

CREDIT QUARTERLY OUTLOOK

# Comfortably Numb

- Spreads are extremely tight, but investors remain upbeat
- Strong technicals provide ongoing support
- Focus on quality IG and disciplined HY exposure

**As Pink Floyd reminded us with *Comfortably Numb*, detachment can feel safe in the moment – but it risks leaving us unprepared when reality finally breaks through. Credit markets today seem to embody that same paradox. In the following pages, we outline our latest views on credit markets and the outlook going forward.**

The third quarter of 2025 has been no less remarkable than the second. Spreads have tightened even further, despite repeated reminders that risks are never far away. Tariff headlines continue to surface under this US administration, but markets seem unfazed.

Even Trump's increasingly assertive influence over the Fed, once unthinkable, failed to shake sentiment. Downward revisions in labor market data, combined with leading indicators pointing to renewed inflationary pressure, have raised the odds of a stagflation scenario, yet even these developments have failed to dent risk appetite. After several false alarms, where spreads widened on recession fears that never materialized, investors feel little appetite to put on hedges again.

The result is a credit market that feels, to borrow from Pink Floyd, 'comfortably numb'. Investors remain comfortably long, detached from risk, and seemingly indifferent to the warning signs around them. Complacency, it seems, has become the prevailing mood.

*“After several false alarms, where spreads widened on recession fears that never materialized, investors feel little appetite to put on hedges again*

## OUTLOOK SEPTEMBER 2025

Marketing material for professional investors, not for onward distribution



**Sander Bus**  
High yield

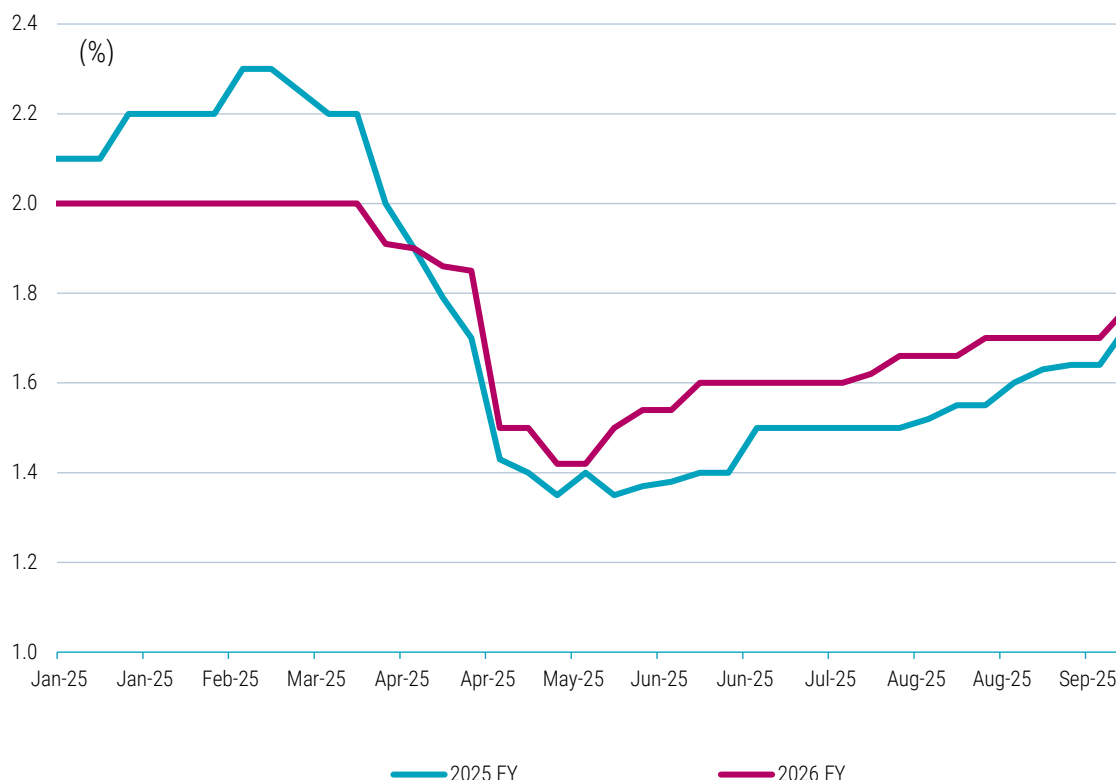


**Matthew Jackson**  
Investment grade

### Fundamentals

The US economy remains on track for a slowdown this year, even if consensus expectations have nudged higher in recent months. Bloomberg's forecast now stands at roughly 1.5% for 2025 growth, still well below trend. Consumer spending remains positive, but also subdued, and increasingly concentrated among the top 10% of households. For the majority, inflation continues to erode wage gains, leaving lower-income cohorts under pressure.

**Figure 1** – Consensus growth forecasts for 2025 & 2026 have crept higher

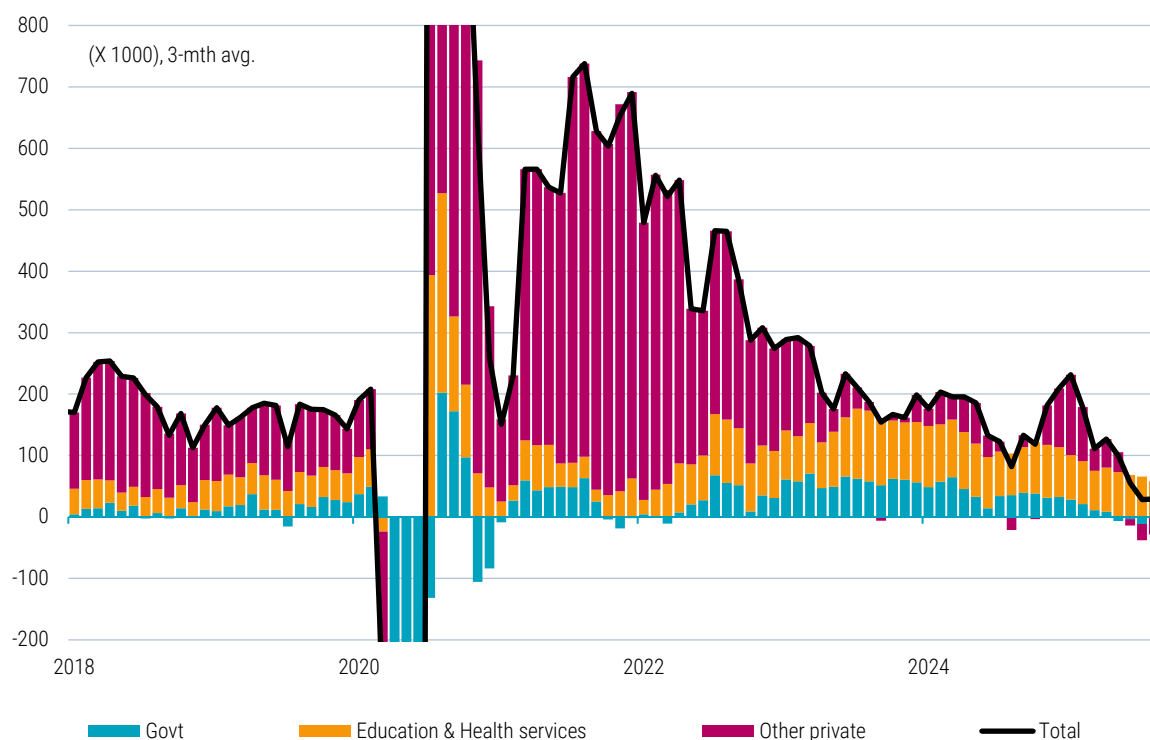


**Source:** Bloomberg, Robeco, September 2025. Please note: variables include building permits, durable goods orders, consumer sentiment, ISM new orders and inventories indices, and hours worked.

The picture from corporate earnings also reveals dispersion. Large-cap companies, particularly those represented in the S&P 500, show stronger earnings momentum, while national accounts data highlight far weaker profit growth among small and medium-sized enterprises. This is significant: smaller firms are the backbone of employment, and their underperformance could carry broader implications for the labor market.

Labor data, in our view, is the single most important metric to watch. Headline job growth has softened, with private-sector employment even turning negative in recent months. Yet this has not led to a meaningful rise in the unemployment rate, a dynamic probably explained by current immigration policies. Today's labor market can best be described as one of 'low hiring and low firing'. The key question in the months ahead will be whether firms succeed in passing higher costs on to consumers. Failure to do so would trigger a margin squeeze, forcing companies into cost-cutting and potential layoffs, a scenario that would quickly shift risk sentiment.

Figure 2 – Nonfarm payrolls monthly change by sector



Source: Bloomberg, Robeco. Note: this excludes the impact from the preliminary benchmark revision

Leading indicators continue to signal weakness, with housing among the contributors. On inflation, risks remain skewed to the upside. Tariffs are gradually filtering through to consumers, while wage inflation could pick up again as immigration slows. Additionally, rising electricity demand from AI-driven datacenter expansion risks putting further upward pressure on prices. Intermediate goods costs are already trending higher, often foreshadowing CPI increases.

Geopolitical risks persist in the background. The Middle East remains tense, and Russia's hybrid warfare tactics have grown increasingly visible, with provocations edging a step further each time. Markets have thus far looked through these developments, but an escalation could swiftly alter sentiment.

For the Fed, the backdrop is uniquely challenging. Political pressure to ease policy is mounting, and the first rate cut has already been delivered. Weakening labor data tipped the balance of the Fed's dual mandate, outweighing concerns about inflation that remains above target but is still being labeled as 'transitory'.

Across the Atlantic, the eurozone faces another year of muted but positive growth. US tariffs and uncertainty remain headwinds, but not existential ones. PMI data suggest signs of recovery, and given that the US is not the primary export market for most European industries, the impact of tariffs is manageable. The German labor market has softened somewhat, yet this is offset by stronger employment dynamics in southern Europe. Meanwhile, households still hold elevated savings buffers, supporting consumption. With inflation back at target, the ECB is under no immediate pressure to act, but retains ample room to cut rates if needed. Overall, we are more comfortable with European fundamentals than with those of the US.

Fiscal policy remains an important source of support on both sides of the Atlantic. Large deficits are clearly unsustainable in the long run, but for now they help explain the resilience of growth and the comfort in markets. In the US, tax cuts continue to cushion the economy, while Europe's infrastructure and defense spending are providing a meaningful offset to weaker external demand. Credit investors, for the time being, see little to complain about.

Emerging markets (EM), meanwhile, continue to stand out for their relative resilience. With lower leverage than developed market peers, EM corporates and sovereigns have weathered the recent rate cycle more effectively. Easing inflation, improved fiscal balances, and a softer US dollar provide additional support. Asia remains the standout region, where robust domestic demand and monetary policy autonomy have helped absorb external shocks. While some countries remain exposed to tariff-related growth risks, the structural shift toward diversified export bases and stronger intra-regional trade has enhanced stability. Importantly, EM growth continues to outpace that of developed markets.

At the corporate level, fundamentals are holding up. Leverage and coverage ratios sit at average levels, while EBITDA margins are near record highs. Since EBITDA typically drives these ratios, the ability of US firms to pass higher tariffs through to consumers will be critical. In Europe and EM, the picture looks somewhat better: input costs are being cushioned by a weaker dollar, reducing the immediate margin pressure. For a deeper dive into our macro outlook, please refer to the Global Macro team's recent report: Fearless.

### Valuations

At Robeco, our primary metric for assessing value in credit remains spreads, defined as the yield of a corporate bond less the yield of the underlying government bond. Total yields can influence flows, but in our view they are a poor measure of credit attractiveness in isolation. With spreads at or near all-time tights across several segments of the market, the current backdrop looks challenging from a valuation perspective. Yields, by contrast, are broadly in line with their long-term averages since 2000. This offers a degree of comfort for yield-driven investors, but does little to alter our fundamental assessment of risk and return in credit.

History provides a useful guide here. At current spread levels, excess returns over the following 12 to 24 months have tended to be negative. However, we caution against reading this relationship too mechanically. Low spreads can persist for extended periods, and on a shorter three-month horizon, subsequent returns have been positive more than half of the time. Investors thus face a familiar conundrum: modest compensation for risk over the medium term, but the possibility that momentum carries valuations further in the near term.

*“Euro corporate hybrids have been a long-standing area of opportunity for us*

Regional dynamics also matter. European spreads have converged to US levels and now trade at similar levels across most rating buckets. However, correcting for the shorter duration of EUR IG compared to USD IG, we still see room for modest further compression. Combined with relatively supportive fundamentals and technicals, this underpins our preference for European credit over US peers. Within spread curves, long-dated USD IG bonds stand out as screening particularly tight, reinforcing our preference for shorter spread duration exposure.

The averages, however, conceal growing dispersion. While the broad credit market appears healthy, pockets of weakness are emerging in specific industries. Chemicals, US homebuilders, and construction-related materials stand out as sectors under pressure, with certain names trading wide for good reason. We are cautious on

advocating large overweights in these sectors, but our team of seasoned analysts is well suited to uncover idiosyncratic opportunities where valuations have overshot underlying fundamentals.

**Figure 1** – Constant quality spread for US IG



Source: Bank of America, September 2025. \*Average Spread (OAS) of a constant US IG mix consisting of 20% AA, 40% A, 40% BBB.

Euro corporate hybrids have been a long-standing area of opportunity for us. Following significant spread tightening, especially versus Euro BB corporates, we now advocate selective profit-taking in this space. European bank subordinated debt, by contrast, has also delivered strong performance but continues to offer relative value. We see this segment as resilient, even in the face of a mild economic slowdown or rising geopolitical uncertainty.

In high yield, the picture is mixed. At the lower-quality end, CCC spreads do not compensate for average default expectations or associated loss-given-default rates. By contrast, B and BB credits still offer scope for positive excess returns under long-term average default assumptions, albeit with a diminishing margin for error. This keeps us cautious on overall beta positioning, while still finding selective value further up the quality spectrum.

Valuations in emerging market credit remain historically tight, largely a result of technical factors. While technical factors such as limited USD issuance and strong inflows have supported performance, valuations now look stretched. Against this backdrop, we retain a more cautious stance, emphasizing selectivity over broad market exposure.

### Technicals

Risk markets have performed exceptionally well this year, even as investors bid up the gold price and discount multiple Fed rate cuts. At first glance, this combination looks paradoxical: how can risk assets continue to rally when tariff risks and geopolitical tensions remain unresolved? We think that the answer lies in investor behavior.

Market participants have been wrongfooted several times in recent years by over-discounting recession risk. The 2022 sell-off proved premature, as growth held up despite aggressive rate hikes. A similar episode unfolded in

August 2024, when weak labor market data sparked fears that were quickly priced out again. The tariff-induced correction in April this year was no different, another dip that, in hindsight, was a buying opportunity. Having been burned by hedges that never paid off, investors are reluctant to position defensively, a behavior that has reinforced today's strong technicals.

Supporting this, sell-side surveys indicate that credit market positioning has surged to its largest overweight since the post-Covid rebound in the summer of 2020. A study of fund betas confirms this trend, with average fund betas now above 1 across all credit classes. That does not mean sell-offs are gone for good, but the next one will likely require firm evidence that growth is truly rolling over.

Another technical development worth highlighting is the structural improvement in liquidity. The rise of portfolio trading has made it far easier for investors to trade baskets of bonds efficiently, compressing liquidity premia across credit markets. Combined with strong demand, this has contributed to the resilience of spreads, even at historically tight levels.

The strength of demand is also visible in primary markets. New issue premiums (NIPs) have narrowed sharply, with many deals heavily oversubscribed despite valuations that look stretched by historical standards. Supply has not kept pace with appetite, keeping technicals firmly supportive. That said, we must remain mindful of how correlations between rates and spreads shift across inflation regimes. In periods of low inflation, the traditional negative correlation tends to hold, providing diversification benefits. But in high-inflation environments, this relationship can turn positive, as we saw in 2022, undermining the defensive qualities of credit. Inflation therefore remains a key variable to monitor.

*“Another technical development worth highlighting is the structural improvement in liquidity*

Interestingly, there has been little evidence of a broad ‘sell America’ trend in credit markets. While anecdotal evidence suggests non-US investors are directing marginal flows toward other regions, they are not offloading their USD credit holdings at scale. Large-scale reallocations among real-money investors are rarely instantaneous, and for now, US credit remains well supported.

Technical conditions in emerging markets remain constructive. Issuers have increasingly diversified away from USD issuance, tapping alternative markets such as EUR, CHF and AUD, as illustrated by the well-received jumbo Colombia EUR deal. This shift has reduced net USD supply, providing a positive backdrop for spreads.

At the same time, issuance elsewhere, particularly from Middle Eastern banks and Latin American corporates, has been readily absorbed, reflecting strong demand. Asian issuers, for their part, are raising more capital locally, further limiting USD supply. Meanwhile, EM fund flows have turned decisively positive, both in local- and hard-currency markets, leaving many global investors underexposed to the recent EM outperformance. Together, these dynamics suggest technicals should remain a tailwind for EM credit in the months ahead.

### Positioning

Against the backdrop of historically tight spreads, our overall stance remains cautious. Valuations leave little room for further tightening, yet strong technicals have so far restrained us from adopting an overly negative bias. Within both Global IG and HY portfolios, our core top-down preference remains for EUR-denominated credit over USD, supported by more attractive relative fundamentals, shorter duration, and still-favorable technicals.

In investment grade, given that spreads have now reached all-time tights, we are inclined to position even more cautiously. Portfolios maintain a notable underweight in the long end of the USD curve, where valuations look

stretched and credit curves remain flat. We continue to favor shorter spread duration and an 'up-in-quality' tilt across both EUR and USD credit.

In high yield, we target around neutral beta versus the performing part of the benchmark (BB and B credits), while keeping a more cautious stance toward stressed names. This positioning results in an overall beta slightly below one versus a broad HY index that includes CCC risk.

Sector-wise, we retain an overweight in financials, particularly European bank subordinated debt, which we see as relatively resilient even in the face of mild economic slowdown or geopolitical stress. That said, the strong performance of the sector has narrowed the relative value gap, and selective profit-taking has been prudent in areas such as corporate hybrids. We also continue to look for idiosyncratic opportunities in industries where dispersion is elevated, while avoiding broad sectoral overweights in weaker areas such as chemicals, US homebuilders, and construction-related materials.

**Table 1** – Current positioning

	Constructive	Neutral	Cautious
<b>Fundamentals</b>		✓	
<b>Valuations</b>			✓
<b>Technicals</b>	✓		
<b>IG credit</b>			✓
<b>HY credit</b>			✓
<b>Financials</b>	✓		
<b>Non-financials</b>			✓
<b>Emerging</b>			✓

**Source:** Robeco, September 2025

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