RBC Global Asset Management

Market views: fixed income and equities

A review of the year and an outlook for 2025

RBC BlueBay

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At RBC BlueBay, our investment experts operate across dynamic market environments, sub-asset classes, geographical regions, and opportunity sets. 2024 was an eventful year, not least from a political perspective, with over half of the world's population heading to the polls. Here we reflect on the key events and share our views on what could lie ahead in 2025.

Our fixed income strategies

Global Fixed Income

Mark Dowding, BlueBay CIO

- Performance was mixed across fixed income markets in 2024. For credit investors, it was a good year, with robust US economic growth. Coming into the year, a recession had been expected, particularly on the back of the yield curve having inverted, as historically, this has been a slight recession indicator. However, we always believed this was a 'false flag' and that the US economy is healthy.
- From a macro perspective, longer-dated bond yields rose this year, again, maybe as recessionary fears receded. At the same time, shorter-dated yields have gone in the other direction, with the Fed announcing its first interest rate cut of 50bps in September, followed by a further cut in October.
- We expect volatility in 2025, with Trump 2.0 bringing a significant amount of change and disruption. In a world of trade tariffs, we also expect to see continued strength in the US dollar. In our view, next year will see a dramatic steepening of the US curve, driven by profligate fiscal policy.
- Investment grade credit may deliver further outperformance against a backdrop of oversupply of government bonds. This is a factor also causing yield curves to steepen.
- US interest rates are seen as staying higher-for-longer under a Trump administration. This may be problematic for assets classes such as private debt, where balance sheet leverage is the most elevated.
- We see opportunities in Euro financials and also in more illiquid credit in special situations in European markets.
- With economic, political and geopolitical uncertainty continuing to drive volatility across fixed income markets, skilled investors should have ample opportunity to generate active performance.

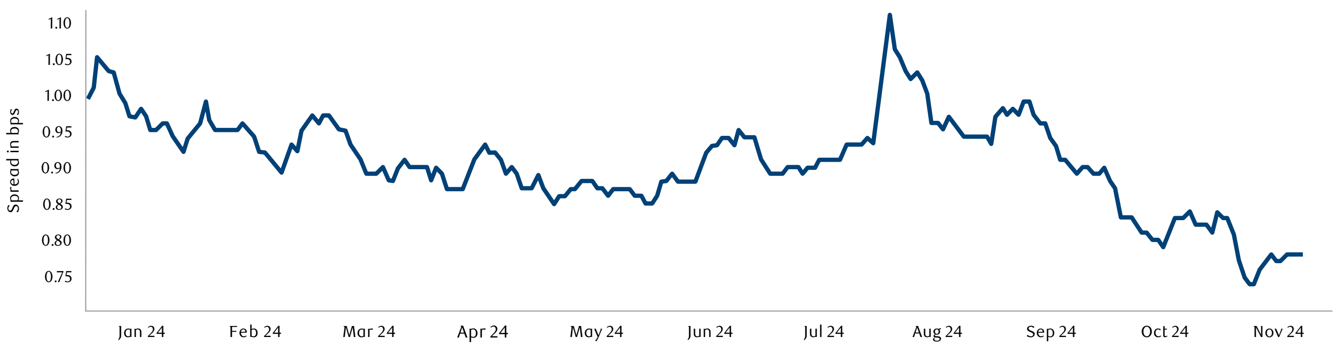
US Fixed Income

Andrzej Skiba, Head of BlueBay US Fixed Income

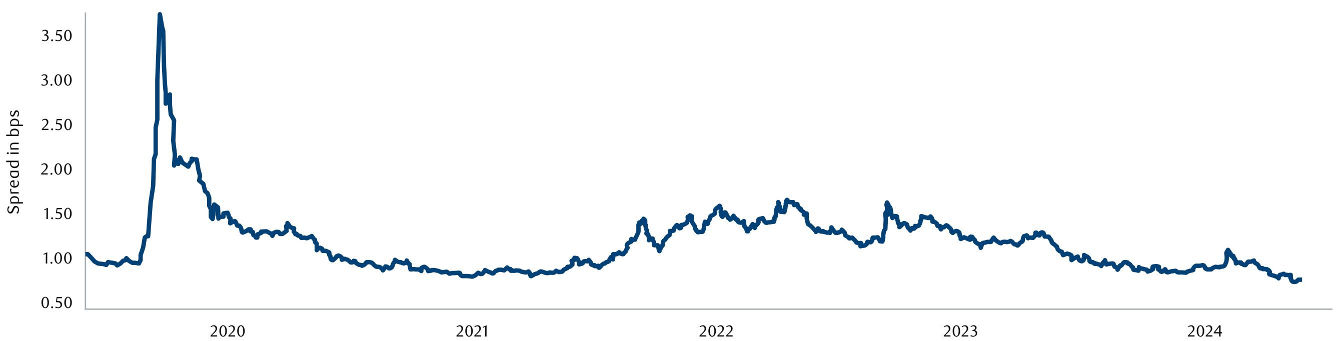
- 2024 saw an abundance of rates volatility, however spreads did remarkably well, helped by broad inflows into US fixed income (Chart 1).
- Looking into 2025, we believe caution is warranted as, in our view, there is a lack of clarity concerning a Trump administration's policy choices.
- If the US pursues an aggressive trade agenda with 10% tariffs imposed on a variety of goods and on most trade partners, inflation is likely to increase. Our analysis indicates that the trade war CPI (Consumer Price Index) impact could be up to 1%. That may dictate the Fed's ability to cut rates. With 2-3 rate cuts priced in for 2025, some or all of that might have to be unwound, putting pressure on front-end Treasury yields.
- Add to that loose fiscal policy causing heavy Treasury supply and it's no wonder we continueto see pressure on longer-maturity Treasury yields as well. We see a good chance that 30-year Treasuries will hit 5% in the months ahead and note that investors may demand extra compensation to move further out the curve. A less aggressive approach to tariffs and government efforts to cut spending could reduce inflationary pressure, and rate cuts could continue.
- In credit, valuations are unattractive, and we see fewer opportunities. This is the reason why across our US strategies we have rotated into shorter duration alternatives. This approach also allows us to make sure we take advantage of periods of dislocation, were these to materialise.

Chart 1: US Investment Grade corporate spreads

Year-to-date



Multi-year tights



Source: Bloomberg, as at November 2024.

Emerging Market Debt

Polina Kurdyavko, Head of Emerging Market Debt

- EM sovereign credits generally have lower debt and gross financing needs compared to developed markets countries, and credit rating trends are likely to remain positive in the coming year. EM corporate credits have also seen material deleveraging over recent years. With net leverage at historical lows and ongoing improvement in debt ratios, corporate default rates are also expected to be low.
- Despite stronger fundamental metrics, EM assets offer a yield and spread pick-up compared to their developed market peers with equivalent credit ratings. EM central banks are well positioned to continue easing, providing attractive opportunities in local rates.
- The asset class remains underinvested, making it less vulnerable to volatility from outflows.
- **Geopolitics:** while US foreign policy could create volatility, a possible resolution of current conflicts could stabilise global markets, improve sentiment and benefit emerging economies, in particular. Countries with friendlier relations with the Trump administration, such as Argentina, El Salvador and Russia, could be winners.
- **Trade:** a shift in global supply chains could present opportunities for some countries in the form of FDI and trade rerouting and, likewise, a Chinese move away from US imports could benefit EM exporters (Chart 2). Countries with domestic growth and reform stories, such as India and South Africa, would be more resilient in the face of global trade repositioning.
- **Commodities:** higher production of US domestic oil and natural gas and possible easing of Russia sanctions could result in weaker oil prices. The stance on trade and infrastructure investment could drive demand for industrial metals.

Chart 2: Potential beneficiaries if China diversifies from the US

Largest global exporters (% of total exports)

Soybeans (US$18bn)		Integrated circuits (US$9.6bn)		Crude petroleum (US$6.9bn)	
Brazil	53%	Taiwan	23.2%	Saudi Arabia	16.2%
USA	35%	Mainland China	22.1%	Russia	10.0%
Argentina	3.5%	South Korea	12.6%	Canada	8.5%
Canada	2.9%	Singapore	8.5%	USA	8.2%
Paraguay	1.2%	Malaysia	8.2%	Iraq	7.6%
Ukraine	0.9%	Japan	3.8%	UAE	7.2%
Uruguay	0.9%	Philippines	3.4%	Kuwait	4.3%
Russia	0.4%	Germany	2.0%	Norway	4.1%
Netherlands	0.4%	Vietnam	1.8%	Nigeria	3.6%
Togo	0.3%	Ireland	1.6%	Kazakhstan	3.3%

Source: RBC GAM, FDI intelligence, Bloomberg, as at November 2024.

High Yield

Sid Chhabra, Head of Securitised Credit, CLO Management and European High Yield

- High yield bonds tend to perform well and represent a good carry opportunity in a moderately positive economic growth backdrop, which we forecast to occur over the next year across the US and Europe.
- From a corporate perspective in 2025, we expect a meaningful pick up in M&A activity and these leverage buyout financing deals provide wider spread opportunities relative to existing bonds in the investment universe.
- The positive dynamic for the high yield market from the growth of the private credit asset class, and loans, is that a number of issuers, many times smaller and mid-scale issuers, have gravitated to these channels to source financing at much higher leverage, resulting in the HY asset class at lower leverage and a higher quality asset class within the broader leveraged finance space, with majority of the index at a BB rating.
- The high yield asset class has delivered compelling long-term returns to investors (Chart 3). For example, over the past 5 years in USD terms, investors have received over 3.50% higher returns from US and European high yield bonds relative to investment grade bonds. While the beta return opportunity remains decent, the alpha opportunity is improving as we are likely to see an uptick in issuance via more M&A/LBOs and more sector dispersion due to an expected uptick in rate volatility and re-adjustment of trade patterns over 2025.

"While the beta return opportunity remains decent, the alpha opportunity is improving as we are likely to see an uptick in issuance via more M&A/LBOs."

Chart 3: Higher spreads have consistently delivered higher returns

	3-year	5-year	7-year	10-year
US HY bonds	3.21%	4.58%	4.61%	4.95%
EU HY bonds	4.40%	4.82%	5.10%	5.68%
US Investment Grade	-1.89%	0.69%	2.09%	2.62%
EU Investment Grade	0.74%	1.39%	2.49%	2.85%

Source: RBC GAM, as at 21 November 2024. Note: US HY Bonds = ICE BofA US HY index; European HY Bonds = ICE BofA European Currency High Yield Constrained Index; US Investment Grade = ICE BofA US Corporate Index; EU Investment Grade = ICE BofA European Corporate Index. Hedged USD returns. Past performance

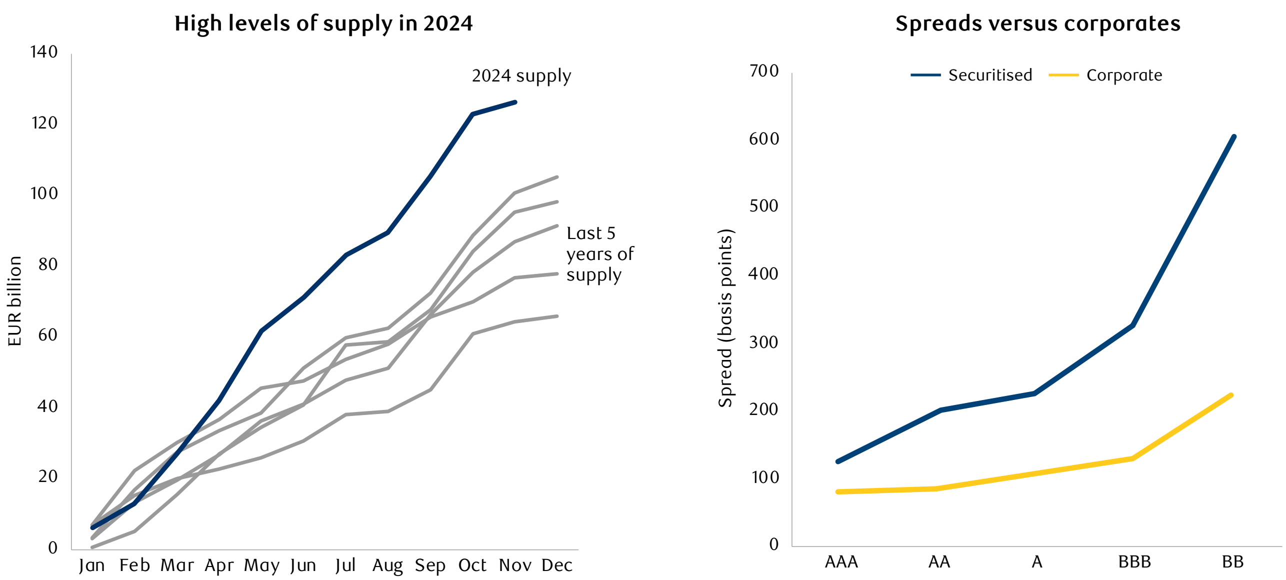
Securitised Credit

Tom Mowl, Portfolio Manager

- Over recent years, securitised credit has performed extremely well against a backdrop of uncertainty and volatility, and 2024 was no exception.
- Fundamentals are strong. The collateral underlying the bonds has been resilient, such as residential mortgages or consumer loans, and capital structures, that are designed to absorb defaults well in excess of even stressed scenario assumptions, are robust.
- Secondly, against the backdrop of rates volatility, the predominantly floating rate nature of securitised credit means the asset class has delivered very stable returns.
- Securitised credit is attractive in both the short and long term, and in benign and volatile market environments.
- We can demonstrate catalysts to generate total returns in a benign environment, and the high levels of supply seen in 2024 are expected to continue, as central bank support has been withdrawn and more issuers are seeing the benefit of issuing into ABS markets. This means overall spreads remain attractive versus corporates (Chart 4).
- In the long term and importantly for periods of market volatility, securitised credit exhibits attractive characteristics such as high credit quality, low spread duration, floating rate, low correlations to traditional fixed income and significant credit protection, due to robust fundamentals and structures.
- Our outlook for 2025 is positive; spreads are attractive, we are well insulated from further rates volatility, fundamentals are robust, and we have a lot of protection from rising defaults with a significant margin of safety (Chart 4).
- We are also cognisant of wider macro risks, and thus keep our strategies in high-quality assets with short average lives to enable us to stay nimble.

"Securitised credit is attractive in both the short and long term, and in benign and volatile market environments."

Chart 4: Supply surge keeping spreads interesting



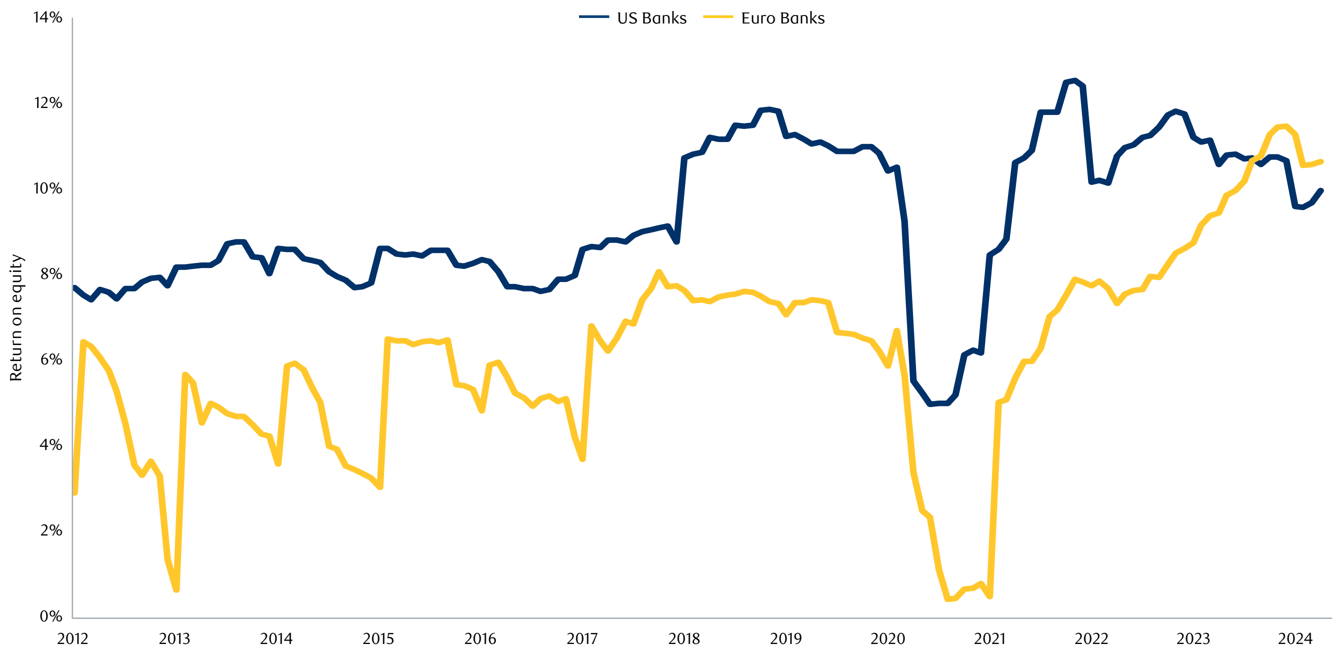
Source: RBC GAM, Bloomberg, Wells, BAML. Indices SWAP OAS AAA – ER10, AA – ER20, A – ER30, BBB – ER40, BB – HE10. Spreads in GBP terms.

Global Investment Grade Financials

Marc Stacey, Senior Portfolio Manager

- The theme of stronger growth and higher rates for longer has meant that financials have enjoyed a profitability tailwind this year, and we believe this to be sustainable. Strong fundamentals in both the US and Europe have been reinforced by earnings growth and a supportive macro background. Pre-provision earnings of around USD350 billion have maintained capital levels at the highs in addition to record shareholder returns, while non-performing loans sit at the lows[1].
- In the context of this, European banks are conducting approximately USD50 billion in share buybacks and USD70 billion in dividend payments[2]. USD120 billion in shareholder returns for a sector with a market cap of around USD700 billion means a significant backstop or tailwind from a share price perspective; this should be good for credit and particularly for subordinated financials.
- In our view, this higher-for-longer rates environment that has been conducive to strong financials will persist. In terms of monetary policy, rates will remain elevated, meaning the trajectory for revenue remains robust. We think the Fed is unlikely to be able to materially cut rates from current levels and may stop at around 4%. In Europe, we believe the ECB rate is more likely to be closer to 2.5% over the course of 2025.
- Looking ahead, we think many themes from 2024 will persist. We expect US growth to remain robust at around 2.5%, similar to the current Atlanta Nowcast prediction. We believe European growth is likely to be about 0.5-1%, which is somewhat lower but still very conducive to an environment that is good for credit.
- With this backdrop, we expect the return on equity for European banks to remain in double-digit territory for a sustainable period (Chart 5).

Chart 5: For any capital instrument, profitability is the first line of defence



Source: BNP Paribas, Bloomberg, as at 31 May 2024.

[1,2] Bloomberg, as at November 2024.

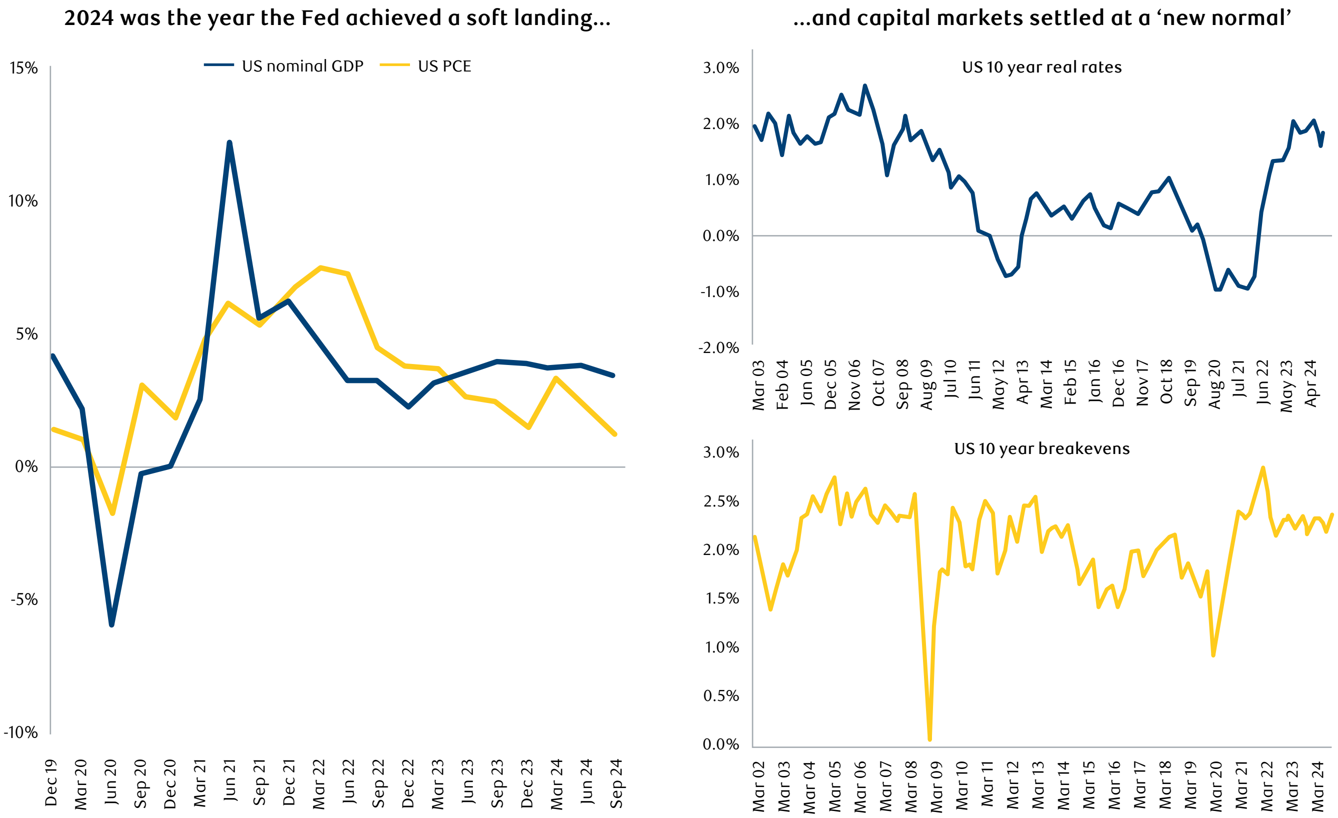
Our equities strategies

Global Equities

Jeremy Richardson, Senior Portfolio Manager

- The Fed successfully engineered a soft landing this year. This created a productive environment for corporate profits, and helped by lower interest rates, valuations responded favourably. In turn, this drove quite a positive year for global equity investors (Chart 6).
- We have now returned to a place where inflation and rate expectations are at levels more consistent with pre the global financial crisis. This has freed investors up to focus on company fundamentals once again.
- Revenues and corporate profits are continuing to improve, as innovation, labour, and capital are applied to solving some of the world's problems. We're seeing that play out in innovation around AI and anti-obesity GLP-1 drugs.
- While 2024 gave some clarity around the economic landscape, there is uncertainty around policy priorities, with a new set of leaders in many democracies around the world.
- This creates uncertainty for investors because if spending policies grow economies, it could be a supportive environment for corporate profits. However, if spending promises are spent less wisely and they adding to the sum of public debt, it could result in interest rates being forced up.
- This dilemma is something that investors will have to weigh carefully, as it brings into conversation how we value those future profits in a world of rising rates.

Chart 6: A renewed focus on company fundamentals in 2024



Source: Bloomberg, as at November 2024.

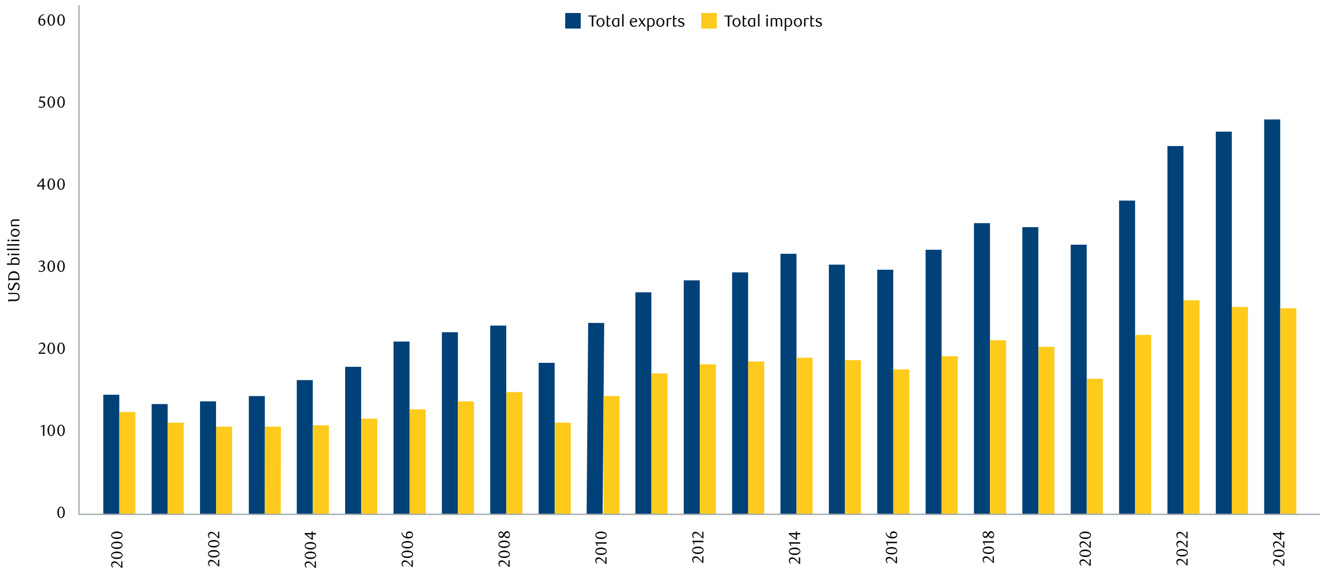
Emerging Markets Equities

Laurence Bensafi, Portfolio Manager and Deputy Head of Emerging Markets Equities

- Quite a few countries performed well this year. Technology stocks in Taiwan did well due to the AI theme. India also continues to perform strongly, and although the election result was surprising, the result was taken quite positively in the end and the stock market reached new highs. China has had a surprise comeback since the end of September; stimulus was announced, and it was taken positively by investors.
- There are still many uncertainties regarding the timing of more rate cuts in the US, the dollar trajectory, and whether a soft landing or a more recessionary environment will occur. Despite the challenging environment, emerging market equities have performed quite strongly.
- This year is one of the most difficult in terms of an outlook. The election of Trump is going to create a lot of uncertainties for the asset class. He has discussed high tariffs for all countries that are trading with the US, and in particular, he wants to implement a high tariff to China.
- This potential tariff would have a big impact and could halve economic growth for the country in the coming years. It would also impact many other EM countries that neighbor China in Southeast Asia. Latin America, and particularly Mexico, would also be impacted by trade tariffs (Chart 7).
- Even though the environment is challenging, much is priced in, and we believe there will be negotiations between the US and several countries. With regard to China, we're hoping for a resolution next year, as we've seen in the past. China can also continue to stimulate its economy and improve consumption patterns, and that should help to generate higher growth.

"Even though the environment is challenging, much is priced in, and we believe there will be negotiations between the US and several countries."

Chart 7: Mexico trade with the US



Source: UNComtrade Data, Morgan Stanley Research, as at November 2024.

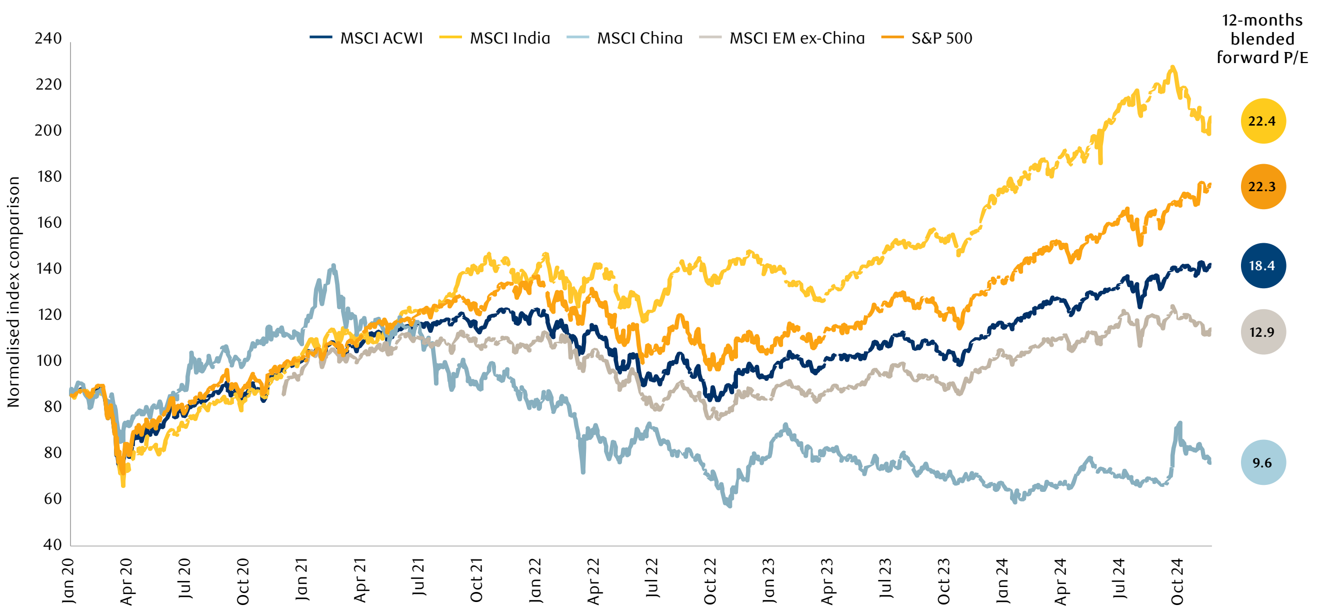
Asian ex-Japan Equities

David Soh, Head of Research and Portfolio Manager

- Reviewing the market, we continue to see China (30%) and India (20%) dominate the MSCI Asia ex-Japan benchmark. However, these two markets have really moved their separate ways. The major decoupling between China and India versus the rest of Asia has continued, if not widened further, in 2024.
- Recently, both India and China have shifted momentum, with Indian equities pulling back and Chinese equities rallying. This was partly triggered by China announcing policies to stimulate the economy, but also because India's valuation premium to China was at extremes (Chart 8).
- Looking ahead, India is fundamentally very exciting. Given India's current developmental stage, with GDP (Gross domestic product) per capita roughly where China was 15 years ago, there's a lot of long-term growth potentia[4]. That said, valuations levels are stretched and recent weakness in consumption and earnings growth estimates also show the need for caution.
- On the other hand, we continue to find greater China attractive, but there's a lot to watch there. The fiscal stimulus and policy measures from Beijing are still lacking detail, be it for the property market or animal spirits in general. Exports played a significant role for growth in 2024, but US tariffs under Trump's second term add uncertainty. The first half of 2025 is likely to be somewhat volatile and headlines-driven, but valuations in China today are at historical lows of 10x earnings[5].

"Given India's current developmental stage, with GDP per capita roughly where China was 15 years ago, there's a lot of long-term growth potential."

Chart 8: China equity has lagged global markets and trades at a large discount



Source: Bloomberg, MSCI, as at 26 November 2024.

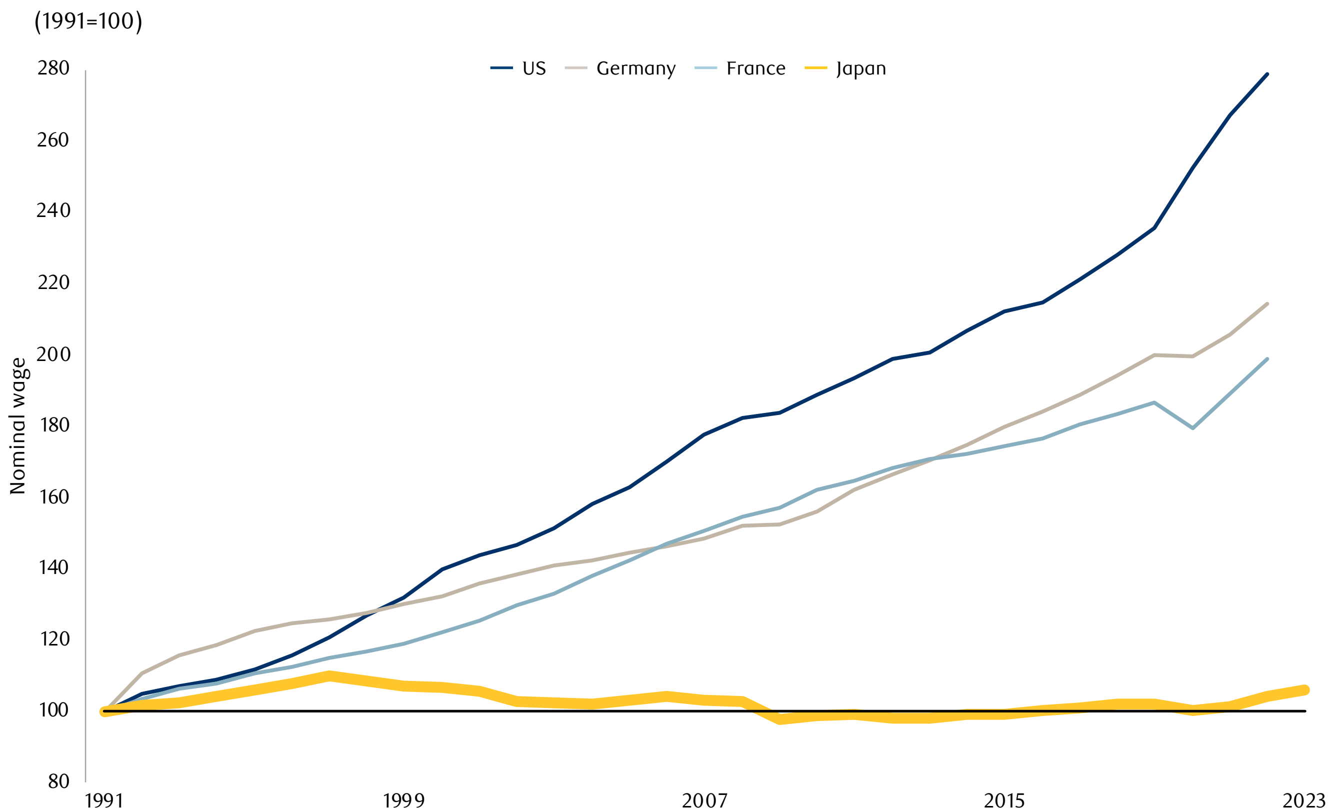
[4,5] Bloomberg, as at November 2024.

Japan Equities

David Soh, Head of Research and Portfolio Manager

- The last few years have been quite dynamic for Japan equities. In 2024, we have seen that Japan Inc. is on track to pull itself out of its lost decades of deflation (Chart 9) and achieve a mindset shift where corporate leaders focus more on value creation and shareholder returns. We continue to see solid trends in terms of corporate fundamentals.
- We believe the fundamentals behind Japan equities will continue to grow more compelling into 2025, although share price movements can still show volatility, largely driven by FX ratherthan uncertainty in corporate fundamentals. Japan equities are still very much under-valued and under-researched.
- In terms of macro, the weak yen should be more of a tailwind to equity investors investing in US dollars or in the euro, supported by the BoJ raising rates and the Fed cutting rates. We are also watching the virtuous cycle between wage hikes and corporates pushing up prices.
- In addition, fund flows should be favourable for Japan equities. Domestic pensions and households are allocating more into equities to position themselves for inflation. Japan is the third-largest economy globally and institutional investors are very underexposed. This set-up has the potential to make Japan a once-in-a-multi-decade investment theme.

Chart 9: Is Japan waking up from a persistent state of deflation?



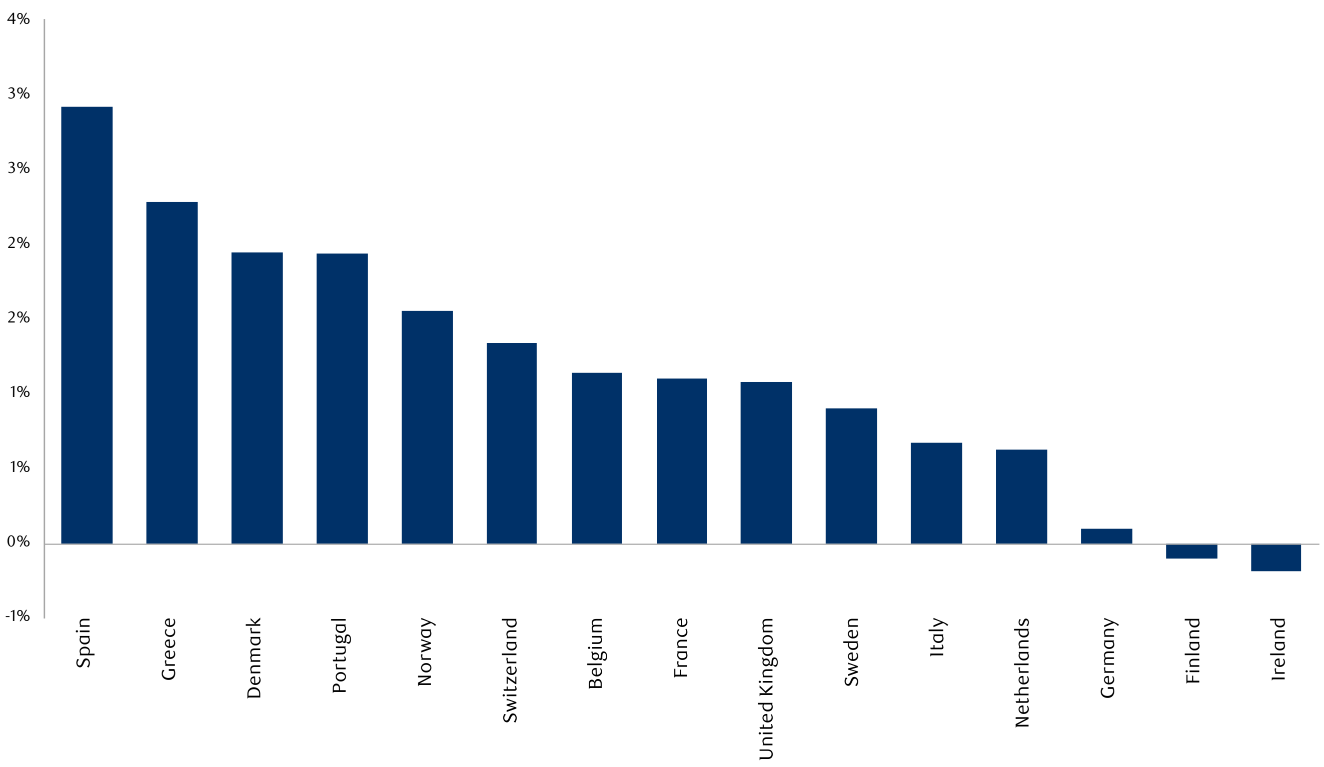
Source: OECD, IMF, MIC, Goldman Sachs Global Investment Research, as at December 2023. Data for Germany and France is only available on a two-year lag and is as at December 2022.

European Equities

Dave Lambert, Senior Portfolio Manager and Head of European Equities

- 2024 was a mixed year for European equities, as we saw a strong rally to May, followed by a period of flat markets.
- Election upheaval in Europe hasn't proved a great backdrop for domestic demand per se. However, European companies are typically very global in nature, so are only somewhat affected by events close to home.
- A key factor that has impacted European equities is China and Chinese domestic demand. China is one of the bigger trading partners within Europe, and the softness we've seen there hasn't been constructive for Europe.
- However, the peripheral countries have been a bright spot (Chart 10). In Spain and Italy, the financials sector has helped pull equity markets higher.
- We see plenty of opportunity within Europe to take advantage of global capital allocation and to benefit from double-digit earnings growth. If we ally that with the valuation base, from both an absolute and relative perspective, Europe looks cheap.
- We would never expect Europe to trade on a par with the US, given the latter's higher return and growth. However, with earnings growth picking up, we might see the valuation gap drop. That bodes well for Europe overall.
- European companies, as well as consumers, are probably more rate sensitive than other regions. If we expect the ECB to continue cutting aggressively, and maybe more than the Fed might do, in relative terms, then this could benefit the European equity space.

Chart 10: Real GDP growth rates in Europe in 2024



Source: International Monetary Fund (IMF), Europe, as at 2024.

Portfolio Manager Perspectives

Our experts offer their perspectives on the latest developments in global credit and the state of the markets.

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