February 27, 2025

Global Credit Weekly:

Notable resilience

BlackRock

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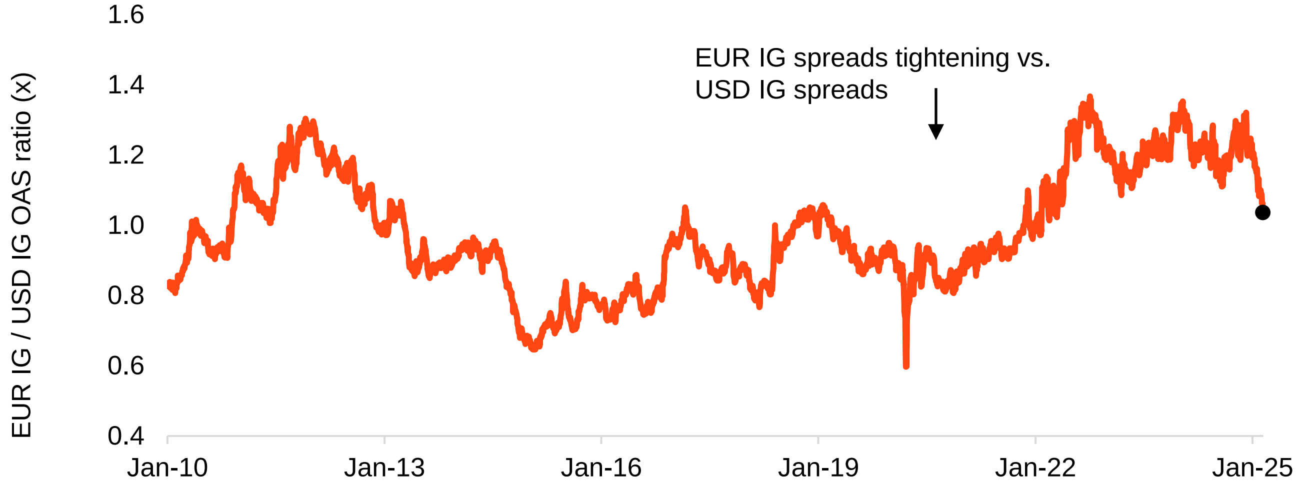
Key takeaways

- 10-year yields (real and nominal) have retraced to levels last seen in late 2024. And market pricing now reflects additional rate cuts from the Federal Reserve in 2025, as well as a lower 'neutral' rate of interest, relative to just a few weeks ago. Softer consumer survey data – coupled with below-consensus retail sales – have refocused market participants on the downside risks to U.S. growth. We place more weight on the labor market data, which we view as more informative for the (bifurcated) universe of U.S. consumers' overall financial health and spending ability.
- For corporate credit investors, the recent decline in yields has provided a mechanical boost to total returns (for fixed rate credit) and catalyzed an active week in the USD IG primary market. One key risk to monitor is whether a sustained decline in U.S. Treasury yields might temper the demand for corporate credit from yield-based buyers (which has been an important technical tailwind for spreads, in our view). Despite the recent focus on downside risks to growth, corporate credit spreads – which are a growth-sensitive asset class – are not reflecting significant concerns. The resilience of the EUR credit market, relative to its USD peer group, has been especially notable (Exhibit 1).
- Another area of focus among market participants has been on the landscape for M&A. While many entered 2025 with lofty expectations for M&A activity, some have started to question whether the long-awaited rebound in this subset of capital markets activity will be delayed. To better understand 'what's next?' for M&A, we reviewed recent commentary from more than a dozen banks and M&A advisors, who we believe provide unique insights into the pipeline of transaction activity, given their proximity to capital markets and ongoing conversations with management teams. The analysis revealed continued optimism around an eventual rebound in M&A activity in 2025, though with a few caveats (detailed within). We also draw a distinction – in terms of volumes – between strategic and sponsor related activity.

Exhibit 1: EUR IG spreads have outperformed USD IG

Option adjusted spread (OAS) ratio for the ICE-BAML EUR IG Corporate Index vs. the USD IG Corporate Index



Source: ICE-BAML, Bloomberg, BlackRock. As of February 26, 2025. **The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results.** Index performance returns do not reflect any management fees, transaction costs, or expenses. Indices are unmanaged and one cannot invest directly in an index.

A focus on the *drivers* of the decline in rates

10-year yields – both real and nominal – have retraced to hover near levels last seen in late 2024 (Exhibit 2). At the same time, market pricing now reflects some additional rate cuts from the Federal Reserve in 2025, and a lower 'neutral' rate of interest, relative to just a few weeks ago (Exhibit 3).

Some market participants have attributed the decline in yields to concerns about downside risks to U.S. growth, pointing to softer consumer survey data which showed a decline in consumer confidence, as well as below-consensus U.S. retail sales released in mid-February.

As we have noted previously, developments related to the financial health of the U.S. consumer warrant careful monitoring, given that consumer spending generates approximately two-thirds of U.S. GDP. Among all of the factors contributing to the well-documented resilience of USD credit spreads in recent quarters, we would place the above-trend growth backdrop in the U.S. at the top of the list.

That said, we place more emphasis on labor market data, which we believe is more pertinent for assessing consumers' overall spending ability (as opposed to survey data, which has signaled 'false caution,' previously). The health of the labor market is especially relevant given the bifurcated nature of consumers' financial health. So far, and on net, the labor market data remain "solid" as the January FOMC minutes acknowledged. We will be watching high-frequency data, such as jobless claims, closely.

Exhibit 2: 10-year yields have retreated to levels last seen in late 2024

U.S. 10-year real (inflation adjusted) and nominal yields

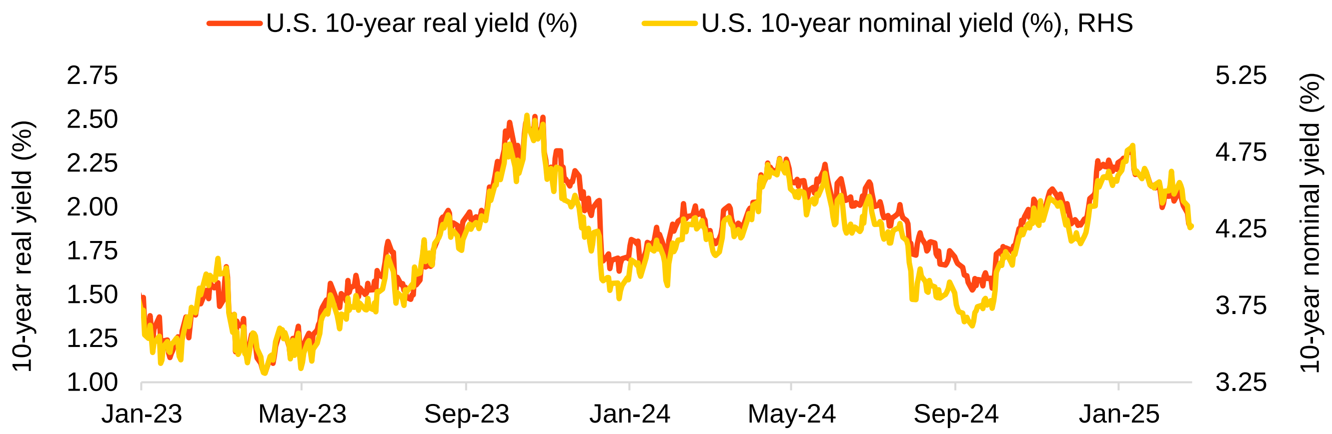


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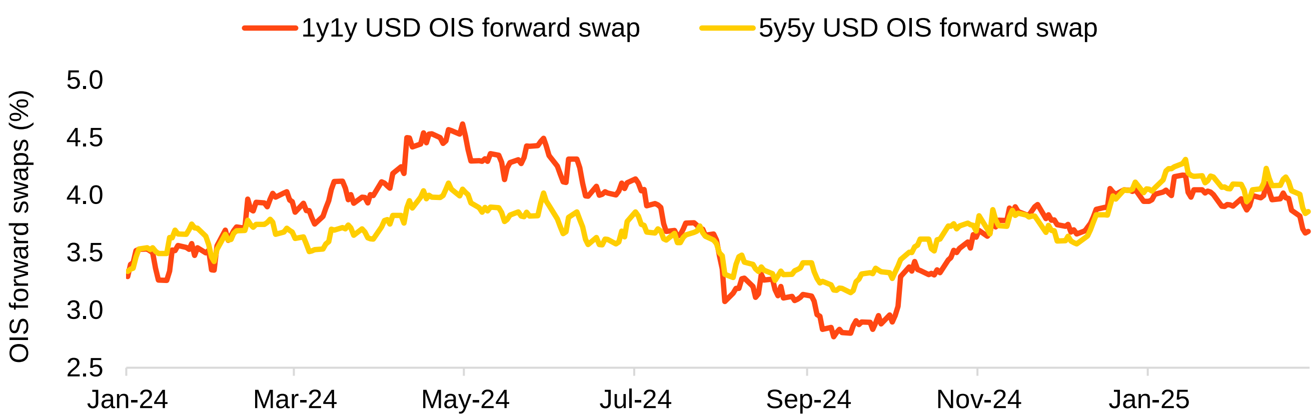
Exhibit 3: Market pricing now reflects more Fed rate cuts in 2025, and a lower 'neutral' rate

1y1y Overnight Indexed Swap (OIS) forwards, as a proxy for the terminal rate of this cycle, and 5y5y OIS as a proxy for the long-term neutral rate



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For corporate credit investors, the recent rally in U.S. Treasuries has provided a mechanical boost to total returns (for fixed rate credit) and has catalyzed an active week for primary market issuance among USD IG borrowers (supply through Wednesday Feb. 26th was already well ahead of consensus estimates for the full week). One key risk to monitor is whether a sustained decline in U.S. Treasury yields may temper the demand for corporate credit from yield-based buyers (which has been an important technical tailwind for spreads, in our view).

Indeed, the drivers of any future declines in rates remain important to watch, in our view. If U.S. Treasury yields fall further on downside surprises to U.S. growth, that will likely present a challenging backdrop for corporate credit spreads. By contrast, if rates fall because of improved inflation and/or moderating concerns over fiscal deficits (most relevant for the long-end), we would view that as a more constructive 'reason' for lower yields.

Credit spreads show only limited instances of modest widening, so far

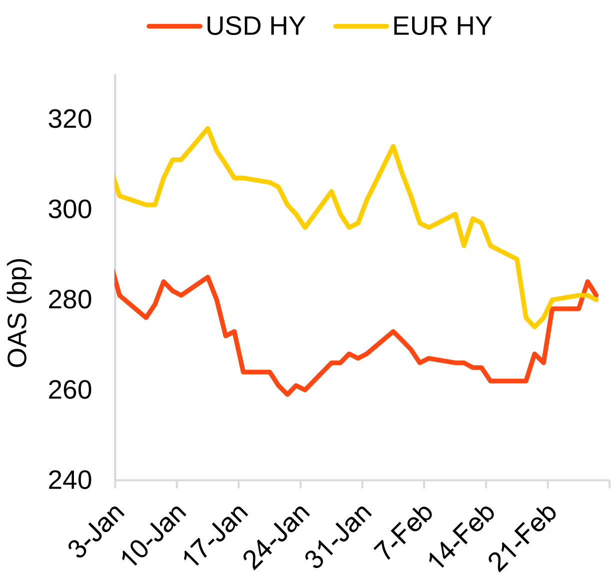
Somewhat surprisingly, despite the recent focus on downside risks to growth, corporate credit spreads – which are a growth-sensitive asset class – are not reflecting significant concerns.

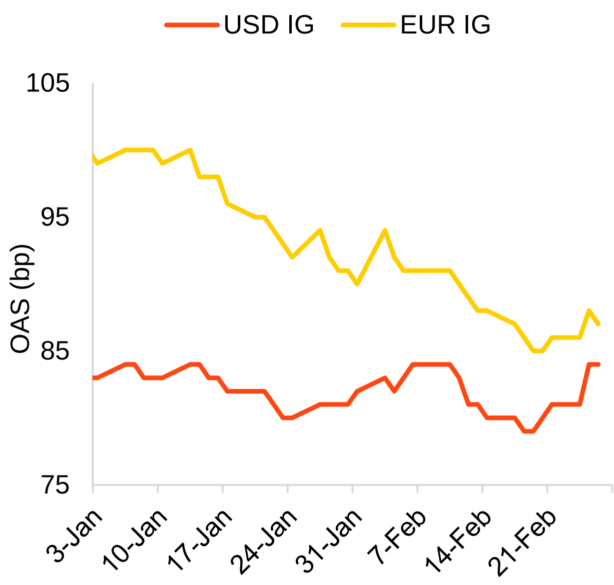
In early February, and after having been constructive on credit spreads (and the case for tightening) for the past few quarters, we outlined an expectation for modest widening in corporate credit spreads – which we believed was likely to materialize over the next few months. As we wrote at the time, we believed some rebuild in risk premia was warranted given recent developments related to trade policy uncertainty.

For the USD market, our base case was for approximately 10-15bp of spread widening in IG, and 30-40bp of spread widening in HY. This would bring index-level spreads to the 95-100bp and 300-310bp areas, respectively, using the ICE-BAML USD IG and HY Corporate indices – levels that were still well below the post-financial crisis averages.

Such a modest widening scenario would also keep the USD HY / IG option adjusted spread (OAS) ratio relatively constant, at 3.2x. Absent a sharp downturn in growth, we noted that we did not expect material decompression, owing to a 'solid enough' fundamental backdrop and technical support factors (both on the supply and demand side) in credit.

Exhibit 4: There have been only limited instances of spread widening since early February
Index-level option adjusted spreads (bp) for the ICE-BAML USD and EUR HY Corporate indices (left panel) and ICE-BAML USD and EUR IG Corporate indices (right panel)





Source: ICE-BAML, Bloomberg, BlackRock. As of February 26, 2025. **The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results.** Index performance returns do not reflect any management fees, transaction costs or expenses. Indices are unmanaged and one cannot invest directly in an index.

We saw scope for incrementally more widening in the EUR IG and HY markets and penciled in 15-20bp of widening for EUR IG and 45-55bp of widening in EUR HY. This would bring index-level EUR IG and HY spread metrics to the areas of 110bp and 360bp, respectively, while also keeping the EUR HY / IG spread ratio at 3.2x. Here too, the widening we anticipated was quite moderate in the context of the longer-term trend, owing again to the impact of supportive technicals in the EUR market.

Since that time, the USD HY market is the only subset that has – so far – experienced any amount of noticeable widening (+12bp since February 5th). The USD IG market is just 1bp wider. And in the EUR market, spreads have moved *tighter*: EUR IG by 4bp, and EUR HY is 23bp tighter. While we do ultimately expect the modest widening to eventually materialize, we acknowledge the bar for a sustained widening appears to be high.

Placing EUR credit's resilience in context

For now, the EUR credit market appears to be looking past the potential overhang of trade policy uncertainty. Indeed, supportive technicals (as well as some positive idiosyncratic developments around earnings) appear to remain in the driver's seat for spreads. The trend of resilience in EUR credit markets echoes the pattern we highlighted in late November. We also believe the resilience reflects some optimism around longer-term themes. This includes a potential ceasefire in Ukraine, which could boost confidence, lower gas prices, and generate reconstruction spillovers to the Euro Area. It also includes the possibility of additional fiscal spending in Germany following the recent election.

Exhibit 5: EUR HY has slightly underperformed EUR IG
Option adjusted spread (OAS) ratio for the ICE-BAML EUR HY Corporate Index vs. the EUR IG Corporate Index

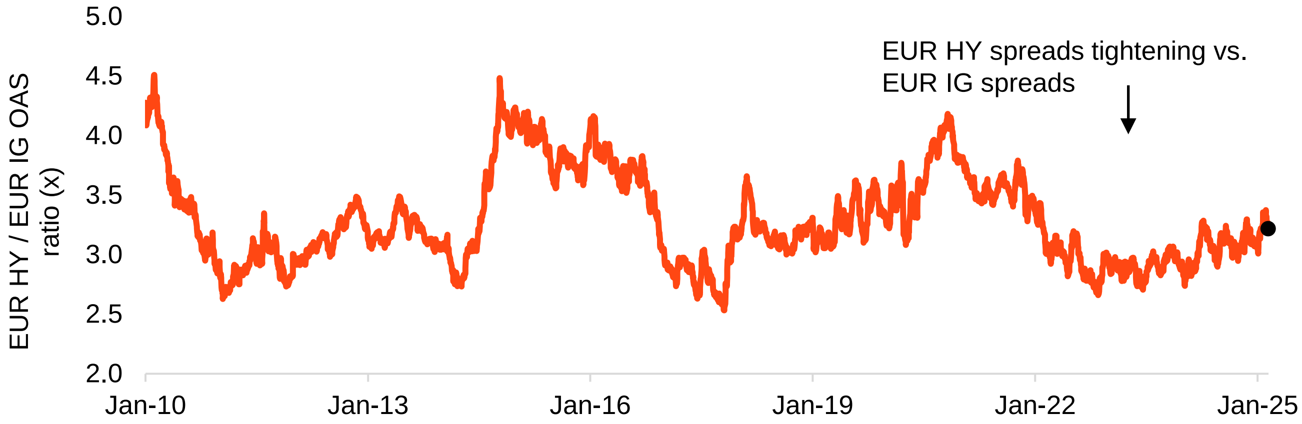
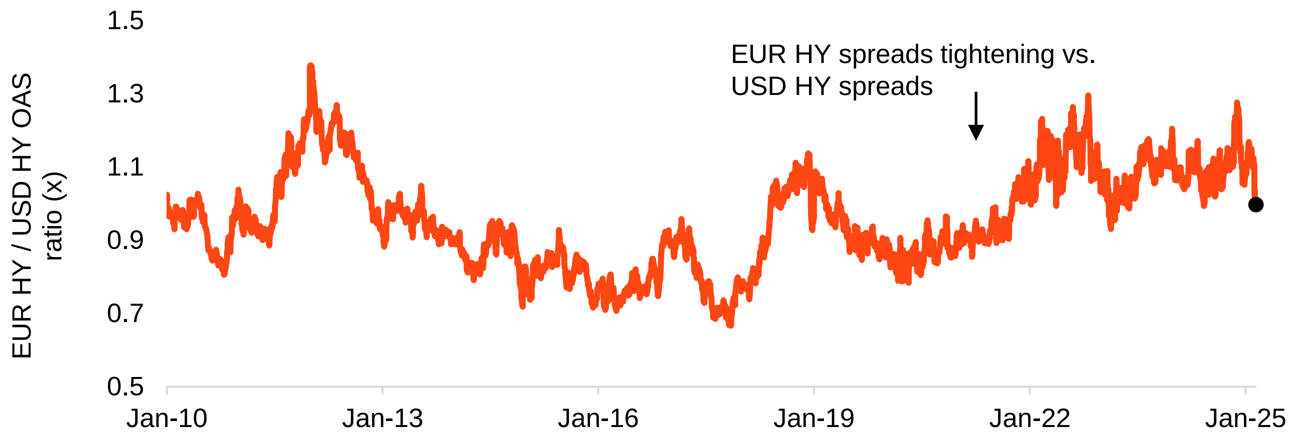


Exhibit 6: EUR HY spreads have outperformed USD HY
Option adjusted spread (OAS) ratio for the ICE-BAML EUR HY Corporate Index vs. the USD HY Corporate Index



Source for both charts: ICE-BAML, Bloomberg, BlackRock. As of February 26, 2025. **The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results.** Index performance returns do not reflect any management fees, transaction costs, or expenses. Indices are unmanaged and one cannot invest directly in an index.

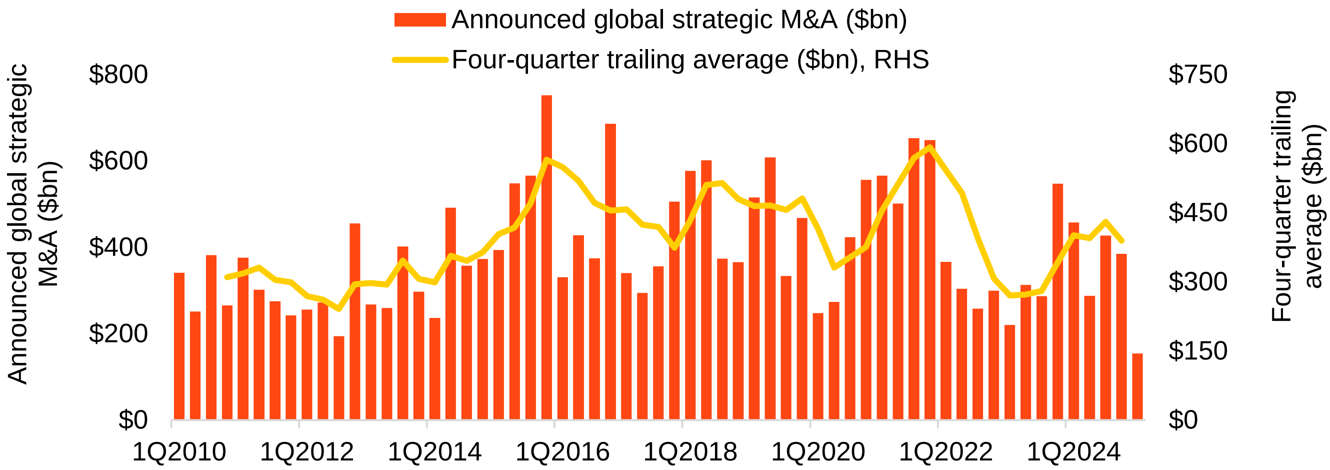
M&A: Assessing the early 2025 activity

Another area of focus among market participants has been on the landscape for M&A. While many entered 2025 with lofty expectations for M&A activity, some have started to question whether the long-awaited rebound in this subset of capital markets activity will be delayed.

To frame the backdrop: in our *1Q2025 Global Credit Outlook*, we noted that a combination of 'directional' clarity on the macroeconomic backdrop, including normalizing monetary policy, and supportive growth would likely set the stage for a potential rebound in M&A in 2025. That said, we made a distinction between the two types of deal activity: those between companies (i.e., 'strategic' deals) and those involving private equity financial-sponsors (i.e., 'sponsor' deals).

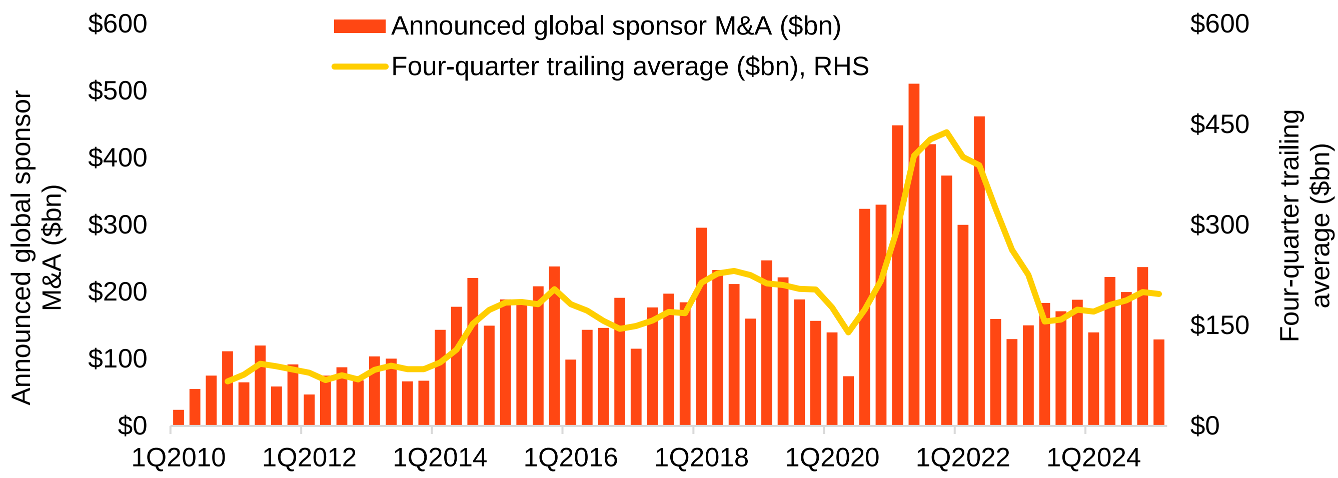
Indeed, as we highlighted in our outlook, we believed the scope for a recovery in deal making was more pronounced on the sponsor-related side, relative to strategic transactions. This is because, as Exhibit 7 illustrates, strategic M&A *had already been increasing* over the past few quarters. But sponsor M&A – especially among larger deals – had been lagging more notably (Exhibits 8 and 9).

Exhibit 7: Strategic M&A experienced a modest rebound in late 2023 and 2024
Global quarterly announced strategic M&A volumes, and four-quarter trailing average (RHS). Captures deals valued at $1 billion or more, at announcement. Excludes cancelled and withdrawn deals.



Source: Dealogic (ION Analytics), BlackRock. Captures quarterly data through year-end 2024. 1Q2025 is as of February 24, 2025. Four-quarter trailing average is through 4Q2024, which is the last full quarter captured.

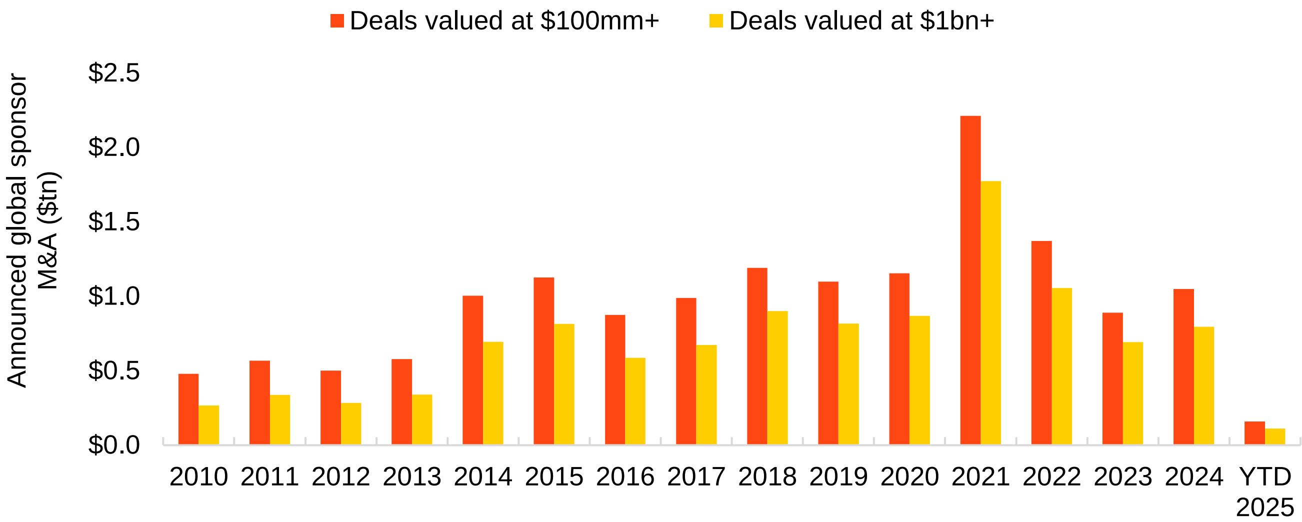
Exhibit 8: Sponsor-related volumes have more room to increase
Global quarterly announced sponsor M&A volumes, and four-quarter trailing average (RHS). Captures deals valued at $1 billion or more, at announcement. Excludes cancelled and withdrawn deals.



Source: Dealogic (ION Analytics), BlackRock. Captures quarterly data through year-end 2024. 1Q2025 is as of February 26, 2025. Four-quarter trailing average is through 4Q2024, which is the last full quarter captured. A deal is classified as sponsor-related if a financial sponsor is a buyer or seller.

Exhibit 9: Tracking smaller sponsor-related M&A deals reveals a more active backdrop, relative to larger deals

Announced global sponsor-related M&A, for two cohorts of deal sizes (at announcement): $100 million or larger, and $1 billion or larger.



Source: Dealogic (ION Analytics), BlackRock. YTD 2025 as of February 24, 2025. Excludes cancelled and withdrawn deals. A sponsor-related transaction is one that involves a financial sponsor (such as a private equity firm) on one or both sides of the transaction (i.e., buyer and/or seller).

What's next for M&A?

To better understand what's next for M&A, we reviewed recent public commentary from more than a dozen banks and M&A advisors, who we believe provide unique insights into the pipeline of transaction activity, given their proximity to capital markets and ongoing conversations with management teams. The analysis revealed continued optimism around a rebound in M&A activity in 2025, though with a few caveats. We highlight a few themes across these remarks (via earnings calls and conference presentations) below:

- **Robust pipelines:** Many noted robust, and expanding, transaction pipelines, supported by "renewed" confidence from board and management teams. Some banks noted that this enthusiasm was well-diversified across sectors.
- **Timing, in 'normal course of business' and due to uncertainty:** Timing was a consideration for many. In addition to the typical lengthy conversion timeline (i.e., moving from a board conversation to a closed transaction can take many / several months), many felt that companies were delaying action until they received further clarity on the macro backdrop, especially related to potential policy shifts.
- **Continued support from structural drivers:** Some noted that structural drivers, such as the artificial intelligence (AI) buildout, demand for energy, and a desire for more resilient supply chains should act as a tailwind to deal activity throughout the year. These, in our view, are and have been important drivers of strategic activity in recent quarters, as well.
- **Sponsor-specific dynamics:** Many cited sponsor-specific pressures that should support deal activity in 2025, including ample amounts of dry powder and pressure to return capital to limited partners (LPs). The aging of private equity inventory, for example, was a theme we recently highlighted.

Implications for corporate credit investors

For corporate credit investors, strategic M&A activity can have meaningful implications for investment performance and warrants close monitoring. This is because these types of transactions can catalyze potentially significant shifts in already-sizeable capital structures – depending on the deal's funding mix and company-specific capital management priorities.

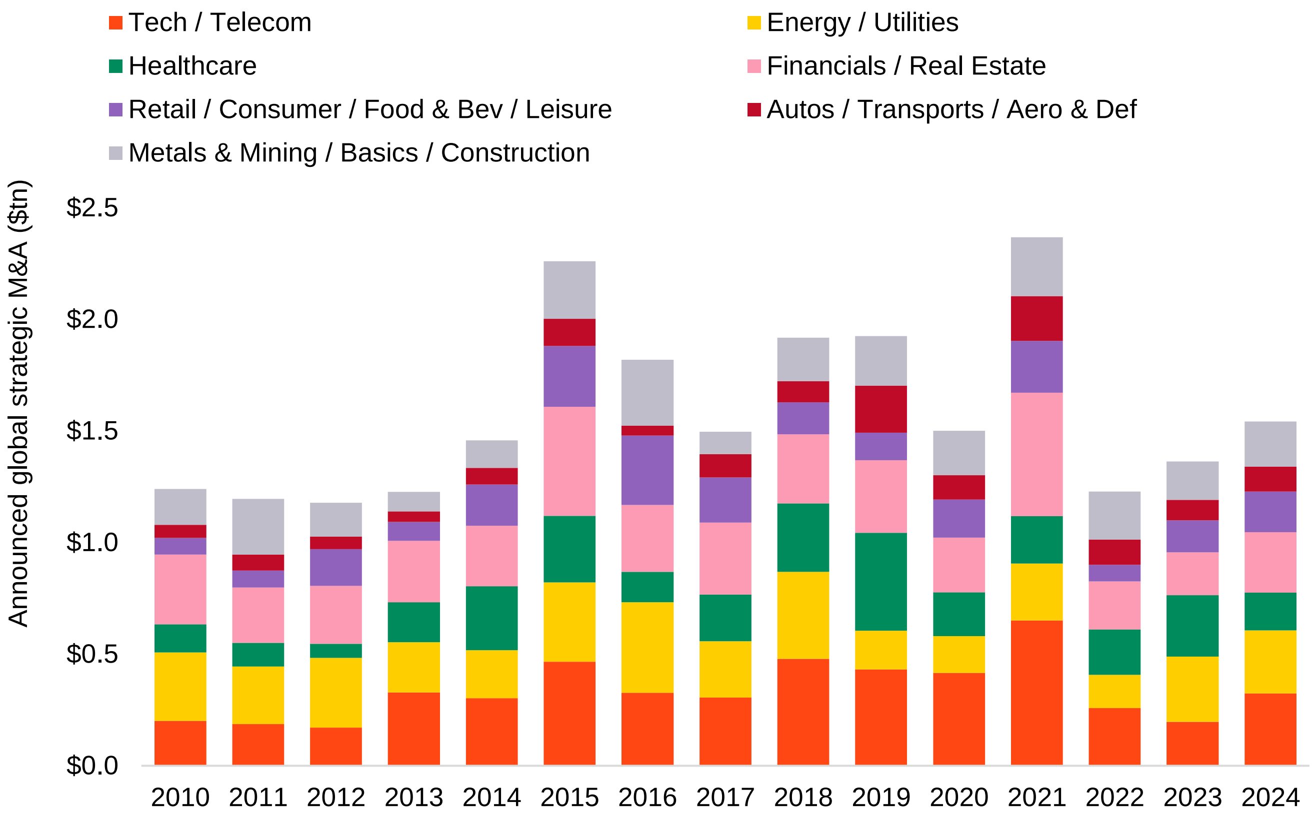
For example, deals slated to be funded with cash can meaningfully reduce existing liquidity cushions, and those requiring additional debt typically result in new bond offerings at a wider spread 'concession' to existing debt in the secondary market. Even in the example of 'cash funded' strategic M&A transactions, often the cash utilized for deal-making ultimately gets 'replaced' with a new debt issue, based on anecdotal experiences over a longer-term history. On the more positive side for bondholders, equity-funded deals can often *improve* leverage metrics (or at least keep such measures stable).

As we have outlined previously, we believe balance sheet strength will remain a key differentiator in the context of future strategic M&A activity. Corporates with strong funding options – especially cash-rich and highly-rated IG firms with ample debt capacity – will have opportunities to grow and diversify their businesses. Meanwhile, higher financing costs might render those same opportunities as uneconomic for financially stretched firms.

In certain instances, we also see a role for the private markets to participate in the financing of strategic buyers' M&A ambitions. This dynamic around access to funding is likely to be yet another driver of dispersion – albeit over a long-term trend – in the corporate credit market, in our view.

Exhibit 10: The sector mix of 2024 M&A was broad based, albeit with a slightly lower contribution from Healthcare vs. the historical pattern

Announced global strategic M&A volumes, by calendar year and deal sector ($ in trillions). Captures deals valued at $1 billion or more at announcement. Excludes cancelled and withdrawn deals.



Source: Dealogic (ION Analytics), BlackRock. Captures data through year-end 2024, and as of January 7, 2025.

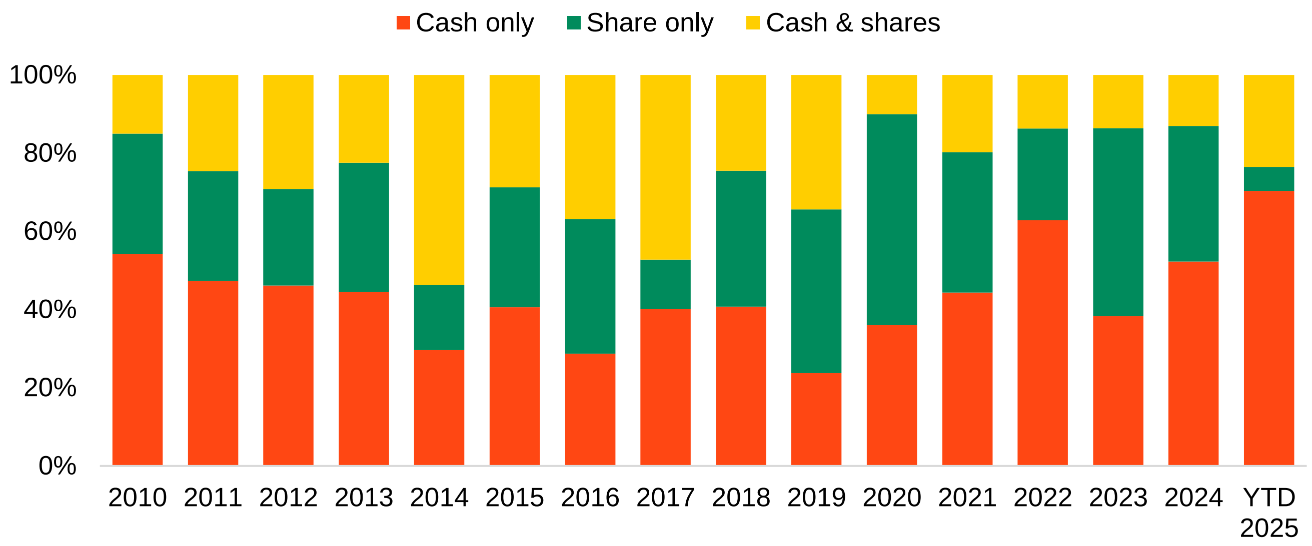
Historical perspective on the aggregate funding mix

Exhibits 11 and 12 provide some perspective on how the strategic M&A funding mix has trended over time, and across geographies. With the important caveat that there is a wide degree of variation at the sector and company levels, we nonetheless find the directional trend informative as a gauge on corporates' capital management postures toward leverage.

For example, 52% of strategic deals by North American acquirers in 2024 were funded entirely with cash – a level that ranks at the higher end of the post-financial crisis range (Exhibit 11). 35% of deals were funded entirely with equity – a decline vs. 2023 (48%) and also below the five-year average of 41% (2019-2023). And relative to North American acquirers, those in Europe / Middle East / Africa (EMEA) tend to rely even more on cash-funded transactions, as opposed to equity-funded deals (Exhibit 12).

Exhibit 11: North America strategic M&A funding mix

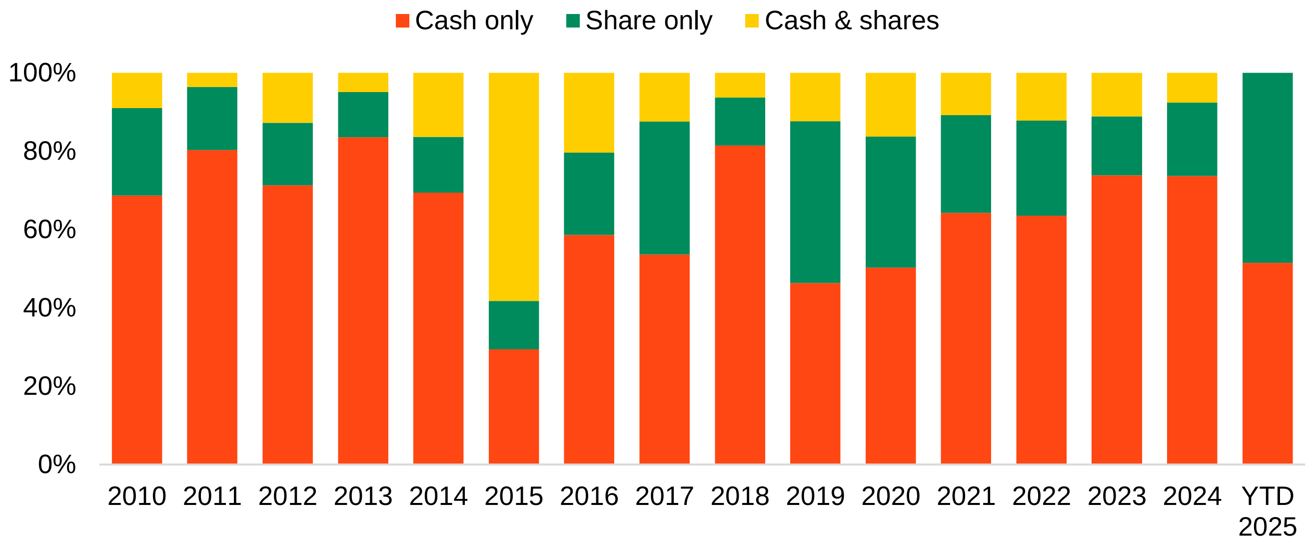
Funding mix of announced M&A, by calendar year, of North American strategic acquirers. Captures deals valued at $1bn or more at announcement. Excludes cancelled and withdrawn deals.



Source: Dealogic (ION Analytics), BlackRock. Captures data as of February 24, 2025.

Exhibit 12: EMEA strategic M&A funding mix

Funding mix of announced M&A, by calendar year, of EMEA strategic acquirers. Captures deals valued at $1bn or more at announcement. Excludes cancelled and withdrawn deals.



Source: Dealogic (ION Analytics), BlackRock. YTD 2025 data is as of February 24, 2025.

Unless otherwise stated, all reference to $ are in USD.

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