April 24, 2025

Global Credit Weekly:

A temporary reprieve

BlackRock

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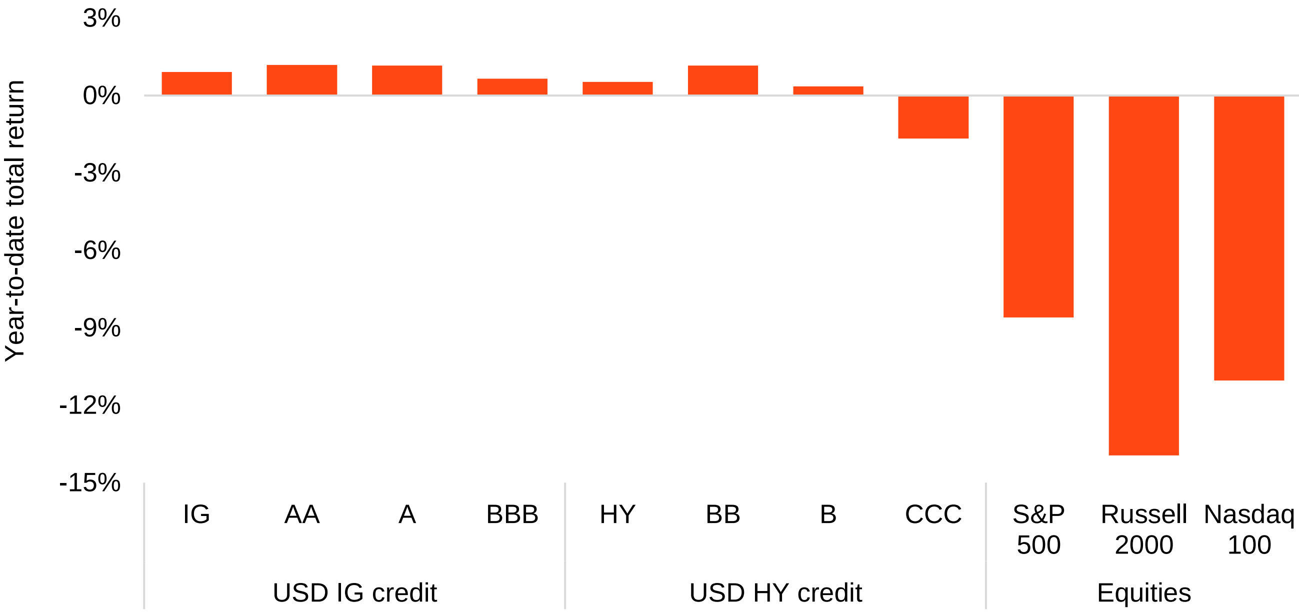
Key takeaways

- As of April 23rd, the USD IG market has retraced roughly one-third of the spread widening since the mid-February local tights, and USD HY has retraced more than 40%. That said, we view this as somewhat of a temporary reprieve. With spreads across most rating cohorts still well below the post-financial crisis averages, we see scope for some additional spread widening.
- Underpinning this view is our expectation for a more challenging growth-inflation mix, as well as our expectation that the 'hard' economic data will eventually 'catch down' to the 'soft' sentiment data. The magnitude of the potential growth slowdown has yet to be determined, however. Indeed, the severity and duration of the growth deterioration will depend on the forward path for trade policy as well as the duration of lingering policy uncertainty.
- The 'feedback loop' between corporate margins, the labor market, consumer spending and overall economic activity is an important signal to watch. High-frequency data on jobless claims and company level commentary on operational leverage and pricing power will be most informative, in our view. Encouragingly, debt capital markets are open and have been active in recent days – although, given the very low near-term maturity walls, this is more relevant for market sentiment as opposed to any urgent refinancing needs (at least in aggregate).
- Amid the broader volatility – and the breakdown of historical relationships between some asset classes – market participants have been focused on two specific areas: (1) the distinction between total and excess returns in the corporate credit market; and (2) the relative performance of corporate credit vs. equities. In this *Global Credit Weekly*, we explore each.

Exhibit 1: Even the lowest quality subset of USD HY has outperformed equities, year-to-date
Year-to-date total returns (%) for various USD corporate credit and equity indices



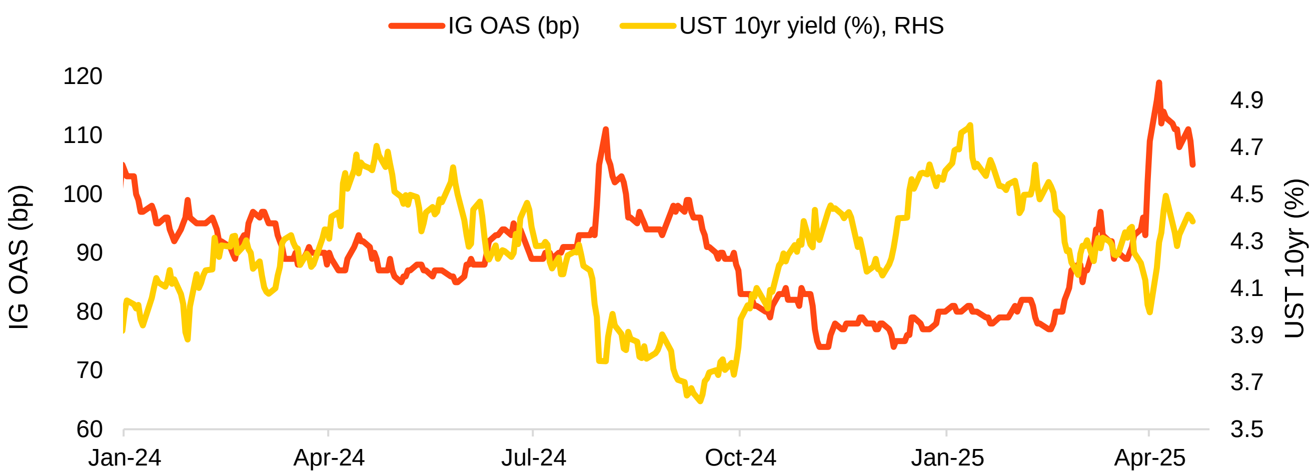
Source: Bloomberg, Standard & Poor's, Russell, NASDAQ Global Market, BlackRock. As of April 23, 2025. **The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results.** Index performance returns do not reflect any management fees, transaction costs or expenses. Indices are unmanaged and one cannot invest directly in an index.

A partial retracement

From the mid-February 2025 local lows through April 8th, USD IG and HY spreads widened 42bp and 197bp, respectively (Exhibits 2 and 3). As of April 23rd, the USD IG market has retraced roughly one-third of that widening, and USD HY has retraced more than 40%. That said, we view this as somewhat of a temporary reprieve. With spreads across most rating cohorts still well below the post-financial crisis averages (Exhibit 4), we see scope for some additional spread widening.

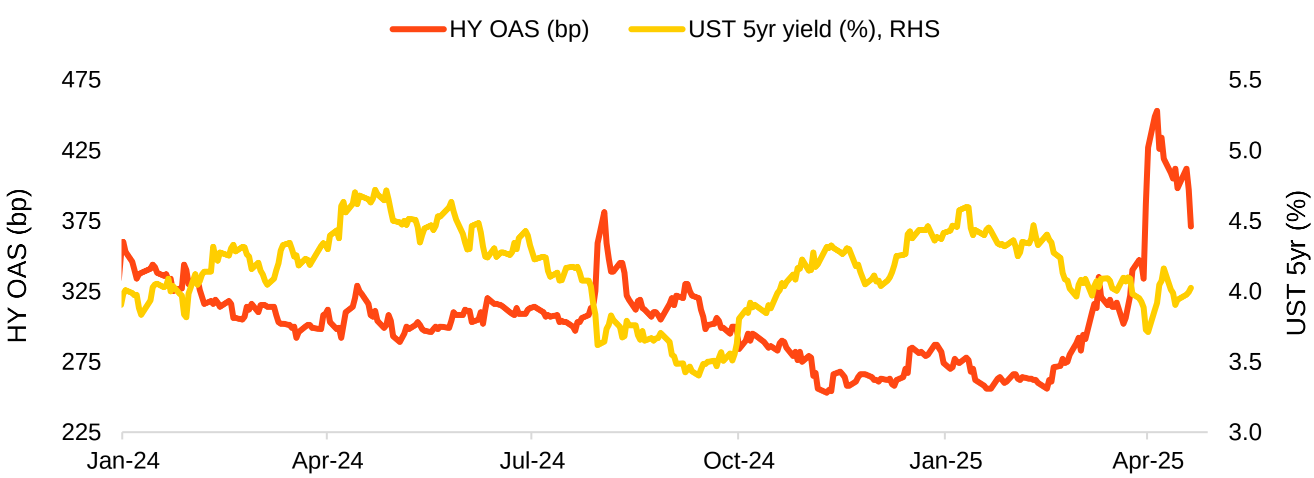
Underpinning this view is our expectation for a more challenging growth-inflation mix, as well as our expectation that the 'hard' economic data will eventually 'catch down' to the 'soft' sentiment data. The magnitude of the potential growth slowdown is highly uncertain, however. Indeed, the severity and duration of the growth deterioration will depend on the forward path for trade policy as well as the duration of lingering policy uncertainty. The 'feedback loop' between corporate margins, the labor market, consumer spending and overall economic activity is an important signal to watch. High-frequency data on jobless claims and company level commentary will be most informative, in our view.

Exhibit 2: USD IG spreads have retraced one-third of their widening since mid-February 2025
Index level option adjusted spreads (OAS) for the Bloomberg USD IG Corporate Index, and the yield on the U.S. 10-year Treasury (RHS)



Source: Bloomberg, BlackRock. As of April 23, 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.

Exhibit 3: USD HY spreads have retraced more than 40% of their recent widening
Index level option adjusted spreads (OAS) for the Bloomberg USD HY Corporate Index, and the yield on the U.S. 5-year Treasury (RHS)



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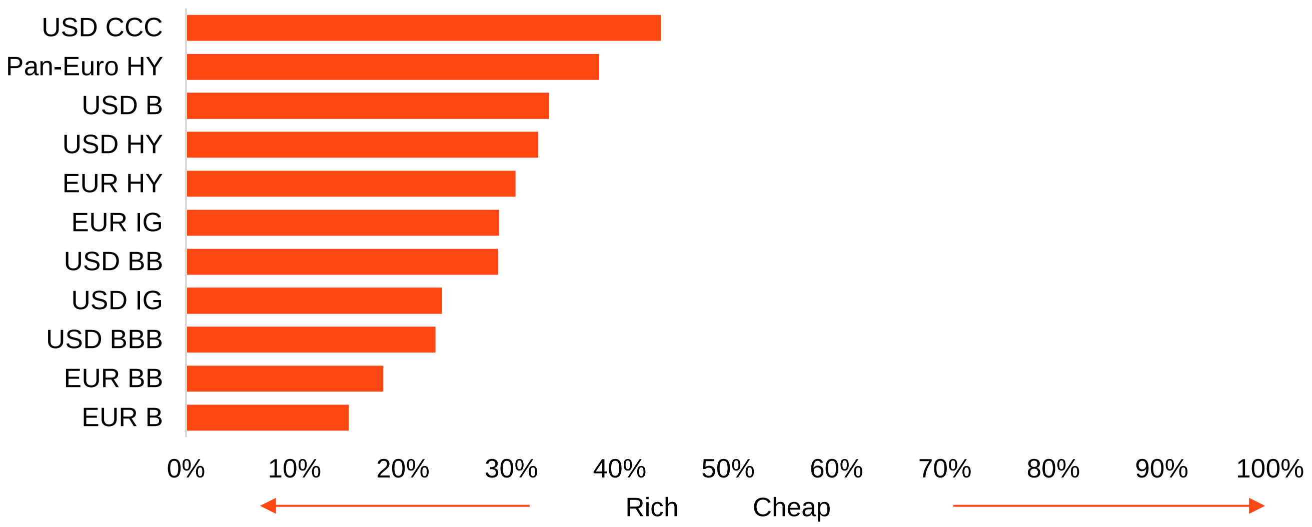
That said, somewhat mitigating this headwind is the solid starting point for credit fundamentals (and supportive technical factors in some markets). This leaves us comfortable *selectively* moving down in quality within credit. Capturing some additional spread is key, in our view, given the volatility in the rates market. Indeed, as Exhibit 1 illustrates, the wider spreads in the USD HY market have (in part) helped to generate year-to-date total returns which are similar to its higher-rated USD IG peer group (i.e., both BBs and As have generated similar total returns of approximately 1.2%).

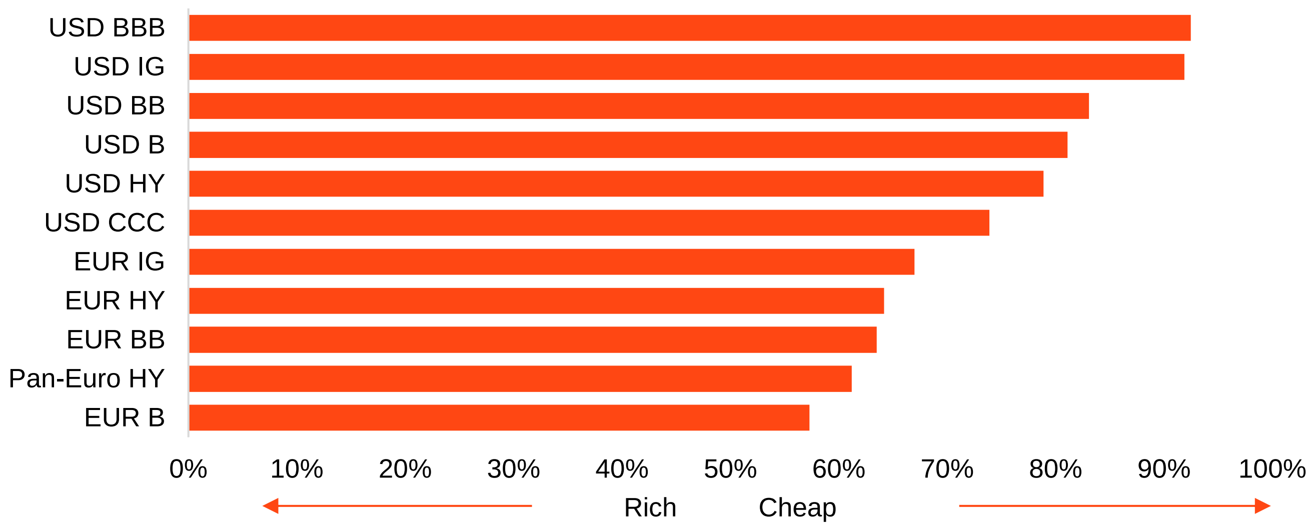
As we outlined recently, we believe USD HY spread levels around 550bp-650bp would begin to reflect an expectation for a sharp growth slowdown, and spreads 800bp-850bp or higher would begin to reflect a recessionary outcome. For USD IG, these levels would be closer to 140bp-150bp (sharp growth slowdown) and 180bp-200bp or higher (recessionary outcome), respectively.

Exhibit 4: Spreads have repriced wider, but remain below post-financial crisis averages
Percentile rank of daily index-level corporate bond option adjusted spreads, since January 1, 2010



Source: ICE-BAML, Bloomberg, BlackRock. As of April 23, 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.

Exhibit 5: All-in yields across most segments of corporate credit are attractive vs. history, boosted by sovereign yields
Percentile rank of daily index-level corporate bond yield-to-worst levels, since January 1, 2010



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The recent volatility in the rates market has also made the distinction between corporate credit *total* returns (which include the performance impact of interest rates) and *excess* returns (which instead primarily capture the performance contribution from credit spreads) increasingly important for corporate credit investors to monitor.

This differential is especially pronounced in the EUR market, given the decline in the German Bund yield since mid-March (Exhibits 6 and 7). The distinction between excess and total returns is also notable in the IG credit market, given its longer duration and resulting sensitivity to the sell-off in long-end U.S. Treasury yields since early April.

Exhibit 6: Month-to-date total vs. excess returns in the USD and EUR HY markets

Month-to-date total returns and excess returns (which exclude the impact of interest rate fluctuations) for the Bloomberg USD HY (left panel) and EUR HY (right panel) Corporate indices

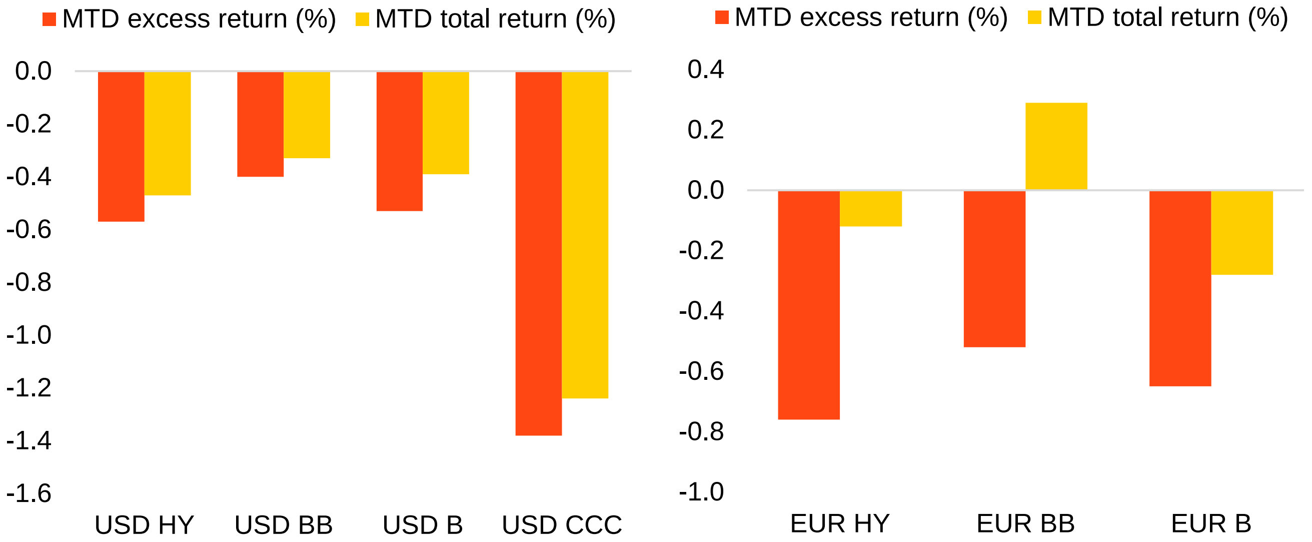

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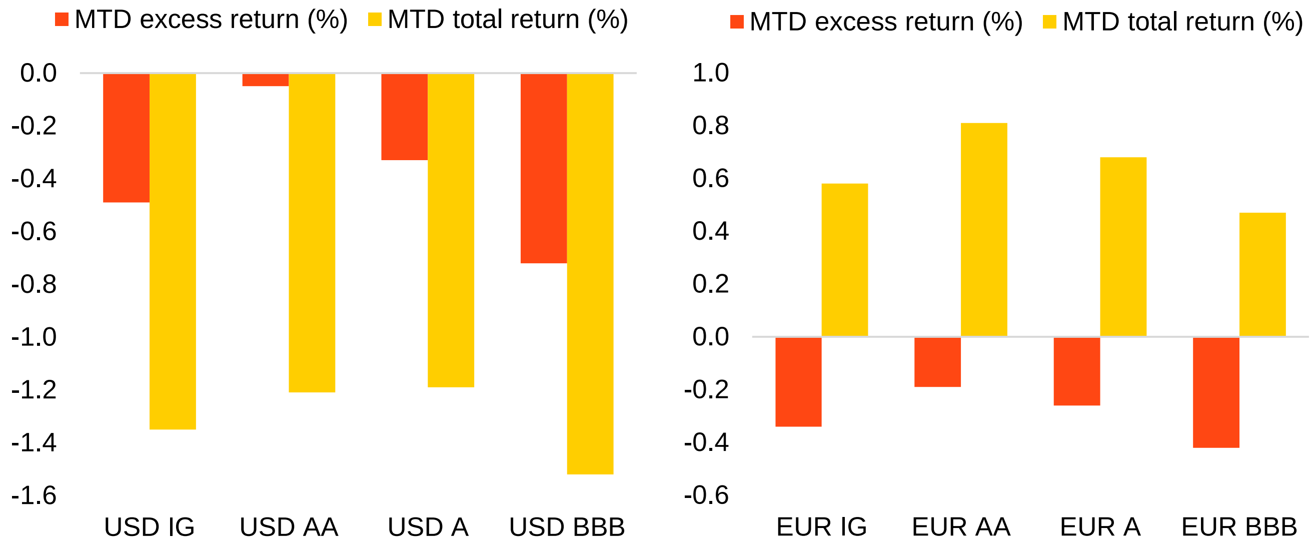
Exhibit 7: Month-to-date total vs. excess returns in the USD and EUR IG markets

Month-to-date total returns and excess returns (which exclude the impact of interest rate fluctuations) for the Bloomberg USD IG (left panel) and EUR IG (right panel) Corporate indices



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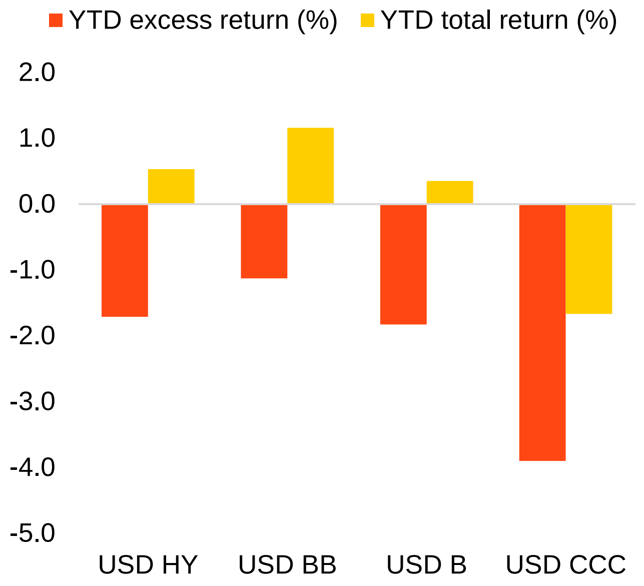
Exhibits 8 and 9 provide the same snapshot of total and excess returns, this time using a year-to-date horizon.

In the USD market, we continue to place the most emphasis on the income and carry (yield) components of corporate credit total returns. By contrast, we place less emphasis on the potential total return from duration exposure, which would benefit fixed rate bond total returns, mechanically, if/when rates decline and/or spreads tighten. And as mentioned previously, we see limited scope for absolute spread tightening from current levels, given the macroeconomic backdrop.

Exhibit 8: Year-to-date total vs. excess returns in the USD and EUR HY markets
Year-to-date total returns and excess returns (which exclude the impact of interest rate fluctuations) for the Bloomberg USD HY (left panel) and EUR HY (right panel) Corporate indices



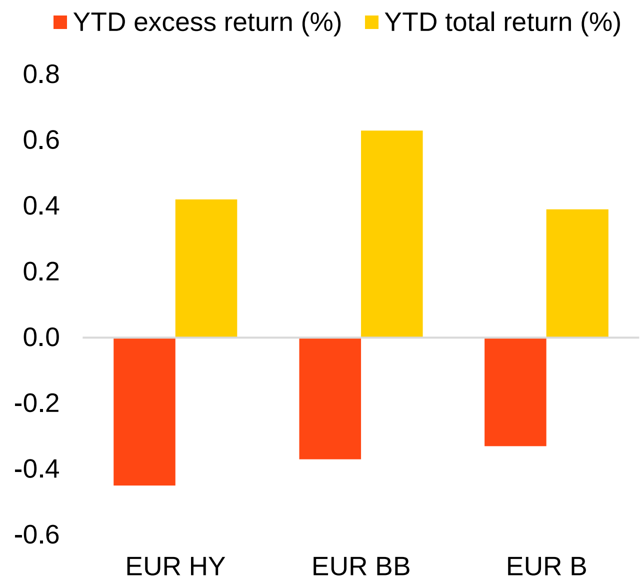


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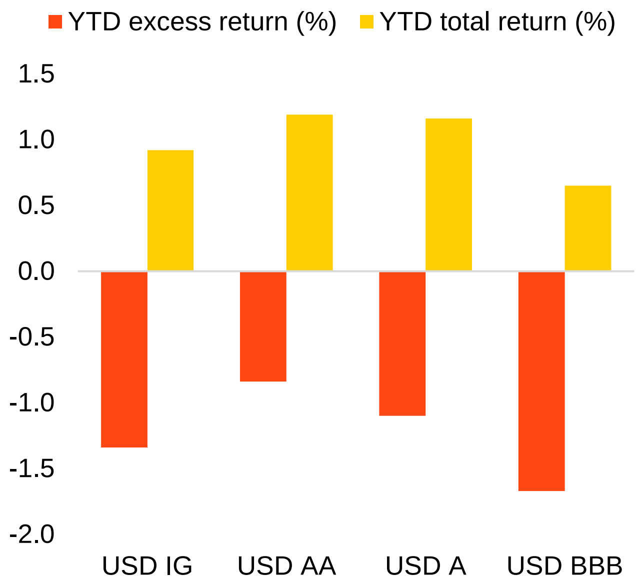
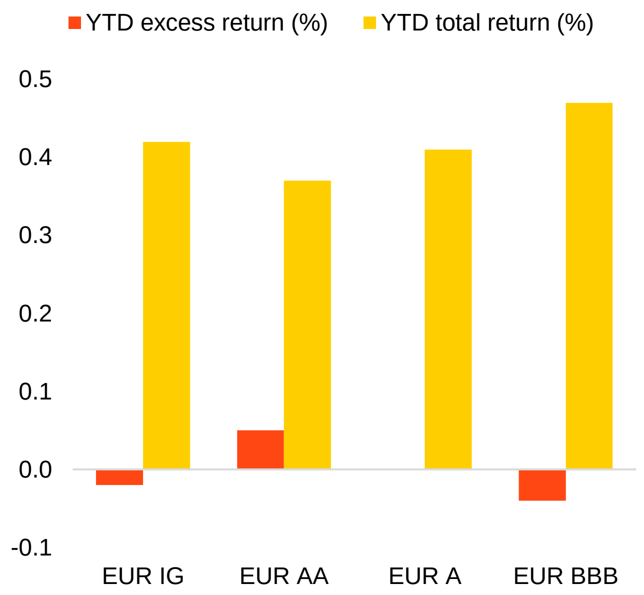
Exhibit 9: Year-to-date total vs. excess returns in the USD and EUR IG markets
Year-to-date total returns and excess returns (which exclude the impact of interest rate fluctuations) for the Bloomberg USD IG (left panel) and EUR IG (right panel) Corporate indices





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We believe a sustained rally in interest rates is unlikely from current levels, barring a significant increase in the probability of a U.S. recession. Over the long-term, our colleagues in the *BlackRock Investment Institute* expect the U.S. fiscal deficit to remain above 5%. This could leave long-term U.S. Treasuries vulnerable to potential increases in term premium (Exhibit 11), as investors may demand additional compensation. They also expect higher long-term bond yields to persist, globally.

And at the front-end of the curve, we believe a more constrained reaction function from the Federal Reserve will likely limit the potential for preemptive rate cuts – at least in 1H2025.

Exhibit 10: We expect structurally higher interest rates in this cycle
Yield-to-worst of the 2-year, 10-year and 30-year U.S. Treasuries (on-the-run securities, mid levels)

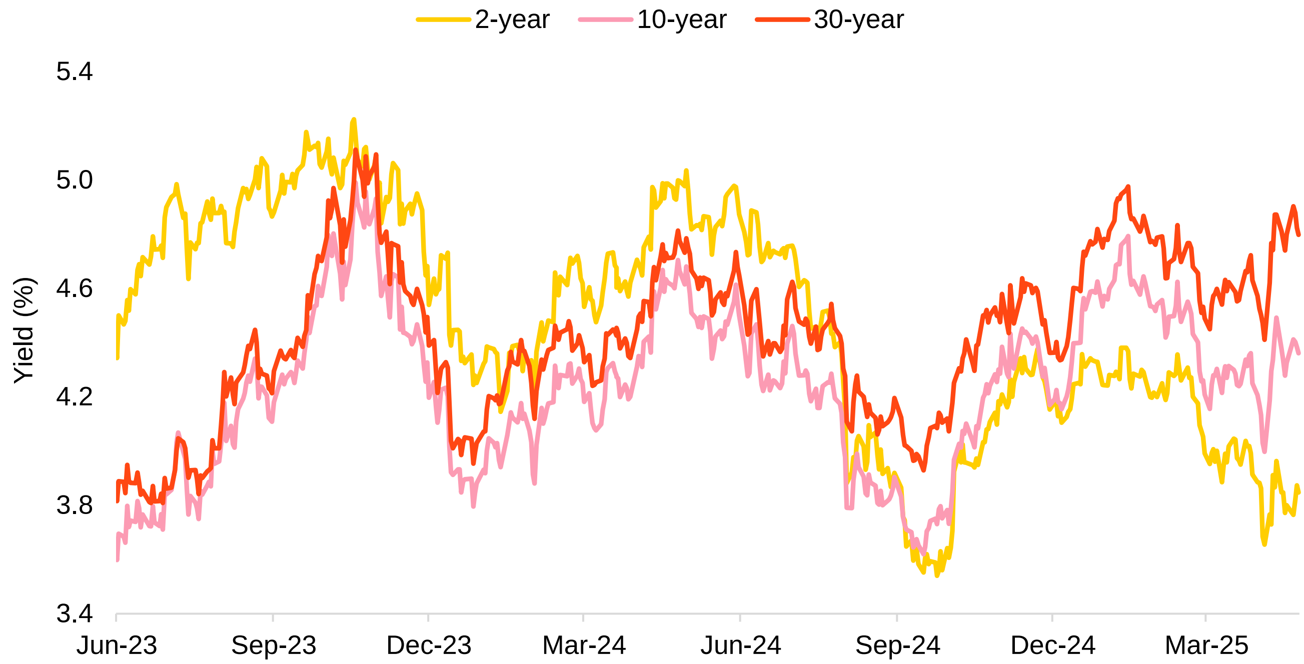

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Exhibit 11: U.S. Treasury term premium has climbed to the highest level in several years
Adrian, Crump & Moench 10yr U.S. Treasury Term Premium (%) estimates (one-year to ten-year maturities)

Source: Federal Reserve Bank of New York, BlackRock. As of April 23, 2025. **There can be no guarantee any forecasts will come to pass.**

Another area of focus for market participants has been the relative performance of credit vs. equities. While both are growth-sensitive asset classes, there are important distinctions between the two – some of which are unique to this cycle. We believe these differences have allowed corporate credit to generate total returns which compare favorably to the equity market – even among the lowest-quality subsets of corporate credit (Exhibit 1).

The three most important factors, in our view, are (1) corporate credit's robust all-in yields, which are elevated by historical standards (again, Exhibit 5) and generate income that boosts total returns; (2) the strong starting point for credit fundamentals, which includes very low near-term maturity walls; and (3) credit's senior position in the capital structure, relative to equity.

Other important factors, such as index concentration (by issuer and sector) also contribute to different return profiles, in our view. For example, the largest sector weighting of the S&P 500 is Information Technology (30% of the index), while the largest sector weight in the Bloomberg USD IG Corporate Index is Banks (23%).

Exhibit 12: Total returns for S&P 500 vs. USD IG

Weekly total returns (in 2025) for the S&P 500 vs. the Bloomberg USD IG Corporate Index

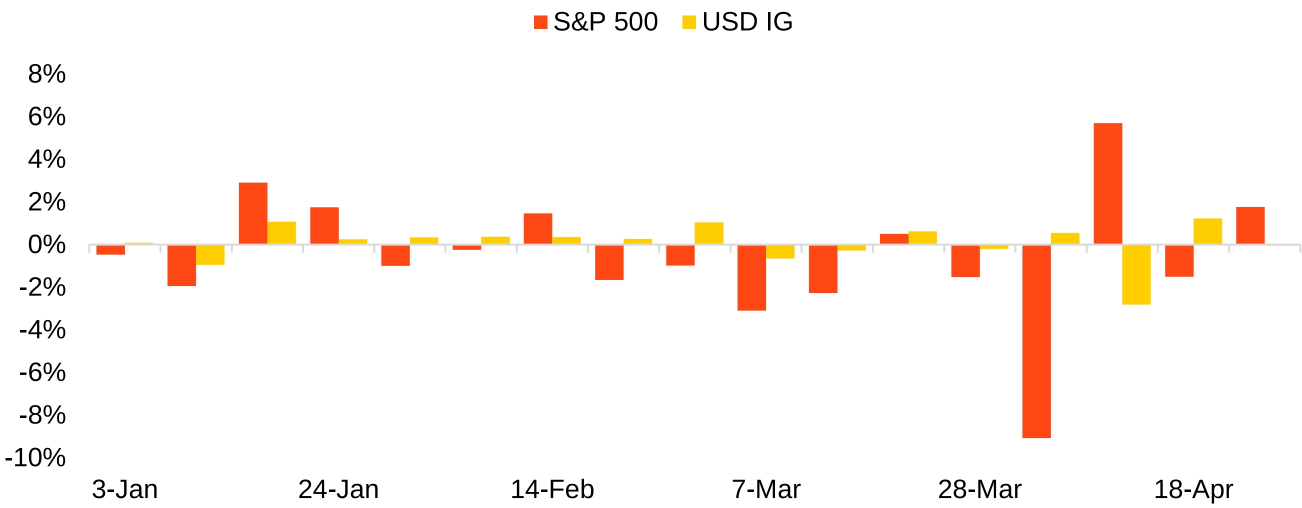

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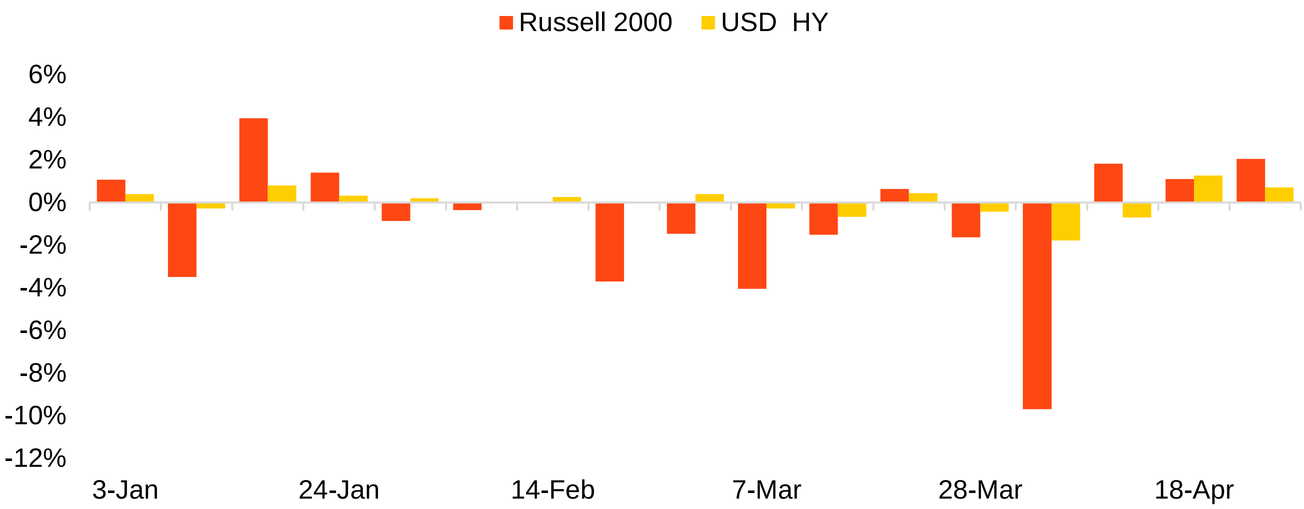
Exhibit 13: Total returns for Russell 2000 vs. USD HY

Weekly total returns (in 2025) for the Russell 2000 vs. the Bloomberg USD HY Corporate Index



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As the scatter plots of Exhibits 14 and 15 illustrate, the relative performance of USD HY credit vs. the Russell 2000 has generally followed the historical beta of the past 10 years (excluding the extreme pandemic outliers).

Exhibit 14: HY credit vs. equity performance – total return

Weekly total return (%) for the Russell 2000 vs. the Bloomberg USD HY Corporate Index. Scatter plot captures weekly observations for the last 10 years, beginning in mid-March 2015, excluding pandemic outliers.

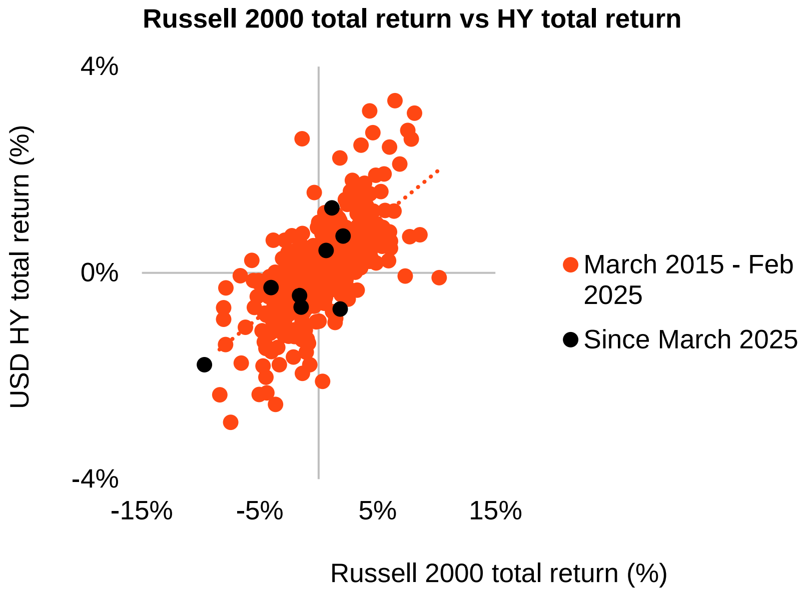

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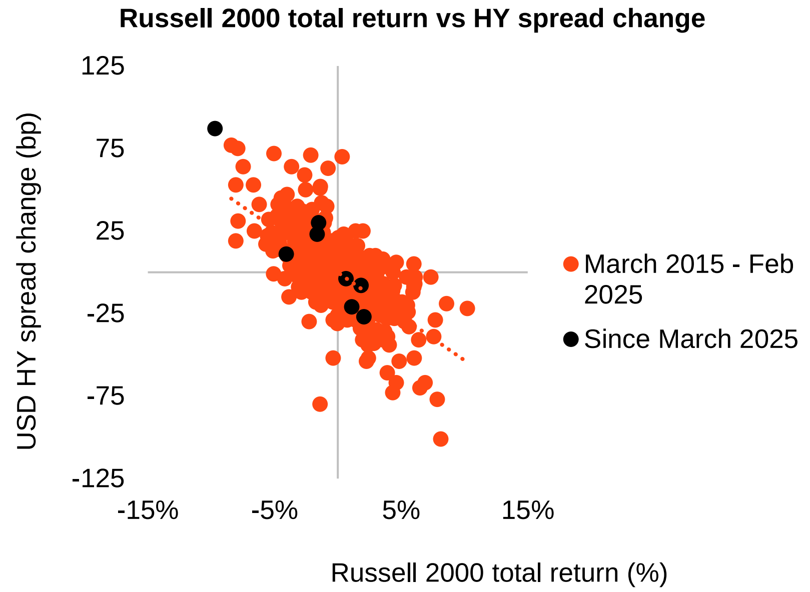
Exhibit 15: HY credit vs. equity performance – spread change

Weekly total return (%) for the Russell 2000 vs. weekly spread change (bp) for the Bloomberg USD HY Corporate Index. Scatter plot captures weekly observations for the last 10 years, beginning in mid-March 2015, excluding pandemic outliers.



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By contrast, the recent relative performance of USD IG credit has varied much more widely, as shown in Exhibits 16 and 17. Among the most notable 'outliers' was the week of April 11th, when USG IG total returns experienced a headwind from higher U.S. Treasury yields (and lagged the move higher in the equity market).

Exhibit 16: IG credit vs. equity performance – total return

Weekly total return (%) for the S&P 500 vs. the Bloomberg USD IG Corporate Index, Scatter plot captures weekly observations for the last 10 years, beginning in mid-March 2015, excluding pandemic outliers.

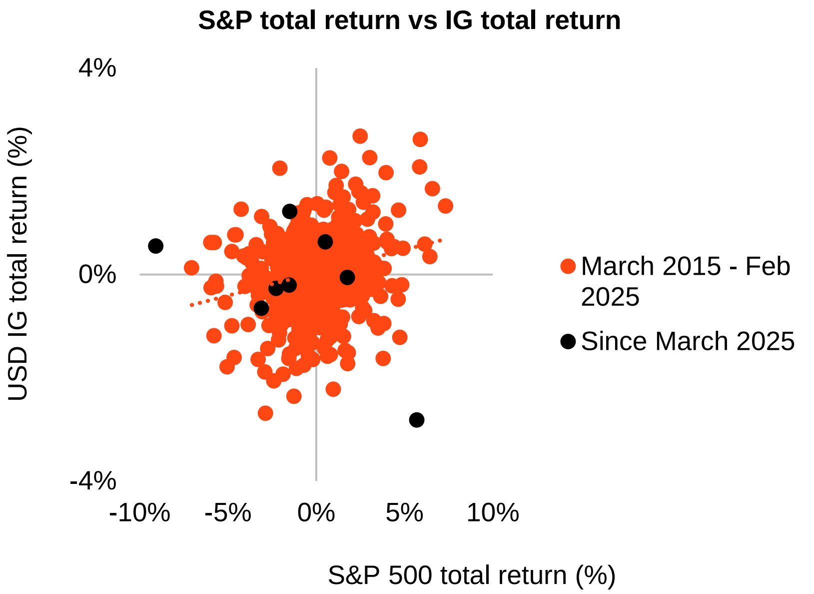

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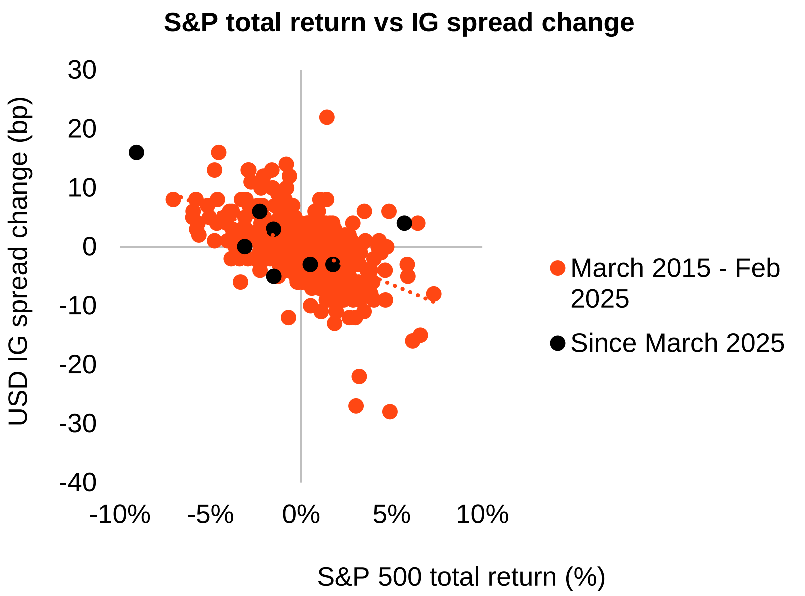
Exhibit 17: IG credit vs. equity performance – spread change

Weekly total return (%) for the S&P 500 vs. weekly spread change (bp) for the Bloomberg USD IG Corporate Index. Scatter plot captures weekly observations for the last 10 years, beginning in mid-March 2015, excluding pandemic outliers.



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