Ostrum ASSET MANAGEMENT

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Market views and strategy

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Axel Botte
Head of Market Strategy
axel.botte@ostrum.com

Zouhoure Bousbih
Emerging countries strategist
zouhoure.bousbih@ostrum.com

Aline Goupil-Raguénès
Developed countries strategist
aline.goupil-raguenes@ostrum.com

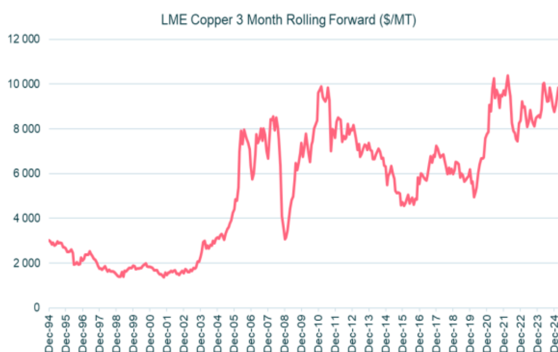
Topic of the week: U.S. high yield: priced for perfection?
by Axel Botte

- The high yield market has been affected by the economic uncertainty stemming from Donald Trump's erratic tariff policies;
- Surveys of financial institutions show no signs of credit rationing at this stage. The number of bankruptcies appears to be in line with their average levels;
- Rating agency Moody's projects a decline in default rates this year, unless there is a sharp economic downturn;
- Fundamentals remain solid, particularly with reduced default rates;
- The main risk for this asset class is a correction in valuation levels. BB and B ratings are trading at very low spread levels, close to two-decade lows. When assessed against leverage, creditor compensation appears significantly weak;
- Inflows have supported the asset class, fostering a sense of security and improved liquidity. However, liquidity in this asset class is directional, and the impact of a potential cyclical reversal could be exacerbated by reduced liquidity.

Market review: Liberation or liquidation Day?
by Axel Botte

- New tariff escalation expected on April 2, with 25% duties on automobiles;
- Rates: the steepening of the curves continues amid budgetary concerns;
- Credit and sovereign spreads remain stable, but high yield spreads are adjusting upwards;
- Gold remains the sole safe haven.

Chart of the week



The price of copper has returned to its peaks of 2019-2020, hovering around $10,000 per ton when the metal, considered the "green" metal, was buoyed by a surge in investments in renewable energy.

The current increase appears to be more closely tied to the threat of U.S. tariffs, similar to the duties applied to steel and aluminum imports since March 12.

Figure of the week

25

The announcement by the Trump administration of a 25% tariff on U.S. automobile imports effective April 2.
Source: Bloomberg

Topic of the week

U.S. high yield: priced for perfection?

Donald Trump's tariff policies are creating a high level of uncertainty regarding the economic and financial market outlook. Wall Street has been underperforming as the U.S. exceptionalism trade reversed. In this context, we explore the value proposition of U.S. high yield, a growth-sensitive asset class. Though default rates remain low, spread valuations look priced for perfection... despite mounting risks to the economic outlook.

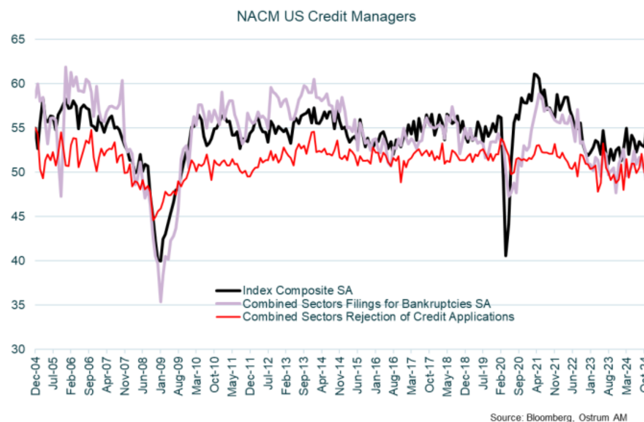
Economic concerns but no credit crunch

Tariff uncertainty weighs on consumer confidence but credit conditions are not tightening

The level of economic and policy uncertainty is unparalleled since the Covid outbreak five years ago. Tariffs are taking a toll on the economy and financial markets. There have been bouts of volatility as the Mag7 stocks' outperformance unravels. Recent data suggests that U.S. GDP growth may have slowed to an annualized rate of 1% in the first quarter of 2025 from 2.9% on average in 2024. Imports of business supplies have skyrocketed as firms secure procurements ahead of tariffs, but that is no indication of a protracted slowdown. We thus refrain from calling a recession at this juncture. Nevertheless, household confidence has fallen significantly and early signs of a deterioration in the labor market are emerging. If consumer spending weakens further, financial market pressure and reduced access to bank credit could spell trouble for risky assets, including high yield bonds. The key for the Fed is to avoid a credit crunch, limiting refinancing possibilities and raising the risk of financial distress.

Surveys suggest credit conditions remain favorable

Credit conditions still appear benign across a range of surveys. The Fed's senior loan officer survey reveals that bank lending conditions turned modestly tighter in the first quarter of 2025. A small majority of banks are reducing the maximum size of credit lines or require more collateral from corporate borrowers. Meanwhile, bank credit demand strengthened somewhat. Likewise, the quarterly survey of the National Association of Credit Managers (NACM) provides some insight about financial conditions for corporate borrowers. And the main takeaway from this NACM survey is that a credit crisis is not around the corner. The index of corporate bankruptcies is just around the 50 dividing line indicating stability in new filings. Rejections of credit applications are also in line with the long-term average, confirming stable credit standards. In addition, Bloomberg tracks bankruptcy cases on a weekly basis. The number of bankruptcies of U.S. companies with at least $50 million of liabilities rose to 43 in 2025 in the week to March 21st. This represents a modest increase from 37 at this time last year but a decrease from 52 in 2023. Health care, industrials and consumer discretionary record about half of the 43 bankruptcy filings in 2025. Fitch ratings also noted rising defaults in healthcare on labor issues and falling revenue. Furthermore, provisioning for loan losses announced by large US banks

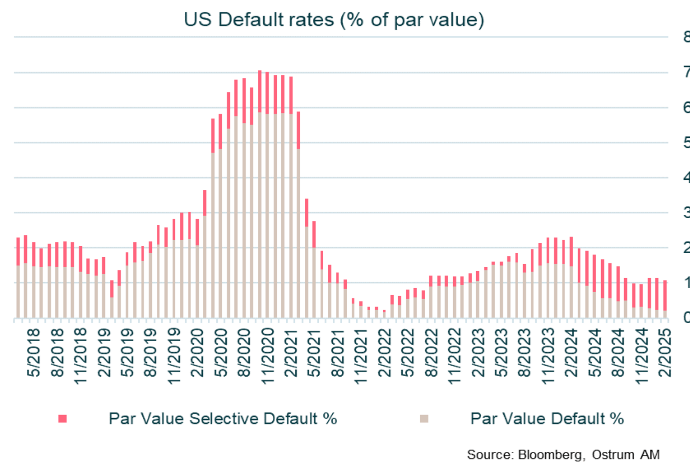


have been stable for the past two years. There are certainly pockets of weakness like commercial real estate or parts of consumer lending (auto loans), but corporate credit quality is not a concern.

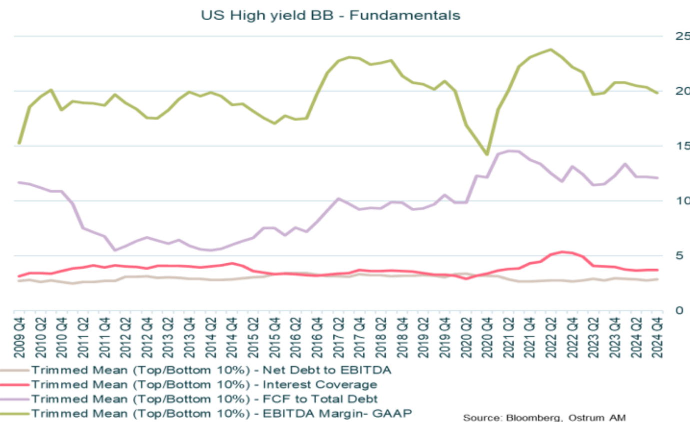
U.S. default rates to remain subdued

Default risk set to decline on Moody's estimates

Default risk is central to high yield bond management. Rating agencies provide estimates of the current (12-month trailing) default rates. Moody's central scenario forecasts that U.S. default rates will fall to 2.7% by the end of the year from 6.2% in the 12 months to December 2024. Moody's optimistic case suggests default rates could fall to less than 2%. Alternatively, more pessimistic scenarios (assuming a sharp slowdown or a recession) point to higher default rates ranging from 5.7% to 8.5% depending on the severity of the economic downturn. However, the universe covered by Moody's is likely much larger than the investable U.S. high yield market. Looking at the Bloomberg U.S. high yield index (LF98TRUU Index) arguably gives a more accurate picture of credit risk faced by investors. The current 12-month trailing default rate is 1%, including selective default (see chart below). Bonds that fall out of the index due to a default or selective default get included in the default count. When calculating default rates, the denominator is the total index bond count from one year prior. The stark difference with the data published by the rating agencies may come from the fact that market universe likely represents a subset of larger companies with better market access and available funding sources.



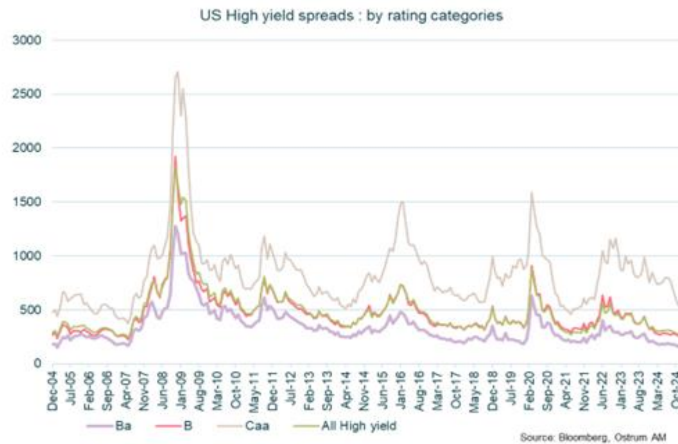
Low default rates reflect sound fundamentals at least for the high end of the high yield market, namely the BB bucket. For BB issuers, EBITDA Margins are off their record highs but still at a healthy 20% (10% top/bottom trimmed mean). Leverage (net debt to EBITDA) is moderate at 2.85x and stable for the past 4 years, though interest coverage has reverted to average levels as Fed tightening gradually impacted refinancing costs for corporate borrowers. Fundamentals are obviously weaker for lower-rated issuers but relative to history our findings for the BB bucket still applies to the broader high yield market.



Valuations: priced for perfection?

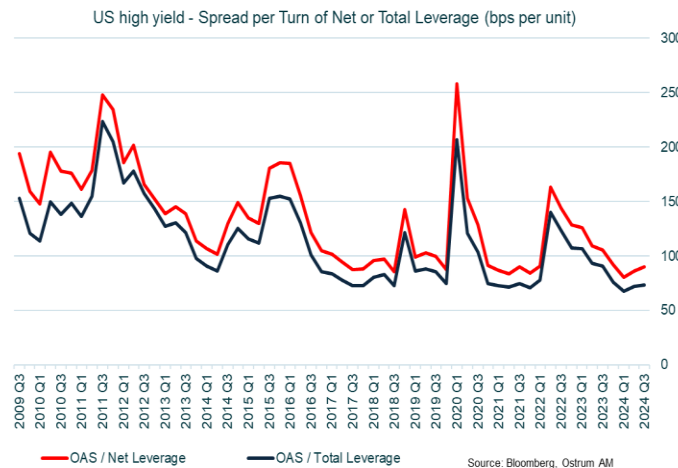
Spreads near 5th percentile of 20-year history on BBs, Bs

In the context of high economic uncertainty, the U.S. high yield market is underperforming in keeping with falling U.S. equities. High yield spreads have widened by around 15 bps year-to-date, though from extremely low levels historically. On a spread to U.S. Treasuries basis, speculative-grade spreads hover around 300 bps, with BBs just over 180 bps and single-Bs near 300 bps. To put things into perspectives, current spread levels near the 5th percentile of their historical ranges over the past 20 years. Lower-rated bonds (CCCs and below) do not exhibit the same degree of richness but still trade well within historical median levels (600 bps vs. 785 bps median for CCCs for instance). It is fair to say that a valuation realignment was overdue in high yield space.



Spread to leverage near multi-year lows

Our assumption is that high yield spread valuations have hurt performance. One way to gauge the value proposition of high yield is to track spreads relative to corporate leverage. Corporate leverage is generally measured as net debt to EBITDA. As can be seen in the next chart, investor compensation for leverage has been falling over time despite some cyclicality in leverage and markets. In aggregate, high yield spreads hover about 90 bps per turn of leverage, compared with 128 bps on average since 2009. Refinancing activity in the wake of Covid-era monetary easing has bought some time for speculative-grade borrowers. It also bought immunity to Fed rate hikes after inflation took off in 2022.

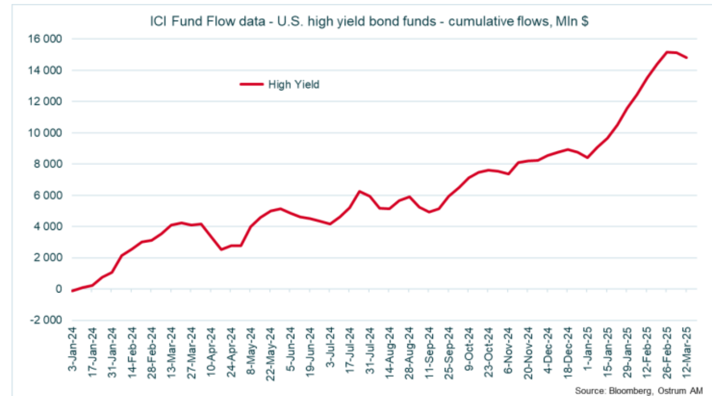


However, the support from near zero interest rates will wane over time. Bond maturities will eventually have to be refinanced. The maturity profile of the high yield bond market (proxied by the relevant Bloomberg index) averages about $5 billion per month through the end of the year (ignoring calls). In 2026, refinancing needs will triple from around $60 billion to $200 billion. The current refinancing premium, or the gap between coupons on debt outstanding and yields to worst, is around 1 % for the market as a whole and 42 bps for BBs and 59 bps for single-Bs. Refinancing costs thus remain acceptable but a further spread move wider could make market conditions more challenging.

High yield fund flows remain supportive for now

U.S. High yield fund flows ignore to growth risks

As high yield bond supply is set to rise, one must pay attention to investor demand and high yield fund inflows. According to ICI fund data, cumulative high yield fund inflows total $14.8 billion as of March 12th since the beginning of 2024. If anything, inflows accelerated in early 2025. Past sustained inflows contributed to improve high yield market liquidity. But it should be a stark reminder that liquidity in niche markets like high yield is mostly directional. This is because high yield represents an off-benchmark exposure for most fixed income investors and asset allocators. If investor sentiment sours on weaker growth, tariff anxiety or specific credit risk, market liquidity will deteriorate, and spreads will widen beyond levels justified by weaker fundamentals.



Conclusion

The current macroeconomic environment has negatively impacted U.S. equity and high yield bond markets. While fundamentals remain solid with low default rates, the widening of high yield spreads from historically low levels suggests that the market is priced for perfection in an increasingly uncertain environment.

Axel Botte

Market review

Liberation or liquidation Day?

The end of the quarter often heralds a period of financial risk reduction. The tariff hikes expected on 2 April ('Liberation Day' in Trump talk) are pressuring equity markets. The yield curve steepening trend persists, as gold remains the sole safe haven.

Risk aversion is on the rise as the U.S. administration escalates its tariff pressures. The new reciprocal protectionist measures are set to take effect on April 2. The European Union and Canada are expected to respond accordingly. Concurrently, vehicle imports will be subject to a 25% tax. Asian stock indices have seen significant declines, with Japanese and Korean automakers losing approximately 5% following this announcement. Japan exports around $40 billion worth of vehicles to the U.S. annually and is likely to implement retaliatory measures. This escalation in the trade war appears inevitable, marking a pivotal moment in the global economy. If the American consumer, burdened by tariffs, ceases to be the engine of growth, demand will need to shift to other countries. China is acutely aware of this and has unveiled a new plan to boost household consumption. This long-term rebalancing could permanently shift the center of gravity of the global economy.

From a cyclical perspective, the U.S. economy is experiencing a first quarter that diverges from the estimated growth of 2.4% recorded between October and December 2024. The unprecedented imbalance in the goods trade balance ($147 billion in February, down from $155 billion in January) is expected to translate into very weak, possibly negative, growth in Q1 2025. While the U.S. economy does not currently show signs of a recessionary dynamic, the plunge in consumer confidence and cautious projections from the retail sector serve as bearish alerts. In Europe, inflation is expected to decrease in March following encouraging figures from France (0.9%) and Spain (2.2%). The ECB is likely to see this as a reason for a further 25 basis point cut in April. However, several members believe that monetary policy is no longer restrictive, meaning a pause is not entirely off the table. The EU's tariff response will also be considered by the ECB.

In the context of escalating trade tensions, equities continue to navigate turbulent waters ahead of the earnings season. European cyclical sectors have plunged by 2% to 3%, while utilities play their role as a refuge. Meanwhile, long-term rates offer no respite. The rise in real long-term rates reflects the deterioration of public finances. The price shock has yet to impact long-term inflation expectations. Should these expectations increase, the Fed would be compelled to react. The 10-year yield hovers around 4.30%, while the 10-year Bund falls below 2.75%, with American influence in Ukraine reviving the search for safety. Inflation, likely close to 2% in March, pushes the Schatz towards 2% (-10 basis points over the week). Sovereign spreads remain stable ahead of Moody's decision on Spain's rating (Baa1). Investment-grade credit offers a premium of 85 basis points over swaps, while valuations in the high yield space continue to hinder performance. The European high yield spread (320 basis points over swaps) has now erased all the tightening observed since the beginning of the year.

Axel Botte

Main market indicators

G4 Government Bonds	31-Mar-25	1wk (bp)	1m (bp)	2025 (bp)
EUR Bunds 2y	2%	-12	-2	-8
EUR Bunds 10y	2.7%	-7	+30	+34
EUR Bunds 2s10s	69.7 bp	+5	+32	+42
USD Treasuries 2y	3.86%	-17	-12	-38
USD Treasuries 10y	4.21%	-13	0	-36
USD Treasuries 2s10s	33.9 bp	+4	+12	+1
GBP Gilt 10y	4.67%	-5	+19	+10
JPY JGB 10y	1.49%	-6	+4	+14
€ Sovereign Spreads (10y)	**31-Mar-25**	**1wk (bp)**	**1m (bp)**	**2025 (bp)**
France	73 bp	+4	-1	-10
Italy	113 bp	+3	+0	-2
Spain	64 bp	+1	+1	-5
Inflation Break-evens (10y)	**31-Mar-25**	**1wk (bp)**	**1m (bp)**	**2025 (bp)**
EUR 10y Inflation Swap	2.02%	-3	+7	+9
USD 10y Inflation Swap	2.48%	+1	-1	+2
GBP 10y Inflation Swap	3.39%	-3	-11	-14
EUR Credit Indices	**31-Mar-25**	**1wk (bp)**	**1m (bp)**	**2025 (bp)**
EUR Corporate Credit OAS	94 bp	+2	+3	-8
EUR Agencies OAS	49 bp	+0	-2	-13
EUR Securitized - Covered OAS	46 bp	+1	-1	-11
EUR Pan-European High Yield OAS	338 bp	+18	+41	+20
EUR/USD CDS Indices 5y	**31-Mar-25**	**1wk (bp)**	**1m (bp)**	**2025 (bp)**
iTraxx IG	65 bp	+7	+11	+7
iTraxx Crossover	333 bp	+28	+44	+20
CDX IG	63 bp	+6	+13	+13
CDX High Yield	386 bp	+49	+71	+75
Emerging Markets	**31-Mar-25**	**1wk (bp)**	**1m (bp)**	**2025 (bp)**
JPM EMBI Global Div. Spread	345 bp	+11	+17	+20
Currencies	**31-Mar-25**	**1wk (%)**	**1m (%)**	**2025 (%)**
EUR/USD	$1.081	0.185	4.174	4.4
GBP/USD	$1.294	0.194	2.854	3.3
USD/JPY	JPY 150	0.716	0.729	5.2
Commodity Futures	**31-Mar-25**	**-1wk ($)**	**-1m ($)**	**2025 (%)**
Crude Brent	$74.1	$1.1	$1.3	0.3
Gold	$3 122.6	$115.4	$264.7	19.0
Equity Market Indices	**31-Mar-25**	**-1wk (%)**	**-1m (%)**	**2025 (%)**
S&P 500	5 581	-1.53	-6.27	-5.1
EuroStoxx 50	5 230	-3.42	-4.27	6.8
CAC 40	7 770	-3.15	-4.21	5.3
Nikkei 225	35 618	-5.29	-4.14	-10.7
Shanghai Composite	3 336	-1.02	0.45	-0.5
VIX - Implied Volatility Index	24.08	37.76	22.67	38.8

Source: Bloomberg, Ostrum AM

Additional notes

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