Fixed Income Asset Allocation Insights

PineBridge® INVESTMENTS

A Strong Fundamental Picture, With Some Cracks

20 March 2025

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

Following strong performance in January, credit markets traded on a weaker note in February and March on the back of increased uncertainty around the macroeconomic outlook, driven by US trade policy and fears of a consumer slowdown. Our base case remains for a slowdown but not a recession, although the probability of a recession has increased. At a minimum we expect to see softer data over the next six months, but after that, the path will be highly dependent on policy – which is very hard to predict in the current environment.

While slowing growth and modestly wider spreads were generally consistent with our expectations coming into the year, the magnitude and speed of change thus far have exceeded expectations. We believe this is primarily driven by a more significant impact than expected from the Department of Government Efficiency (DOGE) and uncertainty around tariff policy. Regarding tariffs, the Trump administration has focused on Mexican and Canadian trade relationships more aggressively and for longer than initially anticipated, which has driven weaker consumer data and lower capex expectations. On April 2, the administration announced "reciprocal tariffs" on more than 180 countries and territories to varying degrees, including a 20% tariff on the EU and 34% on China.

On the positive side, the market is still awaiting more progress on deregulation. While this has seemingly taken a backseat to trade policy and tariffs, a deregulatory environment would ultimately represent a benefit for businesses. Even with the weaker outlook, outside of a recession, we would not anticipate a huge change in our relatively benign default expectations. Credit fundamentals were strong coming into the recent volatility, and at present we do not see the fundamental picture deteriorating to the point that it threatens the solvency of most issuers. However, uncertainty is weighing heavily on sentiment, and at some point that could feed into fundamentals.

The narrative coming out the Federal Reserve following its March meeting was more mixed. On the one hand, it seems clear that the Fed sees an increased risk of a stagflationary scenario, as it downgraded economic growth to 1.7% from 2.1% and increased core inflation expectations to 2.8% from 2.5%. Despite that, the Fed signaled a somewhat dovish tone, as the dot plot still indicated two rates cuts this year and it is reducing its balance sheet tapering. However, the dot plot showed that four members now see no change in rates, up from just one member in January.

Meanwhile, the picture in Europe is diverging from the US. The planned fiscal stimulus in Germany and increased defense spending in Europe are certainly positive, but the initiation of spending is more likely a 2026 story than a 2025 story. On top of a lack of spending this year, tariffs will also be rolling out over the next six months. As a result, we expect to see another downtrend in growth in the more immediate future, with subsequent economic improvement as spending picks up.

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.

Despite the market correction, we continue to believe that the fundamental picture is strong – albeit with some cracks – and that the technical backdrop is supportive overall. Yields remain attractive, which should spur ongoing demand. Cheaper valuations have created more buying opportunities, although more weakness could lie ahead. As a result, we remain selective across industries and issuers, as opposed to broad risk-on positioning. Looking forward, we believe credit markets remain attractive overall despite the current period of weakness. Ultimately, we expect markets to weather the current period of volatility before we see additional policy focus, which could improve the economic outlook during the second half of the year.

Our Asset Class Outlooks

Investment Grade Credit

Despite recent weakness, the credit market remains characterized by rich valuations overall, with relatively strong fundamentals and a supportive technical backdrop. Attractive all-in yields have continued to support demand. Yield and carry should be the dominant drivers of returns over the next 12 months. Over the longer term, we expect spreads to hold in a trading range as economic uncertainty in the face of new policies buffets demand against a relatively strong fundamental backdrop.

Securitized Products

Interest rate volatility has picked up since February, slowing the positive momentum of 2025. Positive news continues to come into the space, with final year-end foreign buyers topping $100 billion. We don't believe the value proposition of mortgage-backed securities (MBS) has changed, except that interest rate volatility increased in March. We therefore maintain our bullish long-term view for the asset class.

Leveraged Finance

While the overall pace of economic growth remains good, expectations are tempered by slowing data, policy uncertainty, and weak earnings and guidance in select sectors. Earnings results to date have remained relatively positive, though guidance is muted due to policy volatility. Markets favor moving up in quality and are sprinting from beta risk, though overall spread moves have been muted. We generally expect positive, carry-based returns from credit, with acceptable drawdown cases. We remain neutral beta, adding value via credit selection, and expect credit to remain favored due to high current income and continued low default rates.

Emerging Markets

EM spreads remain sensitive to US dynamics and have widened in line with a recent deterioration in US risk sentiment over the past month. That said, overall spread levels are not too far from recent tights, consistent with strong local drivers such as improving fiscal outlooks, significant reserve levels, and stronger policy frameworks. While rising risks around tariffs will be harmful for some EMs, and near-term trade uncertainty will weigh on growth and investment, countries involved in any country-specific trade, tariff, aid, or budget support difficulties look to be developing a playbook to navigate these challenges swiftly. We also highlight that the EM-DM growth differential in 2025 is not only positive but accelerating, despite the expected structural slowdown in China. The EM corporate fundamental picture also remains robust, and most of the credits in our coverage are expected to be resilient through the unfolding of Trump's policies. Valuations also look fair following recent widening, and the technical picture is expected to remain supportive.

Non-US-Dollar Currency

While the US dollar was on the backfoot heading into April and yet another major tariff announcement, looking ahead, current US dollar levels may provide an opportunity to rebuild long USD positions. Ultimately, we maintain a bias toward our "soft landing" scenario, although downside risks have increased. We view the deterioration in US consumer sentiment and survey data as a strong test of the underlying growth credentials in the short term, as policy uncertainty has halted decision-making by consumers and businesses. Consequently, we have shifted our short-term view to softer growth, viewing risks as more balanced around a "soft landing" over 12 months. Yet the Fed will remain focused on its dual mandate and will likely stay on hold for some time.

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. Mergers and acquisitions (M&A) may have more of an influence on investment grade (IG) credit metrics in 2025. Tariff uncertainty and its possible impact on economic growth persist.

Valuations

Credit spreads have moved wider but still remain within our expected range. Select credits continue to offer good value, and the intermediate portion of the curve offers value.

Technicals

Demand for US IG credit continues despite a recent backup due to attractive all-in yields. Overseas demand will likely keep waning as hedging costs and relative yields affect markets. Looking ahead, sizeable coupons due to the higher-rate environment will likely support demand.

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 remains low. Management teams, however, are providing cautious outlooks, citing limited visibility into future sales and margins amid an uncertain economic outlook.

Valuations

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

Technicals

Positive. Flows into euro corporates have been strong for the past 12 months, and supply has been well absorbed despite being higher than previous years. Investors continue to be better buyers of credit, and new issues perform well.

Securitized Products

Andrew Budres, Portfolio Manager, Securitized Products

Fundamentals

Fundamentals are sound and have not changed much in the MBS space, given that rates have stayed stubbornly high for borrowers. This, however, is not a bad thing for MBS investors. Rising interest rate volatility in March, on the other hand, may be a headwind for spread tightening.

Valuations

The relative value difference between agency and investment grade MBS spreads has tightened somewhat in 2025 but is still wide relative to historical lookbacks.

Technicals

The technical picture continues to look good from the standpoint of bank buying, foreign buying, and flows into bond funds that must maintain exposure to the MBS portion of the Aggregate bond index.

Leveraged Finance

John Yovanovic, CFA, Co-Head of Leveraged Finance

Fundamentals

Issuer fundamentals remain relatively stable after another quarter of steady revenue and earnings growth, and measures of distress are trending lower, for now. High yield (HY) last-12-month par-weighted default rates moved marginally lower, to 1.25% for HY, while leveraged loans are at 3.90%.

Valuations

US HY option-adjusted spreads (OAS) stood at 315 as of 17 March, 59 basis points wider month over month (with BBs at 195, Bs at 309, and CCCs at 640). Yield to worst was at 7.55%, 35 bps wider month over month. Spreads have been wider in sympathy with broader market volatility, with weakness concentrated in CCCs and cyclical sectors (transportation, retail, consumer finance, building materials, and energy). The decline in loan prices has widened the spread-to-maturity of the Morningstar Index to 417 bps as of 17 March, up from 394 bps at 14 February. IG collateralized loan obligations (CLOs) are holding in, with below-IG CLOs pacing the widening in assets.

Technicals

Both fixed and floating-rate assets are still seeing good demand. New CLO formation remains solid, though widening liability spreads are compressing CLO equity returns. While supply is likely to be higher than last year, we expect to remain undersupplied in general.

Emerging Markets

Sovereigns

Sam McDonald, Sovereign Analyst, Emerging Markets Fixed Income

Fundamentals

EM growth trends are structurally strong, supported by increasing fiscal discipline and reform momentum. The external picture is allowing for more robust current account surpluses, combined with increasing remittance and foreign direct investment and portfolio investment (FDI/FPI) flows – enhancing levels of foreign exchange reserves. Political and geopolitical risks remain high.

Valuations

At 332, the EMBI index was 22 bps wider month over month and 7 bps wider year to date as of 17 March. Spreads are back to late-December 2024 levels following the recent negative shift in sentiment in the US. IG spreads are 13 bps wider month over month, while HY spreads are 35 bps wider over the same period.

Technicals

2025 issuance is expected to be closer to 2024 levels, at around $182 billion gross. Net supply of $91 billion, however, would be a reduction versus 2024's $104 billion. Issuance came in stronger than expected in 2024, driven by higher supply from IG names.

HY has opened more, with names that have a good story able to issue (e.g., Nigeria and Egypt) in addition to new names (e.g., Montenegro and Benin). EM hard currency funds continue to see outflows.

Corporates

Kim Keong, Trader, Emerging Markets Fixed Income

Fundamentals

We are still in the fourth-quarter 2024 earnings season, and results have been broadly as expected, with positive beats. In terms of sectors, we have seen positive beats from consumer, metals and mining, and financials, while utilities, industrials, and Colombia oil and gas have missed on the margin. Our current credit trend matrix reflects this with 15% positives and 11% negatives. The positive skew is more evident in high yield, with 23% positives and 17% negatives, while the split is 11% positives and 8% negatives in investment grade.

Valuations

Over the last month, the CEMBI BD spread to worst widened by 14 bps, with HY (+26 bps) lagging IG (+8 bps) as of 17 March. In terms of regions, Latin America lagged across IG and HY, while Asia HY and CEEMEA IG outperformed. In IG+, Kuwait, Israel, UAE, China, and Saudi Arabia outperformed, while Macau, Brazil, Nigeria, India, and Indonesia lagged. In HY+, Kazakhstan, Hong Kong, China, Zambia, and UAE outperformed, while Ghana, Ukraine, Panama, Argentina, and Mexico lagged. Compared to US DM, EM outperformed by -5 bps in IG and -33 bps in HY, as lower-rated EM credits held up better over the month.

Technicals

Primary activity slowed to $33 billion in February, which has been easily absorbed with scheduled cash flows of $34 billion. Including the unscheduled cash flows, the net financing for the month turned negative, to -$12 billion. Net financing for the year moved lower, to $6 billion. March is typically a quiet month for supply; we have seen $16 billion of deals as of this writing and are expecting modest scheduled cash flows of $27.6 billion, which would translate to net negative financing for the month. Looking at the primary deals in the month, we are still seeing healthy book coverage ratios and ongoing demand from the crossover community, which remains supportive.

Non-US-Dollar Currency

Anders Faergemann, Senior Portfolio Manager, Emerging Markets Fixed Income

Fundamentals

A tariff uncertainty-led US growth scare and sticky inflation have combined to create a “stagflation lite” theme that has already weakened the US dollar across the board. In combination with a seismic shift in German fiscal spending that opens the door for much higher German deficits and a higher ECB terminal rate, it caused a collapse in the two-year UST/bunds rate differential and led to a sharp bounce in the EUR/USD (to just above 1.0900).

Valuations

We raised our 12-month EUR/USD forecast to 1.0750 from 1.0500 after revising our 12-month German bund yield forecast meaningfully higher. We kept our 12-month USD/JPY forecast at 150.00, as the tone from the Bank of Japan has become more hawkish.

Technicals

The theme of EUR/USD topside demand in options that started the year has continued, according to J.P. Morgan as of 5 March. The subtle net demand for EUR/USD calls we’ve seen so far this year has accelerated more recently, with three-month net topside demand in EUR/USD now encroaching +1.5-sigma.

About PineBridge Investments

PineBridge Investments is a private, global asset manager focused on active, high-conviction investing. We draw on the collective power of our experts in each discipline, market, and region of the world through an open culture of collaboration designed to identify the best ideas. Our mission is to exceed clients' expectations on every level, every day. As of 31 December 2024, the firm managed US$190.3 billion across global asset classes for sophisticated investors around the world.

pinebridge.com

MULTI-ASSET | FIXED INCOME | EQUITIES | ALTERNATIVES