

# Fixed Income Asset Allocation Insights

## The Credit Market Rally Continues

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**Robert Vanden Assem, CFA**, Head of Investment Grade Fixed Income and Chairman of Fixed Income Asset Allocation Team

Credit markets extended their rally in September following the anticipated Federal Reserve rate cut, with investor sentiment remaining upbeat. The Fed delivered a 25 basis point (bp) reduction, as expected, and the updated Summary of Economic Projections revealed a lower projected rate path even in the face of higher inflation forecasts. While consumer activity appears resilient on the surface, the data has yet to reflect the full impact of tariffs.

Risks to the labor market have increased, with another soft nonfarm payrolls (NFP) print in August and the job opening rate falling below 1. August headline Consumer Price Index (CPI) inflation rose 2.9% year-over-year, while core inflation (which excludes the more volatile food and energy categories) rose 0.35% month-over-month, the strongest increase since January. Core goods continue to show signs of a gradual tariff pass-through to inflation, and further price increases are expected to filter through as effective tariffs continue to rise. Core services continue to show strength.

Further weak labor market data and a relatively benign tariff pass-through give the Fed more room to move to what they deem as neutral at a faster pace. Economic activity remains on course for a soft landing despite the weak jobs numbers but is far from the strength seen in previous years.

We expect near-term growth to remain below potential in the second half but to rebound in 2026 as the tariff impacts fade, fiscal policy provides tailwinds, and Fed rate cuts ease financial conditions. The risks remain skewed toward sticky inflation, which could pull back the market's expectations for rate cuts. While we think signs are pointing to continued solid credit market performance, we favor positioning that allows us to take advantage of any weakness or volatility that may arise from disappointment around the Fed or other market factors.

## Our Asset Class Outlooks

### Investment Grade Credit

Credit markets continue to shrug off any potential risks and remain steadfastly tight, driven by strong demand. The latest court ruling on President Trump's tariffs has fueled more market uncertainty as investors await a Supreme Court decision. Nevertheless, we expect spreads to stay range-bound for the remainder of the year, supported by attractive all-in yields and robust demand. We will continue to view any widening of spreads as a buying opportunity but think a measured approach is warranted.

### Securitized Products

All the spread tightening we've seen has happened without the participation of the largest owner of agency mortgage-backed securities (MBS)-- the banks. After the actual rate cuts, funding will boost return on equity (ROE), and banks will then likely add more MBS. Overall, we remain bullish, even after the recent rally.

### About This Report

Fixed Income Asset Allocation Insights is a quarterly publication that brings together the cross-sector fixed income views of PineBridge Investments. Our global team of investment professionals convenes in a live forum to evaluate, debate, and establish top-down guidance for the fixed income universe. Using our independent analysis and research, organized by our fundamentals, valuations, and technicals framework, we take the pulse of each segment of the global fixed income market.

## Leveraged Finance

Earnings season continues to support our soft-landing thesis. In aggregate, results were positive, with areas of weakness in basic industrials and in parts of some consumer-oriented sectors. Performance was good overall, however, with significantly more positive earnings surprises and few mentions of cost-cutting. High yield bond and leveraged loan spreads will remain range-bound until fundamentals change or equity volatility increases. We expect positive, carry-based total return and muted excess return from credit, with acceptable drawdown cases. Higher carry indicates that loans will outperform for the time being. Valuations look fair overall. CLOs continue to tighten and look fair, and we remain focused on investment grade tranches.

## Emerging Markets

The domestic macro environment is favorable for most emerging markets, and we expect sovereign credit metrics to continue improving this year. EM economic data remains robust, and external buffers show increases. Domestic conditions in most countries still support policy easing. The EM corporate fundamental picture remains resilient. Valuations look fair to tight, but higher carry remains attractive. The technical picture is strong, and we expect this strength to continue in the coming months.

## Non-US-Dollar Currency

Cyclical fundamentals are gradually turning more USD-positive, contrary to market consensus, leading us to adopt a neutral stance on the dollar. The Fed has turned more dovish, pivoting toward employment protection and largely disregarding tariff-driven inflation. This introduces an asymmetric risk profile favoring rate cuts. Additionally, growing political pressure on FOMC members to lean dovish raises the likelihood of front-loaded monetary easing.

# Segment Snapshots

Using our independent analysis and research, organized by our fundamentals, valuations, and technicals framework, we take the pulse of each segment of the global fixed income market.

## Investment Grade Credit

### US Dollar Investment Grade Credit

**Dana Burns**, Portfolio Manager, US Dollar Investment Grade Fixed Income

#### Fundamentals

Fundamentals remain firm, with good balance sheet strength and leverage metrics. Second-quarter nonfinancial credit metrics improved modestly.

#### Valuations

Credit spreads have rallied back to multi-decade tightness, while all-in yields remain attractive to investors. The primary market has offered select opportunities.

#### Technicals

Negative broker/dealer inventories greater than five years, along with the search for quality credit, continue to support the market. Lower net issuance in 2025 when adjusting for the reinvestment of coupons is also supportive.

### Non-US-Dollar Investment Grade Credit

**Roberto Coronado**, Portfolio Manager, Non-US-Dollar Investment Grade Credit

#### Fundamentals

Neutral. Companies in general continue to post decent results, while balance sheets remain healthy and M&A activity is low. Management teams are providing cautious outlooks, however, citing limited visibility into future sales and margins as the economic outlook and tariff impact remain uncertain.

#### Valuations

Neutral. We view credit spreads as at or through fair value and expect the index to trade within a range in the coming weeks and months. In our opinion, the probability of a large index move in either direction is low. For that reason, sector and security selection will be the key to outperformance.

#### Technicals

Positive. Flows into euro corporates have been strong for the past 12 months, while supply has been well absorbed. Investors continue to be better buyers of credit, and new issues are performing well.

## Securitized Products

**Andrew Budres**, Portfolio Manager, Securitized Products

#### Fundamentals

The plunge in forward interest rate volatility since the April tariff scare has been dramatic. Even with strategists split on how many rate cuts will occur in 2025, the forward interest rate options market is signaling that nothing radical will transpire with rates.

#### Valuations

MBS spreads are still one standard deviation away from relationship with IG corporate bonds (down from 1.7), but the setup for rate cuts allows spreads to grind tighter.

#### Technicals

US banks have plenty of dry powder to come in and be buyers. A wildcard would be if the government-sponsored entities (GSEs) are directed to buy MBS.

## Leveraged Finance

**John Yovanovic, CFA**, Head of High Yield Portfolio Management

### Fundamentals

Earnings season was good for US high yield, with a beat-to-miss ratio of 2.7x, while leverage levels continue to increase modestly and corporate balance sheets remain in good shape. The second quarter saw average revenue up 2.1% and EBITDA up 1.1% year-over-year, while leverage and coverage ratios averaged 4.20x and 4.71x, respectively. Last-12-month (LTM) par-weighted default rates increased slightly month-over-month, to 1.45%. The year-to-date (YTD) par-weighted upgrade/downgrade ratio is 1.09 (or 0.92 by issuer). Loan defaults, including distressed exchanges, have stabilized between 4% and 5%.

### Valuations

US high yield option-adjusted spread (OAS) tightened 15 bps month-over-month, to 270 (BB 168, B 261, CCC 620), while yield-to-worst (YTW) narrowed 35 bps to 6.64%. CCC spreads were materially tighter, though still about 100 bps off the January tights. At current spread levels, the market is pricing in two scenarios: either a continuation of growth or a modest slowdown combined with materially more expansive monetary policy. The spread to maturity of the Morningstar LSTA Leveraged Loan Index declined to S+389 as of 12 September, from S+394 on 19 August. Nominal loan spreads are hovering near their post-financial-crisis lows across every rating bucket.

### Technicals

US high yield new issuance was strong at \$25.7 billion in August, in line with recent months (accounting for the seasonal slowdown in late August). CCC issuance remains low: Split B/CCC and CCC tiers accounted for 3.2% and 1.8% of total YTD issuance, respectively. Fund flows were positive for the fourth month in a row, at \$1.1 billion, though the pace of inflows has slowed from May/June. Near-term technical trends should hold steady, with demand still expected to outpace net loan supply growth. Retail loan fund flows have remained positive recently (with the exception of one week), and CLO issuance has held up despite prospects for lower internal rates of return (IRRs). Both trends supported loan prices over the summer. New US CLO issuance decreased month-over-month following the strongest issuance of the year in July.

## Emerging Markets

### Sovereigns

**Sam McDonald**, Sovereign Analyst, Emerging Markets Fixed Income

### Fundamentals

EM growth trends are structurally strong, supported by increasing fiscal discipline, further monetary easing, and reform momentum. The external picture is allowing for robust current account surpluses, combined with increasing remittance and foreign direct investment (FDI) and foreign portfolio investment

(FPI) flows, which are enhancing levels of foreign exchange (FX) reserves. The EM sovereign upgrade-to-downgrade ratio remains positive.

### Valuations

Spreads have tightened past 2 April and have remained near historical lows. However, changes to country weights and several recently restructured defaulters make historical comparisons difficult. At 289, the EMBI is exactly flat month-to-date (as of 17 September). and 39 bps tighter year-to-date. EMBI high yield spreads tightened by 6 bps month-to-date, while IG spreads were 3 bps wider.

### Technicals

Issuance expectations for 2025 have been revised higher but remain manageable. Supply has picked up since the summer quiet period, with names coming to market largely as expected. Evidence suggests that fund cash balances going into this period are supportive, and fund flow data has strengthened over recent weeks. October also tends to be a positive month for cash flows from EM sovereigns before a drop in November and December.

### Corporates

**Kim Keong**, Trader, Emerging Markets Fixed Income

### Fundamentals

As we are currently in the middle of the second-quarter earnings season, with nearly 80% of our coverage having reported, results have been more mixed. On balance, LatAm has shown a softer skew in results, largely due to weaker performance in Colombia's oil & gas and petrochemical sectors. Outside of this, revenue and EBITDA growth remain healthy at 5%-10%. LTM leverage ratios are marginally higher versus year-end 2024 levels, by +0.1x across both IG and HY, but remain at healthy levels, with net leverage at 1.1x as of year-end 2024. We expect this robust fundamental picture to continue.

### Valuations

Over the last month, the CEMBI BD spread to worst tightened by 2 bps, with HY (-6 bps) outperforming IG (+1 bps). In the IG space, the regional outperformers were Thailand, India, Kazakhstan, Singapore, and Nigeria, while the laggards were Indonesia, Qatar, Peru, Kuwait, and Saudi Arabia. In HY, the outperformers were Kazakhstan, China, Hong Kong, Ghana, and South Africa, while the laggards were Argentina, Ukraine, Peru, Brazil, and Macau. Relative to developed markets, EM IG and HY valuations have lagged by +2 bps over the month.

### Technicals

Primary market activity remained slow in August, with issuance totaling \$24 billion. Scheduled cash flows and elevated liability management exercise (LME) activity pushed net financing into negative territory, at -\$3 billion. September has seen a busier primary market, with \$31 billion issued through to the 17th. The five-year average for the month is \$48 billion, so issuance could potentially test that level. However, scheduled

cash flows for the month are also expected to be high, at \$41 billion, and given ongoing LME activity, we expect net financing to be well balanced. The EM investor community maintained high cash balances going into September, and with continued inflows from both EM and crossover investors, deals have been oversubscribed by an average of 3x-5x. Looking ahead, we expect primary markets to remain active, with deals likely to be well digested and the demand technical to remain intact.

## Non-US-Dollar Currency

**Anders Faergemann**, Senior Portfolio Manager, Emerging Markets Fixed Income

### Fundamentals

The resumption of Fed easing will undoubtedly weigh on the US dollar in the near term. However, easier financial conditions support a moderate growth recovery in 2026, likely avoiding a US recession. This suggests the market may be underestimating US growth and the persistence of US exceptionalism in the context of the dollar.

### Valuations

We kept our 12-month EUR/USD forecast at 1.1500. The US dollar remains overvalued on a real effective exchange basis, and the US twin deficit is weighing on the currency. However, the USD is now better aligned with its cyclical fundamentals, and growth should bottom out in the second half of 2025. We maintain our 12-month USD/JPY forecast at 140.00 to reflect uncertainty surrounding Bank of Japan policy.

### Technicals

2025 issuance expectations have been revised higher, but remains manageable. Supply has picked up after the summer quiet period, with names coming largely as expected by market participants. Evidence suggests that fund cash balances going into this period are supportive and fund flow data has strengthened over recent weeks. October is also a positive month for cashflows from EM sovereigns, before dropping in November and December.

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