# Macro Talking Points

Fixed Income Insights

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## Author

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## In brief

- **Policy uncertainty is reaching extreme levels, reinforcing the need for active management**
- **The reports of US stagflation are greatly exaggerated**
- **US consumer sentiment has taken a nosedive. So what?**
- **EUR IG credit valuation may not be as stretched as it seems**

**Nothing is certain, except uncertainty.** This is particularly true these days, with global policy uncertainty near its all-time high and headline risks the global investor's daily lot. Only COVID caused more concern over policy uncertainty at the global level. We are currently facing numerous sources of risks, with the odds of trade war escalation standing out as the key item to watch at this juncture. With risks and uncertainty come opportunities, however. In some pockets of fixed income, there is also mispricing of fundamental risk, with spread volatility and credit risk still disconnected from the uncertain backdrop. While the current market environment is challenging, the greater the volatility, the more opportunities for an active asset manager to seek to take advantage of potential dislocations.

**The reports of US stagflation are greatly exaggerated.** When the US Federal Reserve revised its growth forecast a bit lower and its inflation projection a bit higher last week as part of their new Summary of Economic Projections (SEP), the specter of stagflation quickly resurfaced. We feel that this is quite a stretch. At the margin, we would prefer to talk about a potential risk of "slowflation." To be clear, from a growth standpoint, the United States is still in a sweet spot, despite some signs of a moderate slowdown. Indeed, a moderate slowdown is a much more desirable outcome than a no-landing scenario, which could have potentially added fuel to the current fire in global markets. The Fed seems to be committed to further easing, although the timing of the next cut looks rather uncertain. At least, financial conditions remain a tailwind for economic growth, which is good news. Looking ahead, the key items to watch include consumer spending and corporate profitability. This week's US GDP update will be important in this regard, as it will include the release of corporate profits data at the broad economy level for Q4-2024.

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**Consumer sentiment data: leading or misleading?** The sharp drop in US consumer sentiment has made a lot of noise over the past few weeks, with some commentators stressing that this could mean that a recession is back on the table. The latest data show the lowest level of consumer sentiment since mid-2022.[1] But how significant is that? Are we giving the data too much credence? Quite possibly. Looking at the numbers, the reality is that there is virtually no statistical relationship between consumer soft data (*i.e.*, based on surveys) and the consumer hard data (the statistics that matter when measuring actual economic activity). Arguably, the most important piece of data about the US consumer is real consumer spending, which directly feeds into the GDP growth calculation. Real consumer spending is still robust, as illustrated by the 3% year over year print in January 2025.[2] While it is true that the pace of spending has slowed somewhat, it does not suggest that the US consumer is in trouble. Likewise, the analysis of real retail sales, another key piece of data, also points to the idea that the consumer sentiment data has very little explanatory power when it comes to predicting retail sales. In other words, it is quite possible that the significance of the consumer sentiment crisis may be overblown. Of course, it is essential to continue watching the macro developments, especially in the face of the elevated uncertainty, but for now we see no cause for panic, even if the consumer sentiment data suggest otherwise.

**In defense of EUR credit valuation.** There is no denying that European investment grade spreads look a lot tighter than they used to be, having basically caught up with their US counterpart. At this juncture, EUR IG and US IG spreads are just two basis points apart, at 92bps and 90bps, respectively.[3] But it is important to note that the European index encompasses much shorter duration. This means that EUR IG still compares favorably on a break-even spread basis. Specifically, EUR spreads currently stand at 21bps per unit of duration, against only 13bps for US IG. Moving on to yields, US IG yields currently trade at 3.16% when hedged back into EUR, or lower than the EUR IG yields of 3.31%.[4] More importantly, the break-even yields look even more compelling to us, given the duration differential between both indices. While the hedged break-even US yield stands at 46bps, the EUR IG yields are currently at 76bps, or some 65% higher. Overall, we believe European fixed income is still well positioned to perform in the period ahead, helped by improving macro fundamentals in the region, strong technicals and fairly attractive valuation on a relative value basis.

## Endnotes

[1] Source: Bloomberg, University of Michigan. Consumer sentiment index, as of March 2025.

[2] Source: Bloomberg, Bureau of Economic Analysis. US personal consumer expenditure, yoy change. As of January 2025.

[3] Source: Bloomberg, EUR IG= Bloomberg pan-European IG credit index. US IG = Bloomberg US IG Corporate index. Spreads = option-adjusted spreads. Data as of 21 March 2025.

[4] Source: Bloomberg, EUR IG= Bloomberg pan-European IG credit index. US IG = Bloomberg US IG Corporate index. Hedged yields are calculated using cost of hedging, based on 3m FX forwards. Data as of 21 March 2025.

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