

CREDIT QUARTERLY OUTLOOK

Stranger than fiction

- Credit spreads have staged an impressive recovery post-Liberation Day
- The credit market continues to be supported by exceptional technicals
- Aside from tight spread valuations, there are still reasons to be cautious

The second quarter of 2025 has been remarkable in many ways. No sooner had we clicked 'send' on our previous edition, than the world was greeted by Liberation Day.

The immediate impact of the tariff shock and associated negativity saw a material weakening in risk assets across the board. Just one week later, ostensibly 'spooked' by sharp volatility in the Treasury and equity markets, came the 90-day reprieve on reciprocal tariffs stoking a dramatic recovery in the markets.

The 'One Big Beautiful Bill Act' (OBBBA), currently under consideration by the Senate, has been a further source of confusion and nervousness. Aside from the potential impact on the US deficit, the inclusion of Section 899 allowing for taxation of foreign investment remains a concern.

Ongoing geopolitical conflicts, particularly in the Middle East more recently, have only added to the uncertainty. Despite all of the above (and much more we could mention!), credit spreads reside at tighter levels than pre-Liberation Day. Stranger than fiction indeed.

In the following pages, we outline our latest views on credit markets and our outlook going forward.

"Truth is stranger than fiction, but it is because fiction is obliged to stick to possibilities; Truth isn't." Mark Twain

OUTLOOK JUNE 2025

Marketing material for professional investors, not for onward distribution



Matthew Jackson
Investment grade



Sander Bus
High yield

Fundamentals

The US economy is set to slow materially this year. Bloomberg consensus expects real GDP growth of 1.4% for the full year, compared to 2.8% for 2024. Recession risks have diminished somewhat following recent policy shifts but have not disappeared entirely. If we had to choose, we'd take the under on consensus expectations for growth. The true economic impact of tariffs and heightened uncertainty will take time to impact the 'hard data'. In fact, much of the H1 data has apparently been flattered by tariff front-running. Ultimately, the effect of tariffs is negative for growth – they raise price levels, eat into corporate margins and erode consumer purchasing power. Policy uncertainty is likely to cause businesses to invest or hire with more caution. To combat this, potential tax cuts, deregulation and the miracle of AI should serve to cushion the blow.

Currently, inflation appears fairly well-behaved. We believe many firms stockpiled inventory in advance and have likely been cautious in raising prices too conspicuously for fear of incurring the President's wrath. Clearly, this cannot last indefinitely. And while wage growth has been muted, this may not persist given the new administration's immigration policies. Recent developments in the Middle East point to upside risks for the oil price, which again will exert upward pressure on inflation.

We do not envy the Fed, with both sides of the dual mandate pushing in different directions. Aside from political pressure, there is little reason for US policymakers to act now, with inflation picking up and the economy refusing to roll over. We expect that the first signs of weakness in the labor market will give the Fed a green light to begin policy easing, while attributing the rise in CPI to 'transitory' factors.

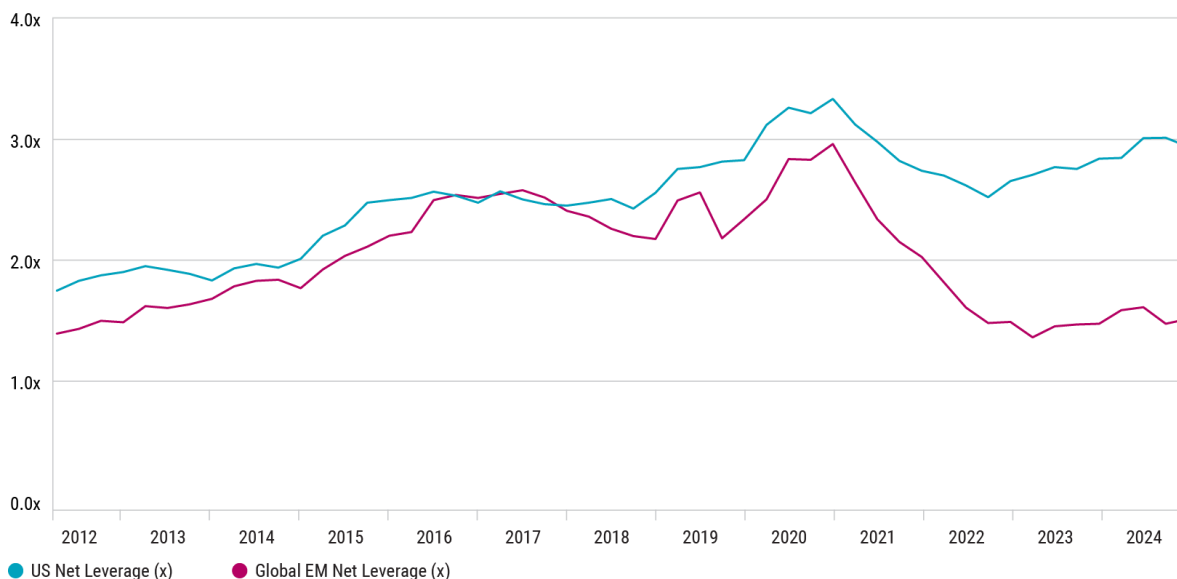
The Eurozone looks set to experience another year of muted, albeit positive, growth. US tariffs and the lingering uncertainty present a major obstacle for growth in the region. Higher energy prices and a stronger currency are also unhelpful. However, it's not all bad news. With inflation stable around the ECB target level, policy rates have already been cut considerably and there remains capacity for further easing. The German fiscal expansion announced in Q1 represents a significant tailwind for future growth, although the near-term impact is relatively small.

Within developed market (DM) credit, it remains a case of 'nothing to see here' on fundamentals for now, with stable leverage trends, healthy margins and subdued M&A activity. Much like the hard economic data, the full extent of tariffs and broader policy uncertainty will take time to play out. 'Creditor-on-creditor violence', however, is back in focus, as aggressive restructurings increasingly pit creditors against each other. Outsiders are often left with meagre recoveries while insiders come out ahead, raising uncomfortable questions about the integrity of the capital structure. For now, the market seems willing to look through it, but repeated episodes risk hurting confidence in high yield and leveraged loans.

Leverage in emerging market (EM) credit remains lower than their DM counterparts, which has helped EM to weather the rising rate cycle of the past few years. They now stand to benefit from the tailwind of easing inflation, improved fiscal balances, and a softer US dollar. These factors have enhanced resilience, particularly in Asia, where monetary independence and robust domestic demand have helped buffer external shocks.

However, this strength is not uniform. Countries with high exposure to US trade such as Mexico and parts of Asia have seen modest downward revisions to growth forecasts due to persistent tariff uncertainty. The US remains an important economic force, but its dominance as an export destination for emerging markets has structurally declined, shifting from 20% in 2000 to 14% today. Meanwhile, EM exports have surged by over 460%. This has been driven by intra-regional trade, the rise of large Asian emerging economies, and EM-led global value chains. Overall, EM growth continues to outpace that of DM.

Figure 1 - Net Leverage (Net Debt/ 2024 EBITDA)



Source: ICE Bofa, Robeco, June 2025

Globally, the overhang of tariffs remains in the near term as we rapidly approach 9 July, where Liberation Day levels may resume in the absence of deals being struck. Markets are behaving as if the tariff threat has passed but we question if 10% tariffs are really sufficient to achieve Trump's objective of bringing manufacturing jobs back home. Indeed, could the recent bullish behavior in financial markets serve to embolden the President and his belief in his policies?

For a deeper dive into our macro outlook, please refer to the Global Macro's teams recent report: *Get used to it*.

Valuations

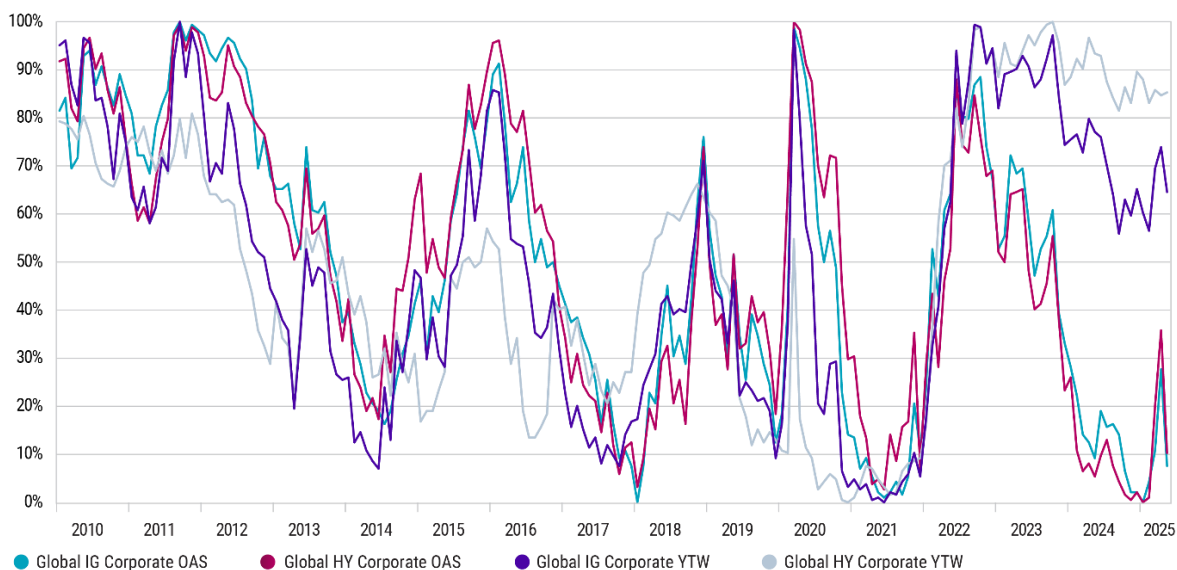
Despite a short, sharp widening post-Liberation Day, spreads have now more than fully retraced that move. With hindsight, we can't help but kick ourselves a bit that we didn't close our eyes and 'buy the dip' more enthusiastically. Our reasons for not doing so were several-fold:

1. The widening came from exceptionally tight levels.
2. Although wider, spreads remained materially tighter than witnessed in previous growth scares such as 2015, 2018 and 2022.
3. We didn't see the policy U-turn coming as the US administration consistently messaged that short-term pain in the markets was a price worth paying for long-term gains.
4. A short-term reprieve does not rule out further policy uncertainty or totally reverse the damage already inflicted.

As much as we'd love to turn back time, we can only think about where we stand today. And today credit investors continue to face something of a valuation conundrum where historically tight spreads meet attractive 'all-in' yields.

"The Eurozone looks set to experience another year of muted, albeit positive, growth"

Figure 2 – Spread and yield percentile rankings: 2010 to date



Source: ICE Bofa Bond Indices, Robeco, June 2025. Past performance is no guarantee of future results. For illustrative purposes only.

At Robeco, our primary metric for assessing value in credit is to look at spreads (yield of the corporate bond less the yield of the underlying government bond) while respecting that overall yield can have powerful technical implications. Spreads now comprise only a small proportion of the overall yield, particularly in the US IG market. Some might argue that's because Treasuries are the real risk asset you should worry about today, and tight valuations against history are therefore not a cause for concern. Time will tell, but we struggle to see a US default in a world where they borrow in their own currency and own the printing presses. Our hunch is that any major stress in the US Treasury market on debt sustainability concerns, or for any other reason, will not lead to tighter spreads.

Figure 3 – USD IG spreads as % of total yield



Source: ICE Bofa Bond Indices, Robeco, June 2025. Past performance is no guarantee of future results. For illustrative purposes only.

Another justification for today's spread levels seems to hinge on the 'Swiss Army Knife' theory. If the world keeps muddling along then you enjoy the carry, but if things go bad then the embedded interest-rate exposure in a corporate bond protects your returns amidst the flight to quality and policy easing that inevitably follows. The concern we have with the latter part of that argument is how unreliable it can be in times of higher inflation, please refer to 2022 for further details!

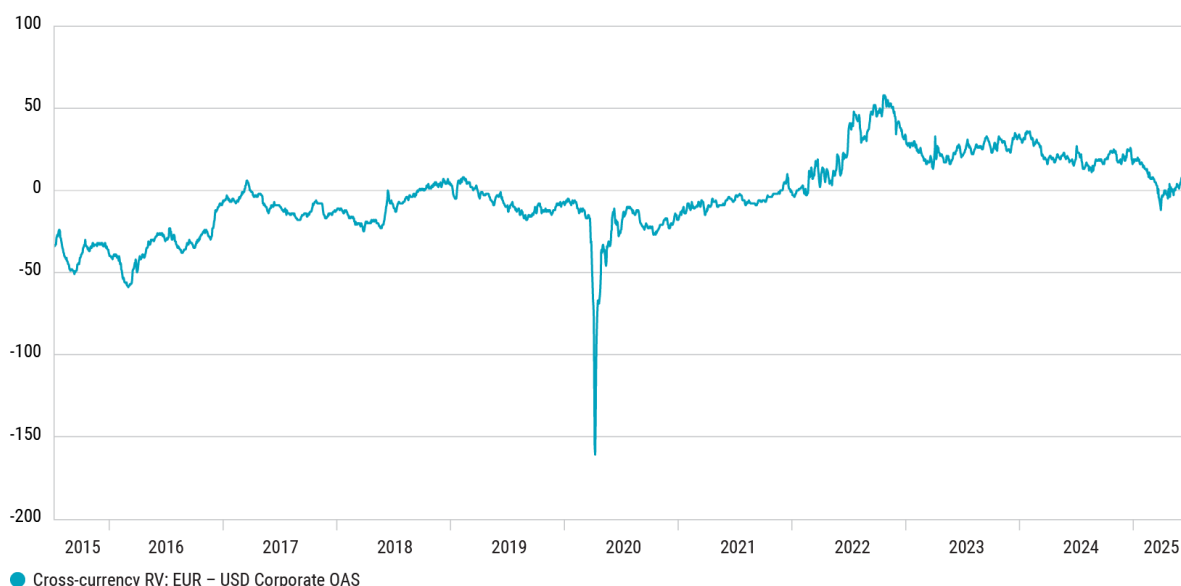
Valuations in EM credit are also being driven by persistent demand from yield-seeking investors, especially in Asia, leading to spread tightening. This technical is likely to remain positive as Asian investors repatriate assets closer to home. Selective value remains in Latin American high yield markets. As investors reassess the narrative of US growth exceptionalism, further pressure on the US dollar would be supportive for EM local currencies and EUR-denominated EM bonds.

In essence, buying credit is selling volatility. With tight spreads here to stay and a plethora of risks on the immediate horizon, we are compelled to keep overall beta positioning conservative while leaning on other levers to generate outperformance.

Following the strong outperformance of EUR credit compared to the US market in the first quarter, portfolios reduced the size of this positioning. As the EUR market has subsequently lagged QTD (more color within 'Technical' below), we have been inclined to rebuild this relative value position. The Euro market has traditionally traded inside the US market, principally on account of its shorter duration, but now with a question mark around the end of US exceptionalism, relative flow dynamics may provide additional support.

The market still looks remarkably compressed to us, both within HY and IG, and we continue to look for 'up-in-quality' trades.

Figure 4 – Cross-currency RV: EUR – USD corporate OAS

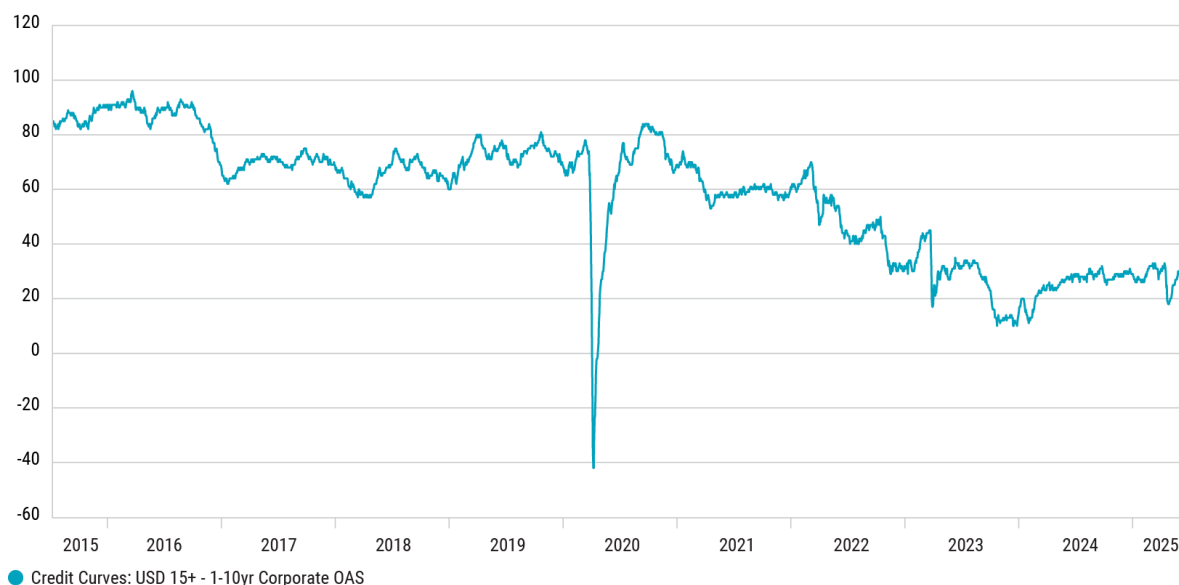


Source: ICE Bofa Bond Indices, Robeco, June 2025

Figure 5 – Credit quality: EUR BBB – A corporate OAS

Source: ICE Bofa Bond Indices, Robeco, June 2025. Past performance is no guarantee of future results. For illustrative purposes only.

Within global IG specifically, credit curves in the US remain very flat. The higher-yield environment has fueled investor demand to lock in these yields for as long as possible, while the belief that rates will be lower in the future has made borrowers more reluctant to issue longer-maturity paper. This technical imbalance would seem to rest on a knife-edge. Should Treasury yields reset materially lower, the all-in yield argument clearly weakens. If the main driver of lower yields turns out to be material economic weakness, that would be a double whammy for long corporate spreads. If yields or rate volatility were to rise from here, then we're not convinced spreads would continue to benefit. We therefore see logic in shortening spread duration where equivalent spreads can be captured.

Figure 6 – Credit curves: USD 15+ - 1-10-year corporate OAS

Source: ICE Bofa Bond Indices, Robeco, June 2025

Technicals

When trying to justify the amazing recovery in spreads and continued resilience come what may, we believe technicals are the missing piece of the puzzle. The lure of higher total yields within credit continues to drive insatiable investor demand for the asset class, particularly within IG. We believe many investors were defensively positioned coming into Liberation Day and the subsequent change in stance has reassured many that the Trump put is alive and well. Investors appear to be thoroughly embracing the 'TACO' ('Trump Always Chickens Out') narrative and looking forward to a quiet summer on the issuance side.

Perhaps counterintuitively, there has been little evidence of 'sell America' in credit markets so far. Indeed, in Q2 the US dollar credit market has decently outperformed the Euro market. An oft-cited narrative posits that so much faith has been lost in the US, and US assets, that a tidal wave of cash will now flow into other markets. We have some sympathy with this view but acknowledge material asset allocation shifts within the 'real money' community are far from instantaneous. We believe the relative performance can be largely explained by a very heavy supply of corporate bonds in the Euro market QTD, with much of it coming from US issuers seeking to diversify their sources of funding.

“Incredibly solid technicals have restrained us from positioning too negatively

Anecdotally, we hear more about Asian interest in the Euro market where well-rated US issuers are typically favored, so this is unlikely to be a pure coincidence. For many years, we've heard the 'TINA' ('There is no alternative') argument for large institutional investors in credit supporting the USD market. With substantial growth in the EUR market in recent years, a much more diverse selection of issuers and larger tranche sizes signals that perhaps there finally is an alternative.

Primary issuance in EM remains active, but net new supply is negative, which supports the EM asset class from a technical standpoint. However, investor flows remain cautious amid policy uncertainty. While the potential repatriation of Asia's current account surpluses could eventually bolster regional bond markets, this shift is still contingent on policy clarity and investor sentiment. Technicals are still a tailwind for EM credit markets.

Positioning

Our positioning remains cautious as current spread levels seemingly leave little room for further tightening. That said, incredibly solid technicals have restrained us from positioning too negatively. Within both Global IG and HY portfolios, our core top-down risk position remains a preference for EUR-denominated credit over the USD market.

IG portfolios also maintain a large underweight to the long end of the USD market given outright valuations and flat credit curves. We see logic in 'up-in-quality' trades here within investment grade and high yield portfolios, as lower-rated credits offer skinny compensation versus higher-rated credits.

On a sector basis, we maintain an overweight to banking but acknowledge the relative value proposition is no longer so compelling. In select eligible portfolios we have added tail-risk protection via out-of-the-money payer options on CDS indices to provide a cushion should the mood in markets change materially in the near term.

Table 1 – Current positioning

	Constructive	Neutral	Cautious
Fundamentals		✓	
Valuations			✓
Technicals	✓		
IG credit		✓	
HY credit			✓
Financials	✓		
Non-financials			✓
Emerging		✓	

Source: Robeco, June 2025

Guests: The authors would like to thank Duncan Toms (HSBC), Viktor Hjort (BNP Paribas), Hans Mikkelsen (TD Securities) in addition to our internal presenters Rikkert Scholten, Martin van Vliet, Rogier Hoogeveen and Daniel Ender for their valuable contributions to our outlook.

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