aegon asset management

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Global fixed income mid-year outlook

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In 2025, investors are learning the cost of macro uncertainty—volatility. While the overall fiscal policy shift could turn out to be a positive supply shock, it must first get through the short-run challenges of sequencing the policy changes (tariff implementation occurs before tax legislation or de-regulation). Thus, the impact so far has been a drag as tariffs weigh on growth, while the stimulative aspect of tax cuts and deregulation are still to come.

Policy aside, the core economy continued to display cooling characteristics. Tight monetary policy is clearly having a negative effect on interest-sensitive sectors (housing and construction come to mind) and aggregate private borrowing. The resulting negative credit impulse removes a key buttress to the consumer and puts the onus on the labor income proxy to fuel spending. Labor income has held up so far, but becomes a key fulcrum for the economic outlook—a continued cooling in labor market would sap labor income, which in turn slows consumption for which there is no private credit growth to offset. The negative income effect of tariffs will only add to this pressure and is a key factor in our below-trend growth forecast.

Inflation remains in the spotlight, with disinflationary demand expected to experience a price-level adjustment due to tariffs. Inflation has clearly been coming off the boil, with a little help from favorable seasonal adjustments. But this will likely change later this year as tariffs start trickling through the price chain. It is worth noting that while tariffs do not result in demand-driven inflation, they can still raise short-term inflation numbers. It is that potential impact on prices that has the Federal Reserve on an elongated rate-cut pause. Powell & Co. want to ensure that the one-time price adjustment doesn't linger and ignite a continual accelerated pricing environment.

While market expectations of Federal Reserve action have been quite volatile, Aegon Asset Management has been pretty consistent with our view of two quarter-point interest-rate cuts in the latter half of 2025. The tail risks around that view are skewed toward more cuts, given the possibility of a faster economic unwind if the labor markets start to crack. Our base-case scenario predicts below-trend growth with a tail risk of recession.

The political landscape in Washington, D.C., adds another layer of complexity to the economic situation. The government shutdown has been avoided as a continuing resolution funds operations through September 2025. The debt limit was reinstated on January 2, 2025, with an X-date expected around August. The tax bill reconciliation is on pace for pre-August recess passage and will address the looming debt ceiling issue as well.

The overall economic outlook for the rest of 2025 continues to be one of policy transition. The landscape should start to look brighter as the fiscal policy wish list manifests itself into actual policy. That should reduce uncertainty risk and potentially impart a positive supply shock on the economy, but it is more likely a 2026 story than a second half of 2025 one. In addition, a resumption of the rate cutting by the Federal Reserve will likely start to add much needed relief to the interest-sensitive components of the economy and allow for positive private credit creation.

Europe & the United Kingdom

Europe has experienced a prolonged period of sluggish growth. The drag from high energy prices, slow productivity growth and more limited fiscal support have all resulted in a substantially lower growth rate compared to the US.

Currently, the European consumer is in a relatively strong position, characterized by a high savings rate and positive real wage growth, so they have ample room to increase consumption. However, confidence is negatively impacted by the ongoing US trade war. That impact will likely be felt both directly, through higher tariffs on the EU, and indirectly, due to a slowdown in global growth. The EU is a relatively open economy and therefore sensitive to the slowdown in trade.

On the more positive side, the German infrastructure and defense package is anticipated to boost growth, but the main effect will only be felt in 2026. At the same time there are many risks. For instance, it seems unlikely that the war in Ukraine will cease, leading to significant costs and risks for the EU due to a prolonged conflict.

Services inflation has been persistent but is now declining in most countries. Negotiated wage figures are also on the decline and the outlook for future wage growth is much more muted. Tariffs on US goods are expected to only marginally raise inflation. A larger effect is likely to come from the disinflationary impact of Chinese exports directed to the EU market. Slower global growth is another factor that is expected to result in declining inflation. Overall, we expect inflation to fall below the European Central Bank's (ECB) target levels.

The ECB has delivered its seventh interest rate cut, with market pricing indicating two more cuts by the end of 2025. Meanwhile, the Bank of England kept rates steady at its June meeting, but a rate cut later this summer could still be an option.

Energy has been a major headwind to EU growth due to the reliance on Russian gas and has limited self-sufficiency. High energy prices are expected to remain a drag on growth in the coming years. However, recently, energy prices have declined due to the expected global economic slowdown.

That said, there are several risks that could impact our forecast. They include an escalation in trade conflicts with the US. The direct trade impact is likely to be negative but probably moderate.

Another factor could be the collapse of part of Ukraine's sovereignty, which would lead to a refugee flow and a hit to confidence, which in turn would likely increase the support for populism.

Also, a renewed escalation of the energy crisis remains the key downside risk for the European economy, particularly for Germany. In addition, political risks are rising with upcoming elections, which could lead to further policy paralysis.

Most risks are on the downside, however there is a more optimistic scenario possible. There could be a period of higher productivity improvement, for example, due to advancements in artificial intelligence. Also, previous reforms have resulted in several countries like Spain and Poland achieving quite impressive growth rates. To get the European average moving, we need Germany and France to start growing more rapidly. Especially in the case of Germany, that could be possible now that the worst of the energy crisis is passed and a looser fiscal policy will be pursued.

Global corporate credit research overview

- Consumer-related companies are responding to cautious consumer spending by maintaining prices to preserve margins, which will likely be more challenging going forward
- Industrial sector companies are being impacted by weakening demand growth, customer affordability and trade and tariff uncertainties
- Financial sector companies benefit from stable borrower/asset credit quality and net interest margins that support earnings
- Leverage ratios for corporate issuers and capital adequacy levels for financial firms remain healthy across most sectors

Geopolitical tensions, tariffs and trade, fiscal and monetary policy, and resulting impacts on inflation and growth, are all contributing to cautiousness on the part of consumers and most corporate sectors and issuers. As a result, we expect moderating but still positive global economic growth in coming quarters. Balance sheets will likely remain healthy, contributing to continued stable credit fundamentals across most sectors.

Wage growth and employment levels continue to support the consumer in developed markets. Consumer credit metrics remain stable including bad debt and overall debt levels. Nonetheless, low-income consumers continue to show signs of stress and middle-income consumers are beginning to adjust their purchasing activity.

Middle-income and higher-end consumers are maintaining their discretionary spending, while continuing their shift away from branded products toward store labels and increasing purchases at bulk retailers and value-oriented retailers.

The luxury sector remains challenged, with more affluent brands faring better than brands targeting aspirational consumers. Consumer companies have held price to protect margins, rather than discounting to maintain volumes, but we are cautious on their ability to further raise prices to counter tariffs.

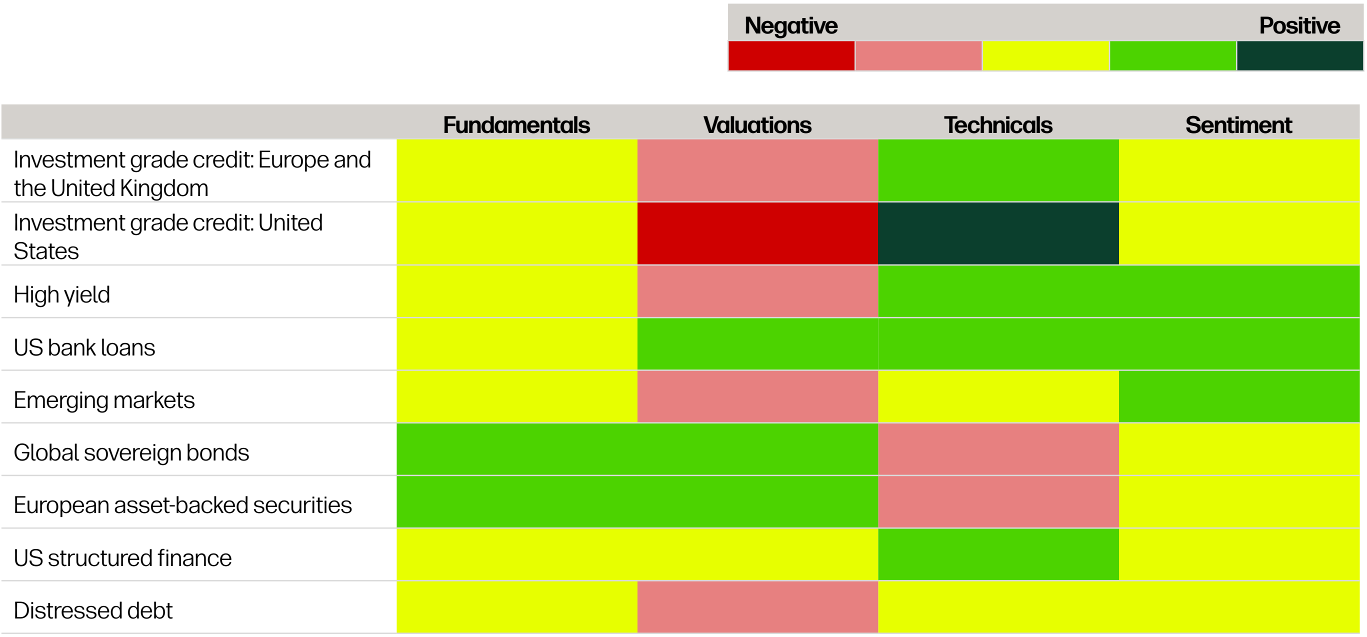
The global industrial sector also reflects a slower-growth environment, with the focus on cost-cutting and efficiency measures to offset softening demand. Inflation and elevated interest rates are creating affordability challenges for consumers that continue to impact housing and autos. While autos saw some demand pull-forward ahead of tariffs, volumes are now weakening. Producers of basic and intermediate goods are also being impacted by trade uncertainties, factoring into cautiousness by customers in their inventory management and order patterns.

Reduced regulatory burden and tax incentives in the US could be more positive impacts in the intermediate term. We also expect data center buildouts in both the US and Europe will continue to contribute to growth for companies in the technology, construction, natural gas and electric utility sectors, among others.

The financial sector outlook continues to be stable with pockets of known weakness particularly in US office commercial real estate. Net interest income should benefit from lower short-dated deposit rates and higher rates on longer-tenured loans as they reprice. The banking sector globally is well-positioned from an earnings, capital and asset quality perspective.

Leverage ratios remain relatively low across most sectors, as companies have reduced debt. While interest coverage has weakened, relatively high yields drive strong investor demand and relatively easy access to capital for most corporate issuers. The strength in credit metrics is a key element of our overall stable fundamental outlook. Having said that, we remain focused on the aforementioned economic uncertainties, as their impacts on corporate debt issuers become clearer in coming quarters.

Fixed income overview



As we enter the second half of 2025, the global investment landscape will be defined by the extent to which economic resilience can continue in the face of increasing policy uncertainty, geopolitical risks and the lingering effects of elevated interest rates. While inflation has continued to moderate during the first half of 2025, its outlook remains uneven, leading to divergent stances on monetary policy across the globe. The Federal Reserve and ECB appear set to continue to reduce policy rates, while the Bank of Japan maintains a more hawkish stance. In the US, the relative impact of tariffs on inflation and growth will play a crucial role in determining the path of Federal Reserve policy and interest rates generally.

Treasury yields are likely to remain elevated from a historical perspective, with a bias for a steeper yield curve as Fed rate cuts and a softening economic outlook pull front-end yields lower, while elevated supply and policy uncertainty pressure term premium higher. While we expect a steeper yield curve, Treasurys are likely to remain within recent trading ranges.

Across credit markets, investors will be tasked with navigating a landscape defined by tight valuations but solid underlying fundamentals and technicals. Corporate balance sheets are generally robust, with disciplined capital management in investment grade and high yield markets, and technicals that are supportive given relatively muted net issuance and strong demand from all-in yield buyers. However, tight spread levels reflect little upside and heightened downside risks to excess returns, particularly against a backdrop of restrictive trade policy. Bifurcation is increasingly thematic in distressed debt, with liability management exercises giving way to idiosyncratic opportunities.

Sector and security selection will likely take on heightened importance given the prolonged period of elevated funding costs, limited room for outright spread compression and an uncertain policy landscape. At the same time, all-in yield starting points provide a solid backdrop for total returns, with the potential for yields to rally and offset equity weakness in a worst-case scenario.

Investment grade credit: Europe and the UK

	Negative				Positive
Fundamentals			X		
Valuations		X			
Technicals				X	
Sentiment			X		

- In terms of fundamentals, investment grade firms remain in solid shape
- With spreads close to multi-year lows, valuations are relatively tight
- Technicals are very strong with continued strong demand for the asset class, both from a yield as well as a carry and rolldown perspective
- However, a trade war or heightened political tensions could weigh on markets

Corporate fundamentals are looking good at the time of this writing, but a trade war could impact corporate earnings, particularly for corporations that have exposure to the international supply chain. Second-quarter earnings season should provide some of the first indications about the direct impact of tariffs and more clues will likely emerge from firms' forward-looking outlook statements.

The ECB's rate-cutting cycle may well come to an end in the second half of the year. But despite lower yields on the very short end of the yield curve and the credit spreads over bunds sitting at multi-year tights, European investment grade credits are still in high demand. Investors seem drawn to the asset class due to the still-attractive all-in yields.

Additionally, since interest-rate curves have steepened, corporate bonds offer attractive rolldown, which is tempting holders of (very) short-term paper to extend their exposure to further out on the curve. In addition, the safe-haven status of European assets is gaining traction as the US budget deficit situation appears to be worsening and Japanese debt as a percentage of that country's GDP continues to rise into unchartered territory.

Meanwhile, building geopolitical tensions (in Gaza, Iran, Ukraine and elsewhere) have the potential to sour the mood. However, barring any catastrophic developments on those fronts, we expect the outlook for European investment grade credit to be fairly benign in the second half of 2025.

Valuations in pound-based investment grade credit are also relatively tight on a multi-year basis, although slightly less compressed when compared to euro-based investment grade spreads. UK corporate fundamentals remain on a solid footing. As for many companies elsewhere, the potential macro-economic headwinds related to tariffs and geopolitical risks will test that strength in the coming period.

The market is currently pricing in an additional two rate cuts from the Bank of England before year-end, which reflect expectations of headwinds in the second half of the year. That will likely serve to underpin resilient market technicals, supported by inflows into the asset class and a lack of meaningful new issuance. Given already tight valuations for companies in Great Britain, we expect a range-bound spread environment going forward.

Investment grade credit: US

	Negative				Positive
Fundamentals			X		
Valuations	X				
Technicals					X
Sentiment			X		

- After a brief bout of volatility, valuations have snapped back to frothy levels
- Fundamentals are stable outside of a few idiosyncratic stories
- Technicals remain a ballast in an otherwise shaky environment
- Expect credit spreads to modestly widen from current levels

We entered the year with the US investment grade market priced to perfection on the expectation that economic growth and inflation would moderate, while corporate fundamentals remained resilient. The credit index was at its tightest level since 1998, which left little room to absorb volatility and generate positive excess returns. As we move into second half of the year, the outlook for both economic growth and inflation is more challenged. With spreads offering little compensation relative to historical averages and elevated uncertainty, we prefer to position for spread decompression.

Credit fundamentals are on solid footing as we enter a period of elevated uncertainty. Earnings growth continues to outpace debt growth as management teams show signs of discipline. This cycle has been so quick, that we never really saw major re-leveraging in the corporate sector. Forward guidance is more muddled than in recent quarters due to trade policy, but outside of a few idiosyncratic stories, we expect investment grade companies to be able to weather the storm.

Coming into the year, we were wary of leveraging merger and acquisition activity (M&A) pressuring fundamentals. While it's too early to say that's no longer the case, we suspect that management teams will be more cautious at this juncture. Although M&A has been more muted than previously expected, investment grade primary supply has been elevated compared to prior years. Issuers rushed to the market to take advantage of attractive funding spreads, undeterred by still-elevated yields. Demand has proven to be nearly insatiable from yield-based buyers and inflows into the asset class. Primary supply should start to taper off as we head into the seasonally slow summer months, before another big push from syndicates in September. The next few months could see spreads grind modestly tighter as demand outpaces supply.

As we said previously, the outlook for excess returns hinges on the starting point of spreads. Historically, excess returns are more challenged when starting at current levels. Although a moderate-growth environment is typically conducive to investment grade, we remain more cautious and position for decompression between higher- and lower-quality credit. Credit selection will be paramount as we navigate the remainder of the year and wait for opportunities to add at more attractive levels.

High yield

	Negative				Positive
Fundamentals			X		
Valuations		X			
Technicals				X	
Sentiment				X	

- Despite macro uncertainty, high yield companies are performing well in general and we expect fundamentals to remain relatively stable with muted bond default activity
- From a valuation perspective, spreads are tight and look relatively expensive, however the market continues to offer reasonably attractive yields and relatively high income
- We expect heightened macro uncertainty will persist and could create pockets of market volatility, which can create compelling opportunities for investors
- Provided the strong market technicals remain supportive and the economic outlook does not decline materially, we could see coupon-like returns for the remainder of the year

The outlook for the high yield bond market remains mixed with elevated macro uncertainty contrasted by solid company fundamentals and supportive market technicals. However, the ongoing tariff saga, as well as the intensifying situation in the Middle East are likely to continue to create heightened uncertainty. For the high yield market, we expect the macro uncertainty will result in bouts of market volatility in the second half of 2025, which can create compelling opportunities for investors.

- **Fundamentals:** High yield company fundamentals remain in relatively good shape as most companies have healthy balance sheets relative to historical averages. Credit metrics have declined from prior peaks but remain healthy versus historical standards. However, the tariffs and the uncertain economic outlook have created headwinds and have the potential to negatively impact fundamentals, particularly within the more tariff-exposed sectors. On the surface, we believe most companies are performing decently and are well-positioned in this environment. Although the situation remains fluid, in the near-term we do not anticipate a material increase in the default rate for high yield bonds.
- **Valuations:** The valuation picture remains mixed with elevated yields contrasted by tight spreads. Although the high yield market experienced some volatility in early April and an overdue valuation reset with spreads moving wider, that quickly dissipated as sentiment improved and buyers stepped back into the market. Now, spreads are back near historically tight levels and we think it is unlikely that spreads will experience material tightening going forward. Although spreads could remain range-bound in the absence of a volatility catalyst, we continue to think that spreads are more likely biased toward widening. That said, as we saw in April, the spread widening could be short-lived. If spread widening does persist, it could be relatively contained given the higher-quality composition of the market today, provided the technicals remain supportive.
- **Technicals:** We expect market technicals to remain moderately supportive as the supply-demand imbalance persists. While we have seen an uptick in new issuance recently, primary market activity is likely to be relatively muted with low M&A activity and elevated rates. Fund-flow data has additionally turned more positive recently, and this adds a further layer of support.
- **Sentiment:** Market sentiment remains cautiously optimistic, however sentiment could be fragile in the second half as the macro outlook and political developments evolve.

Although sentiment temporarily turned more negative amid the tariff talk in April, it quickly rebounded and a risk-on tone ensued as tariffs were dialled back. Overall, cash balances in funds remain stable, risk positioning remains defensive and we have not seen a material shift back into the high yield market at this time. If we see a notable change in sentiment, it could signal buying opportunities.

All of that leads us to be cautiously constructive. We expect economic uncertainty to persist and there are various catalysts that could prompt volatility in the market. However, high yield company fundamentals are expected to stay in relatively good shape and default expectations to remain muted. In addition, high yield bonds continue to offer reasonably attractive yields, which translates into attractive long-term return potential. The high yield market also continues to offer high income and we could see carry-like returns for the remainder of the year if market technicals remain supportive and the economic outlook does not materially decline.

US bank loans

	Negative				Positive
Fundamentals			X		
Valuations				X	
Technicals				X	
Sentiment				X	

- Heading into the third quarter, fundamentals are mixed as decent underlying earnings are offset by tariffs and geopolitical uncertainty pressuring the outlook
- Valuations are strong. Potential re-pricings and additional Federal Reserve interest-rate cuts will likely reduce coupons by around 25 basis points by year-end
- Collateralized loan obligations (CLOs) remain the bedrock of the market, while retail fund flows aren't expected to be a major driver during the second half

Our outlook for US bank loans in the second half of 2025 is roughly for coupon-like returns, as the second-quarter price rally moved the Morningstar LSTA US Leveraged Loan Index back to the high 96 level, leaving limited price upside—particularly for medium- to higher-quality names that were already trading around par.

Meanwhile, the S&P UBS Leveraged Loan Index offered a 3-year yield of 8.32% as of this writing, which is an attractive starting point and would require many additional Fed cuts for the coupon to be below long-term averages. As such, while price rallies could be limited going forward (other than for stressed/discounted names), the carry alone is still attractive.[1]

Our bias in this environment is toward high-conviction names with decent coupon rates, while staying diligent about CCCs and discounted names in the face of ongoing high interest rates, which can cause cash-flow challenges and some secular changes in older business models—especially in the ever-changing world of tech, media and telecom.

The ongoing trade war also limits our desire to invest in lower-quality names until more certainty comes through from the Trump administration. With the indexes at such a high level, it also becomes important for managers to avoid downside risk since most loans are priced for perfection, i.e. the price cushion is not there right now.

From a fundamental perspective, we expect to see most credits navigate the uncertain outlook with solid performance, especially given our bias toward domestic, less-GDP-sensitive business models, namely in the packaging and food and beverage industries.

Higher interest rates have stretched certain lower-rated balance sheets and while the 2024 Federal Reserve interest-rate cuts have helped interest coverage ratios, they remain lower than long-term averages. Leverage, thankfully, has been fairly stable during the first half of the year and we'd expect that to continue into the second half.

Defaults remain above long-term averages (3% to 3.5%) or around 4.5% if you include distressed exchanges. But we expect the percentage could lessen somewhat into second half of the year, as most of the obvious distressed exchanges have played out. While many of these companies are avoiding true chapter 11 bankruptcy, there is still pain being borne by loan investors in the form of principal haircuts taken, typically in the range of 10% to 25%.

Rating agency downgrades have continued to outpace upgrades as interest coverage ratios have tightened across the asset class. The pace of downgrades has been measured for the most part, which has allowed the market to absorb most of the downgrades without significant selling pressure.

Technicals and sentiment are positive for the asset class. The recent outflow blip early in the second quarter is now behind us and given the strong starting valuations, retail funds will likely take in incremental flows going forward.

CLO liability spreads are expected to stay around multi-year tights, resulting in new CLO creation continuing to offset CLOs exiting their reinvestment periods. The decline in CLO spreads is also making it attractive for managers and their sponsors to reset many of these older CLOs, effectively re-opening investment capacity for an additional three to five years and spurring additional demand.

From a loan supply outlook, we expect a modest pickup in leveraged buyout and M&A activity going into the second half of 2025. But uncertainty from the presidential administration, still-high interest rates and potential geopolitical storms will likely keep supply muted and limit the growth of the indexes. As such, we don't expect supply to be materially positive on a net-issuance basis, with private credit, syndicated loans and high yield markets all fighting for market share on deal creation, amid the aforementioned decent CLO issuance and potential retail inflows pushing up the demand side.

Lastly, from a valuation standpoint, we see the current entry point as attractive for long-term investors. Price rallies are limited going forward, but high starting coupons are still compensating investors nicely. We are watching for pockets of volatility to emerge again as the developments come through on trade, tariffs and geopolitics, resulting in potentially attractive entry points for tactical investors. However, for investors willing to see through the potential volatility, we think the second half of the year will be another solid period of returns for the asset class.

[1]Data is provided for illustrative purposes only. Indices do not reflect the performance of an actual investment. It is not possible to invest directly in an index, which also does not take into account trading commissions and costs. All investments contain risk and may lose value.

US emerging market debt

	Negative				Positive
Fundamentals			X		
Valuations		X			
Technicals			X		
Sentiment				X	

- Emerging markets debt (EMD) enters the second half of 2025 with attractive yields but faces compressed risk premia, slowing global growth and heightened policy uncertainty, requiring selective positioning and active management
- We believe a defensive stance is warranted, reflecting the recent recovery in spreads following the first-half 2025 selloff, which has reduced the attractiveness of risk-taking at current valuations
- Country selection is key, with opportunities in resilient, domestically driven economies and risks concentrated in trade-sensitive and commodity-reliant markets

The second half of 2025 presents a complex and uncertain environment for EMD investors. While the asset class benefits from supportive technicals and attractive yields, the macro landscape is increasingly shaped by policy-driven volatility. This calls for a focus on security selection and selective positioning.

Credit spreads have tightened sharply since the Liberation Day selloff, compressing risk premia to multi-year lows and leaving little room for error. This is occuring against a backdrop of slowing global growth—now forecast at 2.3%—due to escalating trade tensions and policy uncertainty. Although recent developments, such as easing US trade frictions and legal setbacks to aggressive tariffs, have provided some relief, investor caution is likely to persist until a new trade framework emerges.

Monetary policy divergence adds another layer of complexity. The Federal Reserve remains on hold, balancing soft landing hopes against inflationary pressures from tariffs. Meanwhile, the ECB and Bank of England have begun easing, while the Bank of Japan maintains a hawkish stance. This divergence fuels cross-asset volatility and makes the US dollar's path highly unpredictable—a key variable for emerging market (EM) returns.

In this environment, local currency (LC) debt appears more compelling. Many EMs offer high real yields and have contained inflation, creating a favorable setup—especially if the dollar weakens. However, this exposure must be actively managed to navigate volatility from global policy shifts. Hard currency (HC) debt, while less attractive broadly, still plays a role. Investment-grade HC debt offers defensiveness, while high-yield HC names present idiosyncratic alpha opportunities, particularly in reform-oriented or International Monetary Fund-supported credits.

Country selection will likely be the main driver of returns. Domestically driven economies like India show a "Goldilocks" mix of strong growth and moderating inflation. In contrast, trade-dependent markets like Mexico remain vulnerable to US policy shocks and risk recession. Commodity exporters, excluding gold, face renewed headwinds as global demand softens.

On the fundamentals, EM sovereigns have made progress stabilizing post-pandemic debt dynamics. However, high interest burdens and fiscal deficits remain concerns in a higher-for-longer rate environment. That said, strong external balances across much of EM provide a buffer against funding stress. Low US interest rates also offer support—assuming they remain stable or decline.

Overall, the second half of 2025 continues to be challenging and uneven for EMD. While capital flows are stabilizing, valuations already reflect a relatively optimistic outlook—one that may not materialize if global growth weakens further. Success will depend on nimble, active management and a disciplined focus on fundamentals. Investors must embrace the bifurcation within the asset class and apply rigorous country-level analysis to identify resilient credits. The opportunity set remains, but navigating it will require caution, selectivity and adaptability. Selloffs should be viewed as potential entry points for the remainder of the year.

Global sovereign debt

	Negative				Positive
Fundamentals				X	
Valuations				X	
Technicals		X			
Sentiment			X		

- In our view, persistent uncertainties in the global economy will support an allocation to sovereign debt in the second half of 2025
- Most G7 central banks are expected to deliver one to two interest-rate cuts during the second half of 2025—except for Japan, where persistent inflation may require further monetary tightening
- Inflation globally has eased significantly with policy rates declining at a moderate pace, leading to positive real rates in some countries, while steeper yield curves improved the carry and roll-down of the asset class
- Sentiment around sovereign debt is somewhat mixed due to consistently wide budget deficits and high debt levels in major economies, which are proving difficult to address

Global government bonds are expected to remain an attractive asset class in the second half of 2025. We anticipate that the global economy will continue to face uncertainties around geopolitical shifts and trade re-routing, which may require investors to rebalance portfolios away from overvalued assets and adopt a more cautious approach to risk management. In this environment, global investment-grade sovereign debt is well-positioned to perform, given the universe of liquid bonds with a high average credit ratings.

In the second half of the year, the main positive drivers of asset performance are likely to be cooling economic data and further easing of interest rates by major central banks. Consumer prices are not expected to pose a significant risk to monetary policy, although the pace of disinflation may slow, particularly if geopolitical tensions trigger sudden disruptions in energy markets or supply chains. Episodes of market volatility could reinforce the appeal of the asset class as a relative safe-haven investment, potentially supporting further inflows.

From a valuation perspective, sovereign debt continues to offer outright yields not seen in over a decade across many regions. Declining inflation has resulted in positive real rates in some regions, while steeper yield curves have alleviated concerns about negative carry and a roll-down in longer-term maturities. Technical factors may become a headwind for performance given high budget deficits in major economies that require consistent debt issuance to finance spending on crucial items from defense to social support. This could weigh on market sentiment toward global sovereign debt although many governments have taken note of the increased risk premia and may reduce their borrowings in the longer maturities, which have become more expensive.

In summary, investment in global sovereign debt is expected to deliver positive returns in 2025, although the active selection of issuers and positioning on the yield curve will remain important to reduce the potential impact of adverse technical factors and volatile market sentiment.

European asset-backed securities

	Negative				Positive
Fundamentals				X	
Valuations				X	
Technicals		X			
Sentiment			X		

- We believe European asset-backed securities (ABS) are attractive from a valuation perspective
- Risk premium and carry is high and has the potential to partially absorb any potential spread widening
- Low interest-rate duration provides return protection in an uncertain rate environment
- We expect spreads to largely remain range-bound

We expect European ABS credit spreads to stay broadly similar to current levels. Some compression across the credit curve has occurred, but there is some additional tightening possible for the sub-investment grade portion. However, the intensifying conflict in the Middle East, rising geopolitical tensions, the trade war and the fragile global economy could put upward pressure on spreads.

Although European ABS tends to be more insulated from volatility in the broader market if generic sentiment in the market changes on the back of the aforementioned circumstances, it is not immune, and spreads will widen out (as we saw in the weeks following Liberation Day).

Market expectations for central bank actions and the order of magnitude as to which they are priced in by the markets, can cause volatility of returns, especially for longer-duration products. The uncertain outlook for the global and European economies will likely lead to periods of changing sentiment in markets going forward as concerns about inflation, the growth prospects of the eurozone economy and the impact of higher interest rates remain. Higher-carry and short interest-rate-duration assets are set to outperform in such an environment.

From a fundamental perspective, consumers started the year in a position of strength: household net worth and savings rates are strong, there is less uncertainty on the path of interest rates (at least for European consumers) and unemployment remains low on an historical basis.

However, it is certain that consumers are facing headwinds, with those in the US impacted more than their European peers. However, for corporates, there are more similarities and we expect the impact for European corporates to be higher. So far, inflation reports have shown minimal impact, but there is some pressure on certain corporate sectors especially for those that receive the majority of their revenue from exports to the US.

Overall, we expect that corporate defaults will be going up toward the end of the year and will continue to increase in 2026. However, while deterioration is expected to occur in some underlying exposures of ABS and CLOs, structural protection such as excess spread and subordination should be sufficient to withstand this possible increase in losses.

Overall, we do not expect spreads to tighten much more from current levels and income (coupons) will likely be the main driver of returns. From a relative value perspective, spreads versus equally rated corporate bonds are at or above their historical averages and valuations are therefore attractive as the conventional spread pickup is still available. The current macro backdrop has also set the stage for the European ABS market to deliver attractive total returns from this point forward, as we believe that ABS will likely outperform in an environment where there are many uncertainties.

In summary, the relatively high carry value of European ABS, limited concerns from a fundamental perspective and (relative) valuations that are attractive from an historical perspective, make European ABS an attractive asset class.

US structured finance

	Negative				Positive
Fundamentals			X		
Valuations			X		
Technicals				X	
Sentiment			X		

- We believe the securitized market still offers an attractive relative-value proposition compared to other assets
- We expect modest deterioration in collateral performance, but investment-grade tranches should remain well protected
- The technical environment remains favorable

We maintain an optimistic outlook for the US securitized market for the remainder of 2025. We continue to view securitized spreads as offering an attractive relative-value proposition when compared with competing risk assets. Current spreads, combined with elevated yields, offer attractive risk-adjusted return opportunities.

Asset-backed securities (ABS)

Fundamentals within on-the-run ABS have been mixed, with prime borrowers exhibiting strong performance across both delinquencies and net losses. Within subprime consumer ABS, performance could be characterized as resilient, albeit with delinquencies and losses that are more pronounced than in the prime space. With tighter spreads and an overall lack of tiering across issuers, more focus on sponsor-specific underwriting is warranted. We expect stable performance across consumer fundamentals for the remainder of 2025. If performance deterioration were to materialize, we believe structures are robust with meaningful hard enhancement to absorb this, particularly for investment-grade-rated tranches.

Esoteric ABS performance is specific to each collateral type, but performance has been quite strong generically speaking. Data center ABS has continued to grow and is on its way to becoming a benchmark ABS sector.

Other collateral types that have a digital infrastructure flavor have seen meaningful demand amid strong performance and strong secular tailwinds such as digitalization and an undersupply of needed infrastructure.

Solar (particularly solar loan ABS) has been under pressure and we expect that to continue throughout 2025 and into 2026. Investors are leaning on the structure of these solar deals, and senior bonds look to be well insulated from this additional stress on the sector and benefit from structural mechanisms that speed up cash flows to senior bonds. Across other esoteric ABS sectors, we continue to believe there are attractive opportunities that can provide additional yield, as well as diversification.

Residential mortgage-backed securities (RMBS)

In the residential mortgage market, mortgage rates are modestly lower compared to this year's highs. But affordability remains constrained due to still-elevated rates and tight housing supply. Some regional softening is occurring, particularly in areas with increased listings. Home prices will likely continue to be supported by structural supply constraints and the large cohort of homeowners locked into low-rate mortgages.

New home construction is down from post-COVID highs, muting the supply headwind, as builders continue to face labor, land and material shortages. Street estimates suggest that recent tariff and immigration policy changes will have only a minor impact on new-home construction and are not expected to materially affect housing prices or performance.

Demographic tailwinds remain a key support for housing demand. Millennials, now in their peak home-buying years, continue to drive demand, while Gen Z is entering the market earlier and at a faster pace than prior generations. Together, these two generations represent the largest share of the US population, underpinning long-term housing demand.

Our outlook remains constructive. The Federal Reserve's expected gradual rate cuts are expected to support mortgage credit. RMBS underwriting standards, issuance and demand remain strong and are expected to continue. While credit performance is generally stable, delinquencies have slightly increased in some recent non-qualified-mortgage vintages where higher rates and inflation took its toll on the consumer, however this looks to have stabilized. Nonetheless, favorable demographics, constrained supply and a stabilizing macro backdrop continue to support the housing and RMBS markets in the near- to medium-term.

Commercial mortgage-backed securities (CMBS)

CMBS new issuance continues to make a comeback with year-to-date new issuance volume now 65% higher relative to the same period in 2024. Issuance has been led by single asset/borrower transactions, which have made up 56% of the volume, while conduit (primarily 5-year issuance) has made up about 21%. Issuance is expected to continue this trend for the remainder of the year.

CMBS loan delinquencies remain elevated with a concentration in matured loans. Despite the higher levels, we continue to expect servicers to resolve troubled loans primarily through modification and extension.

Stability in the capital markets bodes well for commercial real estate, while economic uncertainty can mute the recovery in property transaction volume and pricing. Given the current environment we continue to look for opportunistic exposure in deals with conservative underwriting secured by assets providing sustainable cashflows.

Collateralized loan obligations (CLOs)

Despite current challenges and uncertainty, we remain optimistic about the corporate fundamentals as we enter the second half of 2025. Leverage and earnings are well-positioned, supported by improving interest coverage ratios. However, if economic conditions shift toward higher inflation, slower real growth and a potentially softer labor market, it could lead to some deterioration in corporate metrics over the next 12 months. The population of distressed loans has unwound the increase in April of 2025 and now is at the midpoint of the run-up from interest-rate hiking cycle of 2022. Default activity is expected to continue primarily impacting loans rather than bonds, with liability management exercises (LMEs) being the primary recovery path. Historically, recoveries outside of LMEs remain low, yet CLO structures continue to demonstrate resilience.

CLO liability spreads are off the tights from earlier in the year. The technical grind tighter resumed in May and the first half of June after the pullback in pressure from tariffs. However, given the elevated macroeconomic uncertainty, further spread widening may occur in the latter half of 2025 as additional premiums are priced in. As Federal Reserve Chairman Jerome Powell noted in a speech in April, the Federal Reserve is "well positioned to wait for greater clarity before considering any adjustments to our policy stance." The combination is making the carry in floating-rate assets particularly appealing. We anticipate that by this time next year, the Fed will have a new chair, with the administration potentially advocating for rate cuts.

The year began with a record-breaking pace of resets and refinancing activity, which slowed during the second quarter. By the end of 2025, we expect completion in managing the wider liability spreads from the 2022 to 2023 period. Amortization volumes may decline in upcoming quarters due to lower loan repayment rates and decreased post-reset deal volumes. New issuance volume lags last year's pace, as the CLO market looks to the leveraged loans market for new supply.

In terms of strategy, we favor the primary market over the secondary due to spread concessions. Floating-rate carry remains attractive and we recommend prioritizing quality and reducing spread duration, with a preference for 3-year, non-callable, 1-year structures over 5-year, non-callable, 2-year deals, aiding capital requirements in line with the proposed changes in the regulatory framework for CLOs.

US structured: technicals and valuations

Overall, we believe the US securitization market should see reasonably active new-issue deal flow for the balance of 2025, while supply and demand dynamics are favorable at the moment. Despite the ongoing challenge of elevated interest rates, a combination of continued capital market momentum and persistent refinancing needs is expected to support robust issuance across the market. Additionally, certain sub-sectors may experience a modest uptick in issuance, contingent on the continued resilience of economic conditions, stable interest rates and restrained volatility.

Yields remain attractive across many US securitized sectors and we continue to see many areas of opportunity from a valuation standpoint. That said, the direction of spreads for the rest of 2025 will likely be more influenced by broader economic trends, Federal Reserve policy, the agenda of the Trump administration and overall financial market conditions, rather than by factors specific to the securitized market.

Despite experiencing bouts of volatility around Liberation Day, credit curves have re-flattened due to strong demand for spread/yield, so we recommend maintaining an up-in-quality strategy. While relative value opportunities are present and securitization structures remain resilient, we believe that credit selection will remain important in for the rest of 2025, as additional prudence will be necessary to achieve the best risk-adjusted returns.

Distressed debt

	Negative				Positive
Fundamentals			X		
Valuations		X			
Technicals			X		
Sentiment			X		

- We believe that lower-quality, high-yield credit—particularly within the Caa ratings category—will offer compelling investment opportunities over the next 6 to 12 months, allowing astute investors to take advantage of specific idiosyncratic situations and market dislocations
- Defaults may slightly pick-up as we approach the 2026 to 2027 refinancing cliff given that the higher-rate environment likely to persist
- In the short-term, we still expect a continued wave of liability-management exercises (LME) and amend and extend (A&E) transactions

During the first half of 2025, we saw shifting macro winds related to trade policy and geopolitical risks. While capital markets largely recovered, there were the beginnings of bifurcation within lower-quality credit, which could be magnified over the next year given elevated rate expectations and the looming maturity wall within leveraged finance.

The evolution of the broader high-yield space toward a higher-quality mix leaves the Caa cohort concentrated with more cyclical issuers—those whose performance is closely tied to macroeconomic shifts and the ability to access capital markets to navigate their balance sheets. Although the all-in yields remain attractive, the market's current spread valuation warrants caution, especially considering lower-quality spreads are near their tightest levels in years.

Historically, such conditions have preceded mean reversion, which can be more pronounced in lower-quality, high-beta credits like Caa. The segment's sensitivity to shifts in investor sentiment and macroeconomic data can lead to swift reversals, adding an element of heightened volatility, which we would expect to experience more of during the remainder of 2025 and into 2026 given current spread levels.

Our outlook for lower-quality credit and our call for renewed volatility and bifurcation is also driven by our expectation that LMEs will persist, as issuers facing upcoming maturities seek to optimize capital structures through restructurings, distressed exchanges and refinancings. These situations can warrant caution and present opportunities for distressed investors. These activities often generate volatility and fear within the market, creating moments of price dislocation that discerning investors can exploit. We also believe that high-yield and distressed investors will require sufficient yield to participate in these types of transactions, which will likely limit substantial Caa tightening from current levels.

For example, we are cautious about companies that have been experiencing prolonged margin pressures due to elevated labor costs or lingering supply-chain issues. We are watching situations that involve capital structures with limited creditor protections and/or aggressive owners. Although these situations could occur across various sectors and industries, we could see more weakness within certain segments facing secular changes.

While some issuers may struggle in this environment and we anticipate LMEs and restructuring solutions will persist, we expect default rates to slightly increase as we approach the next maturity wall. That said, absent an unexpected industry-wide shock or recession, which is not our base case, we don't envision a material spike in US corporate default rates.

Although defaults should remain subdued on the surface, we expect many intriguing stressed or distressed investment opportunities to arise in the second half of 2025. For example, companies with fundamentally sound business models but stressed capital structures can present exceptional value opportunities when their prices overreact to market drawdowns and/or LME-related situations. Active investors who can differentiate between genuine distress and temporary dislocations should be well-positioned to capture compelling risk-adjusted returns within this evolving landscape and within select Caa-rated credit.

In summary, while clear risks remain in lower-quality, high-yield credit in aggregate, the stage seems to be set for idiosyncratic opportunities over the next year given current spread levels and expectations for continued elevated rates, as well as heightened levels of LME activity. By leaning into fear-driven market inefficiencies and overreactions, we continue to expect meaningful opportunities to generate strong risk-adjusted returns in lower-quality credit over the next 6 to 12 months.

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