2024: Quarter 4

Credit Chronicle

Market review from Ninety One's Developed Market Credit team

Market review

Against the backdrop of rising sovereign bond yields, the fourth quarter was a mixed period for global credit markets. Markets with floating-rate coupons were the top performers from a total return perspective as these offered protection from the rise in yields. Assets such as collateralised loan obligations (CLOs) and leveraged loans, both in the Europe and the US, benefited. In addition, credit spreads in these markets continued to tighten over the period, particularly in the US given the positive economic growth outlook.

In other areas of the credit market, high-yield bonds in Europe meaningfully outperformed those in the US, with credit spreads tightening more in the former as US high-yield spreads were already close to the tightest levels seen in the past decade. Corporate bonds in the US also faced a more significant headwind from a larger rise in government bond yields than that seen in Europe. In the investment-grade space, European assets again outperformed the US, with the latter posting a negative total return over the quarter given the sharp rise in Treasury yields. Credit spreads ended the period tighter in both markets.

Despite the mixed performance seen in the fourth quarter of the year, all credit markets posted positive returns in 2024. CLOs and loans were the top performers, followed by high-yield and investment-grade bonds.

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	grey	red	light teal
European high yield	orange	orange	light teal
US investment grade	light teal	red	light teal
European investment grade	grey	grey	light teal
US loans	orange	orange	light teal
European loans	orange	orange	light teal
Bank capital	grey	orange	light teal
Corporate hybrids	grey	orange	grey
EM corporate credit	grey	orange	light teal
Short-duration high yield	grey	orange	light teal

Key: Worst ← red, orange, grey, light teal, dark teal → 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, loans, and selective parts of the short-duration high-yield and bank capital markets – offer an attractive income profile and favourable downside characteristics.
- In 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.
- From a sector standpoint, we see value in selective parts of the banking sector – in both senior and subordinated instruments – although this is less pronounced than a year ago. We also see better value in more defensive sectors than in cyclical sectors given compressed valuations between the two.

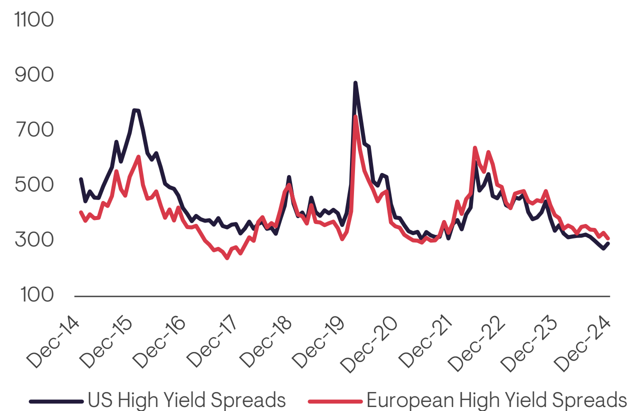
Sector by sector

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.

US and European high-yields spreads, basis points



Source: BofA, 31 December 2024. Option-adjusted spreads.

Unlike elsewhere in global financial markets, US exceptionalism was not a theme in evidence in high-yield (HY) markets over the fourth quarter, with US HY total returns broadly flat (+0.2%), while European HY posted a 2.1% gain. Wider spreads at the start of the quarter, coupled with a divergence in financial conditions across the two markets (Europe looser, US tighter) led to the outperformance of European credit. In aggregate, European HY option-adjusted spreads (OAS) tightened 31bps to 311bps, while US HY spreads were 11bps tighter to end the quarter at 292bps.

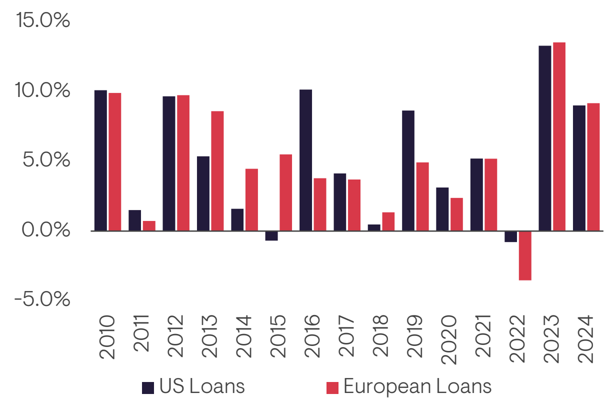
In Europe, we saw spread compression, with the single-B rated segment tightening by 20bps versus BB rated debt over the quarter, taking the former to its 18th percentile on a historical basis, which we view as tight (expensive) given the current macro-economic outlook. In the US, only the CCC rating segment saw further spread compression, tightening by a further 57bps to 524bps relative to BB rated debt in OAS terms. A shared characteristic across both sides of the Atlantic was credit default swaps underperforming cash bonds, as the technical backdrop (supply/demand dynamics) remains favourable in bond markets, even if less so than earlier in the year.

Global loans

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

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

US and European loans had a strong 2024



Source: BofA, Bloomberg, 31 December 2024.

It was another solid quarter of returns for loans, with steady performance mirroring prior quarters (December was actually the 14th consecutive month of positive returns for US loans). Over the quarter, US and European loans returned 2.3% and 2.0% respectively, comfortably beating US high-yield market returns of 0.2% and performing in line with the 2.1% return of the European high-yield market, as government bond weakness, particularly in US Treasuries, impacted fixed income markets there. For the full year, US and European loans returned 9.0% and 9.2% respectively, outperforming US and European high-yield market returns of 8.2% and 8.6%.

Fourth quarter and full-year loan issuance was robust, particularly in the US, with the US gross issuance of US$1.33 trillion seen in 2024 setting a new record and not far short of the US$1.46 trillion seen across 2021-2023. Momentum continued through to year end, with US December loan repricing* of US$163 billion also marking the busiest on record and indicative of the broader trend over the year. The record gross issuance was driven by repricing and refinance activity, but there was limited net new loan supply as M&A and leveraged buy-out (LBO) volumes remained light given the more volatile rate backdrop. In the US and Europe, net new loan supply was just 18% and 24% of total loan volumes respectively. A further driver of high issuance levels was the continued strength of the technical backdrop, which also supported asset class returns. It was also the strongest quarter since 2019 for US CLO formation, while European CLO formation of US$51.6 billion for 2024 overall exceeded 2022 and 2023 combined. Similarly, flows in both markets remained strong. This continued solid technical backdrop, coupled with attractive all-in yields, places the loan market on a strong footing as we enter 2025.

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

Developed market credit indicator: Credit Chronicle

Investment grade

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

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

US investment-grade spread and yield divergence

Source: BofA, 31 December 2024. BofA US Investment Grade. Spreads are option adjusted spreads (OAS).

Investment-grade (IG) markets experienced a bout of volatility over the fourth quarter following the sharp rise in risk-free rates. This was especially stark in the US where 10-year Treasury yields moved a significant 80bps higher, driving US IG total returns of -2.8% for the quarter (versus -1.6% for global IG). Returns were negative even as credit spreads continued to grind tighter, reflecting the magnitude of the move in risk-free rates. Zooming out, 10-year US Treasury yields of c.4.7% are effectively back to the highs of the last twelve months and are approaching the 5.0% level reached back in late 2023. For context, the last time (pre-2023) the 10-year Treasury traded at 5%+ yields was back in 2007, pre-the Global Financial Crisis. However, higher risk-free rates also translate to higher US IG yields, and the rise in risk-free rates more than offset the sustained tightening in spreads, which at just +85bps are now back to 2005 levels.

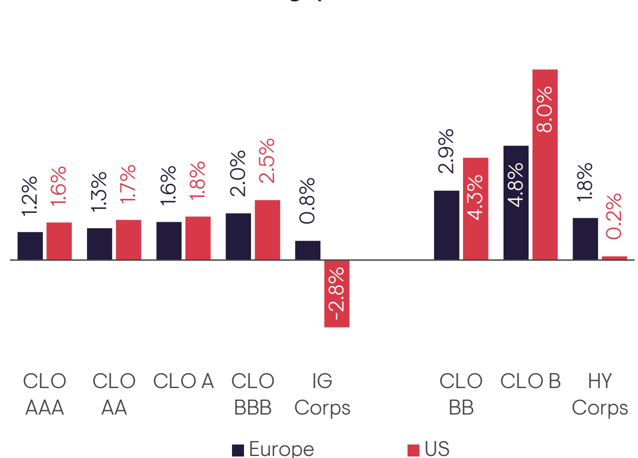
This dynamic can be seen for the year as a whole: US IG returned an uninspiring 2.8% in 2024 despite an impressive (22bps) tightening in spreads, reflecting the significant negative impact of higher rates. Low-quality bonds outperformed in this environment, with the BBB rated segment returning 3.5% versus 2.3% for the single-A rated segment over 2024, resulting in the BBB/A spread ratio now sitting at the low end of the post-Global Financial Crisis range. Unsurprisingly, spreads in most sectors within the US IG market now trade at or near multi-year tights. Offsetting these tight spreads is the fact that US IG all-in yields are back to an attractive c.5.4%, which will likely be significant driver in attracting buyers back into the asset class in 2025.

Structured credit

Senior CLOs (AAA/AA)	- -	-	0	+	+ +
Fundamentals			●		
Valuations		●			
Technicals				●	
Mezzanine CLOs (A-BB)	**- -**	**-**	**0**	**+**	**+ +**
Fundamentals		●			
Valuations			●	○	
Technicals			●		

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

CLOs had another strong quarter



Source: JP Morgan, BofA, 31 December 2024.

The global CLO market concluded 2024 on a strong note, benefiting from rising interest rates and tightening credit spreads. These factors allowed floating-rate CLOs to outperform fixed-rate corporate debt, particularly in the US. For example, US AAA and BBB rated CLOs delivered Q4 returns of 1.6% and 2.5% respectively, outpacing the -2.8% and 0.2% returns of US IG and US HY corporate bonds. A stronger spread rally across US CLOs helped all rating categories outperform their European peers in the quarter (see above chart).

New issuance remained robust, with full-year volumes setting new records. The US market saw US$202.5 billion in issuance, while Europe reached €48.6 billion, according to JP Morgan. Growing demand across a range of investor categories and the expansion of the middle-market CLO segment in the US contributed to this growth, helping volumes surpass previous records set in 2021 in both markets.

Regarding credit fundamentals, at the start of 2024, CCC concentrations (loans rated Caa/CCC by Moody's and S&P) accounted for a higher proportion of overall CLO loan portfolios in the US than in Europe (1.6% higher by Moody's and 3.6% higher in S&Ps rating buckets). However, by the end of 2024, the differences had dissipated/narrowed to -0.1% and 2.3%. This shift was driven mostly by the European market seeing downgrades of some widely held issuers in European CLOs, increasing the proportion of CCC rated holdings, while CCC holdings in US CLOs gradually declined 2024, helping narrow the gap between the two markets.

Developed market credit indicator: Credit Chronicle

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) generated a total return of 1.7% in Q4, rounding off a strong year for the asset class, which posted a total return of 9.3%. This compares favourably to the global high-yield market (8.9%) and global investment-grade market (3.4%). Real estate was once again the most topical sector as Heimstaden Bostad, a BBB- Swedish real estate company, re-opened the primary market after a lull period of two years with no issuance from the sector. The material compression in spreads and strong returns from corporate hybrids in 2024 has left spreads at historically tight levels. At current spread levels, front-end carry trades remain favourable, with higher-reset instruments offering better risk-adjusted returns. With tight spreads and low dispersion, a selective and defensive approach remains crucial. An issuer's ability to remain investment-grade rated and company management's commitment to the asset class continue to be among the most crucial considerations for investors in corporate hybrids for 2025.

The **bank capital** market, or AT1s, ended the last quarter of year on a somewhat softer footing than in the previous three quarters, posting a USD hedged return of 1.6% in Q4 (Q3: 5.2%) and mainly driven by carry. However, performance in 2024 as a whole was robust, with a USD hedged return of 12.8% for the asset class (2023: 6.5%) making it the third strongest year in a decade. The macro environment was more challenging in the fourth quarter, with real yields moving up sharply in December and political risk edging up in Europe (e.g., France). Despite this, market dynamics remained conducive over the quarter, with 10 new AT1s issued by European banks across EUR and USD markets and demand for new issues remained robust. Furthermore, banks continued to call their bonds and we expect this to continue in the first quarter of 2025. 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 and we still believe this to be the case, in light of current valuations.

The **emerging market (EM) corporate debt** market showed its resilience against a challenging backdrop of rising government bond yields, with the JP Morgan CEMBI BD ending the quarter only 0.8% lower. Negative performance was driven by investment-grade bonds, as a tightening in credit spreads was insufficient to outweigh the negative impact of the rise in US Treasury yields. In contrast, the high-yield segment returned 0.3%, boosted by spread tightening and carry. Within EM economies, developments over the quarter included the People's Bank of China shifting its monetary policy stance to "moderately loose" from "prudent" for the first time in 14 years, aiming to boost consumption and stabilise the housing and property markets. In Latin America, Argentina's government continued with its fiscal adjustment, improving investor sentiment towards the country and having a positive spillover effect in the corporate bond market, while in Brazil, fiscal challenges at the sovereign level weighed on investor confidence and negatively impacted the corporate bond market.

Developed market credit indicator: Credit Chronicle

Credit market performance	Q4 2024 return (US$ hedged) %	Yield-to-worst %	Spread*	Duration
US high yield	0.2	7.5	292	3.4
European high yield	2.1	5.5	311	2.8
US investment grade	-2.8	5.4	82	6.5
European investment grade	1.2	3.2	101	4.4
US loans	2.3	8.3	435	0.1
European loans	2.0	7.2	491	0.2
Short duration high yield	1.3	7.4	352	1.7
CoCo's	1.6	6.7	277	3.2
Emerging market corporate debt	-0.8	6.6	206	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 31 December 2024.

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.

Important information

The content of this communication is intended for readers with existing knowledge of financial markets.

This communication is provided for general information only. Nothing herein should be construed as an offer to enter into any contract, investment advice, a recommendation of any kind, a solicitation of clients, or an offer to invest in any particular strategy, security, derivative or investment product. The information may discuss general market activity or industry trends and is not intended to be relied upon as a forecast, research or investment advice. The economic and market views presented herein reflect Ninety One's judgment as at the date shown and are subject to change without notice. Views and opinions presented herein will be affected by changes in interest rates, general market conditions and other political, social and economic developments. There is no guarantee that views and opinions expressed will be correct and may not reflect those of Ninety One as a whole, different views may be expressed based on different investment objectives. Although we believe any information obtained from external sources to be reliable, we have not independently verified it, and we cannot guarantee its accuracy or completeness. Ninety One's internal data may not be audited. Ninety One does not provide legal or tax advice. Reliance upon information in this material is at the sole discretion of the reader. Investors should consult their own legal, tax and financial advisor prior to any investments. Past performance should not be taken as a guide to the future. Investment involves risks; losses may be made.

Except as otherwise authorised, this information may not be shown, copied, transmitted, or otherwise given to any third party without Ninety One's prior written consent. © 2025 Ninety One. All rights reserved. Issued by Ninety One, January 2025. In South Africa, Ninety One SA Proprietary is an authorised financial services provider.

Investment Process

Any description or information regarding investment process or strategies is provided for illustrative purposes only, may not be fully indicative of any present or future investments and may be changed at the discretion of the manager without notice. References to specific investments, strategies or investment vehicles are for illustrative purposes only and should not be relied upon as a recommendation to purchase or sell such investments or to engage in any particular Strategy. Portfolio data is expected to change and there is no assurance that the actual portfolio will remain as described herein. There is no assurance that the investments presented will be available in the future at the levels presented, with the same characteristics or be available at all. Past performance is no guarantee of future results and has no bearing upon the ability of Manager to construct the illustrative portfolio and implement its investment strategy or investment objective.

Indices

Indices are shown for illustrative purposes only, are unmanaged and do not take into account market conditions or the costs associated with investing. Further, the manager's strategy may deploy investment techniques and instruments not used to generate Index performance. For this reason, the performance of the manager and the Indices are not directly comparable.

MSCI data is sourced from MSCI Inc. MSCI makes no express or implied warranties or representations and shall have no liability whatsoever with respect to any MSCI data contained herein. The MSCI data may not be further redistributed or used as a basis for other indices or any securities or financial products. This report is not approved, endorsed, reviewed or produced by MSCI. None of the MSCI data is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such.

FTSE data is sourced from FTSE International Limited ('FTSE') © FTSE 2025. Please note a disclaimer applies to FTSE data and can be found at www.ftse.com/products/downloads/FTSE_Wholly_Owned_Non-Partner.pdf