Euro Credit Quarterly Outlook, January

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Hello and welcome to our first quarterly video of 2025 on Euro Credit markets. Before we look at our expectations for the year ahead, what can we take away from 2024?

2024 started with excessive rate cuts expectations but overcame the dial back. Despite the volatility on the rates side, 2024 has been another strong year for euro credit investment grade with a total return of 4.7%[1]. The picture was even brighter for high yield, which posted 8.6% of total return.[1]

Dispersion between sectors was a key element last year, with differentiation between underperforming sectors like automotive and retail, and industries where fundamentals are still healthy, or even improving, like financials and real estate.

Finally, 2024 was also a record year for primary issuance in both investment grade, with around €650bn issued and high yield with over €100bn of issuance[2]. Fortunately, it was also a year of high flows into the credit asset class.

Now, what do we expect for 2025? In the very short term, markets remain anxious about higher inflation and stronger growth, notably in the U.S. While this is not a concerning scenario for credit, this may have an impact on the yield curve and hence on credit demand. Yield remains attractive at over 3% for investment grade and 5% for high yield.[2]
From a spread perspective, we expect corporate credit risk premium moving sideways in the coming months, implying that the key source of return will probably be carry.

However, this will not be without volatility, as investors will have to deal with a few unknowns related to fiscal policies, Trump announcements and elevated debt levels. On fundamentals, they should remain fairly supportive. Despite anaemic growth in the eurozone, we expect credit metrics to stabilise or even slightly improve in some defensive sectors.

Financial discipline and cash preservation tend to remain a focus in Europe. As such, we don't expect a wave of fallen angels or a jump in default rates. Technicals has been a key driver of credit performance over the last couple of years and we think it may continue to support spreads again in 2025.

[1] Source: AXA IM, Bloomberg as of 31st December 2024

[2] Source: AXA IM, Bloomberg as of 31st December 2024

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The search for yield is likely to continue and with lower “risk-free” rates to follow, we see no reason for the IG (investment grade) flows to stop.

On the supply side, with a massive primary issuance in the last couple of years, we may have a stabilisation or even a deceleration this year. The only caveat is a potential M&A from US companies this year.

Regarding positioning, we maintain our constructive view on financials and real estate where both fundamentals and technicals should remain supportive. We recognise that both sectors have already been the major outperformers last year, but we continue to think that spreads will be supported by good profitability and improving leverage.

Overall, we anticipate a compression of financials versus non-financials. We continue to like telecoms, utilities and hybrid. On the other hand, we remain underweight on cyclicals, like basic industries, like automotive sector, where the prospects are still subdued while valuations are not attractive enough. In this environment of tight spreads, we believe selection will be key to avoiding idiosyncratic risk.

Thank you for watching this video and see you soon.

Source: AXA IM as of January 2025

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