obligations which may also lead to a financial loss. **Interest rate:** The value of fixed income investments (e.g. bonds) tends to decrease when interest rates rise. **Liquidity:** There may be insufficient buyers or sellers of particular investments giving rise to delays in trading and being able to make settlements, and/or large fluctuations in value. This may lead to larger financial losses than might be anticipated.

Glossary

Alpha: outperformance of a reference index or market through an investment manager's active investment decisions.

Bank capital: additional capital held by banks to absorb losses under duress. Cheaper and quicker for banks to issue than equity. Helps banks to improve their capital ratios.

Bank preference securities: issued by banks to meet their required capital ratios. These have characteristics of both equities and bonds. The securities are perpetual (with call features), pay dividends, and are subordinated relative to other forms of debt.

Callable bonds: bonds that can be redeemed by the issuer prior to the maturity date of the bonds. The issuer may look to issue new bonds at a lower coupon.

Carry: the net-of-cost return earned by owning a security – a 'carry trade' might involve borrowing at a low interest rate to invest in a security offering a higher interest rate to earn the additional 'carry'.

CLO: collateralised loan obligations are bonds that are backed by pools of (typically sub-investment grade) corporate loans. Several bonds of varying risk and return characteristics are usually issued against each pool of loans. Lower-risk, 'senior' tranches have higher priority claims on the cash flows from the loans but offer a lower yield than the lower-rated 'junior' tranches, which are the first to suffer losses if the underlying loans underperform.

Corporate hybrids: subordinated debt of Investment-grade issuers. They combine characteristics of bonds (payment of coupon) and of equities (no maturity date or very long maturities) and are typically rated a few notches lower than the same issuers' senior debt. Usually callable by the issuer five or 10 years after issue

Coupon: the regular interest payments a bondholder receives from the issuer of the bond.

Credit rating: a score awarded by an independent rating agency to indicate the financial strength of the issuer of a bond, and the potential for it to default on interest and principal payments. The top credit rating is 'AAA'. The lowest rating to be considered 'investment grade' is 'BBB'. Below 'BBB', bonds are termed 'sub-investment grade' or 'high yield'. The higher the credit rating of the issuer of the bond, the higher the 'quality' of the bond.

Credit spread: the difference between the yield offered by a corporate bond and the yield offered by a sovereign (government) bond of an equivalent maturity. This is the reward the investor gets in return for taking on a greater level risk than they would if they just invested in the sovereign bond.

Credit risk: see *Default risk*.

Currency swap: a swap is an agreement between investors to exchange future cashflows, such as interest payments. In a currency swap, the parties to the agreement exchange future cash flows of different currencies

Default risk: the risk that the issuer of a bond may not be able to meet interest payments or repay the money it has borrowed. The lower the credit rating of the issuer, the greater the risk of it defaulting on its debt and the greater the risk of the investor suffering an investment loss.

Duration: a measure of how much a change in interest rate will impact a security's market value. There is an inverse relationship between interest rates and bond prices.

Emerging market credit: bonds issued by companies from emerging markets (e.g. China, Brazil). Can be rated high yield or investment grade. Largely US dollar-denominated, although a small local currency corporate bond market exists.

Excess return: the total return of the bond minus the return attributable to changes in underlying treasury yields of an equivalent maturity.

Extension risk: the risk that the bond issuer will seek to delay when it pays back the amount it has borrowed from bondholders.

Fallen angel: an investment-grade bond issuer that has subsequently had its debt downgraded to a high-yield credit rating.

Floating-rate notes: the floating nature of coupon provides protection in a rising interest rate environment. Issued by both investment-grade and high-yield borrowers. These are typically shorter duration (up to five 5 years).

Interest rate risk: see *Duration* above.

Leveraged loans: loans that are structured, arranged and administered by at least one commercial or investment bank. Typically issued to support a merger or acquisition or to finance company growth. Sub-investment-grade rated. Typically, the coupon is a floating rate rather than fixed.

Maturity: The date the issuer will repay the bondholder.

Subordinated debt: debt that is repaid only after other debt has been repaid (i.e. comes further down in the order of priority for repayments) in the event of the issuer of the debt falling into financial difficulties.

Synthetics: highly liquid financial instruments that artificially simulate other credit market investments. Instruments can be related to a single corporate, or to a whole credit index. Allows for efficient implementation and hedging.

Total return: the investment return on a bond which takes into account a change in credit spread and a change in the yield of the underlying treasury of an equivalent maturity.

Yield: the return investors earn for owning a bond to maturity. This is a function of the price paid for the bond, the coupon, and the time to maturity.

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