RBC Global Asset Management

Floating rate is still cool

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Securitized Credit team

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Floaters are cool, again

A surprisingly resilient US consumer, strong labour market and the US Presidential election has delayed the rate cute outlook that was anticipated after the Fed's September meeting. The 10-year Treasury Bond is 50 bps *higher* since the Fed's 50 bps rate *cut*[1]. And flows into floating rate assets have continued to be strong. So how should investors position for this change in expectations?

Don't abandon your floaters

In our view, an allocation to floating rate assets remains beneficial for investors and strikes us as prudent asset allocation. The path of rates is uncertain and the market has already meaningfully cut back its rate cut projections. However, volatility around these expectations makes floating rate asset classes with higher credit spreads attractive.

When rate cuts do come into fruition, there are two key considerations for floating rate assets:

1. **The impact on all-in yields:** since floating rate assets pay a spread over base rates, lower rates will translate to lower all-in yields. However, the starting point on floating rate assets such as leveraged loans or securitized credit is very attractive versus comparable fixed rate asset classes such as high yield or investment grade corporates, both of which are at historical tights. Therefore, despite anticipated rate cuts, all-in forward yields of floaters are comparably very attractive.

2. **The impact on fundamentals:** rate cuts are positive for underlying issuers with floating rate liabilities, as falling rates will provide relief in the form of increased cash flows and improved debt service ratios. Thus, lower rates will increase the likelihood of private equity sponsored sales or private credit takeouts, a tailwind for loans and CLOs.

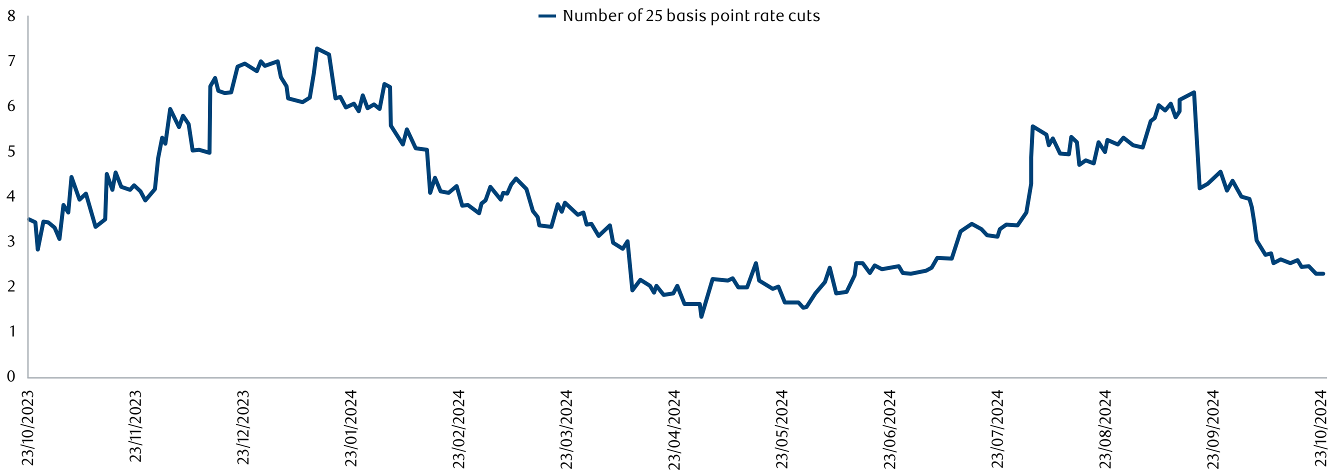
[1] Bloomberg.

Let Securitized Credit float your boat

There are a few ways to take advantage of the uncertainty in rate expectations. In securitized credit, we see value in short duration floaters such as CLOs and ABS, which benefit from an inverted forward curve and short spread duration, while providing attractive credit spreads.

Bottom line, an allocation to floating rate assets remains beneficial in the current environment if central banks are inclined to cut at a slower pace than the market projects. The direction of rates is indeed lower, but as we've seen time and time again this year, the path to get there will not be linear.

Figure 1: Number of US rate cuts priced in by forward curve through Janaury 2025



Source: Bloomberg.

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