GENERALI INVESTMENTS

ACTIVE CREDIT IN 2025

MARCH 2025

Is volatility creating one of the best credit-picking opportunity sets in recent years?

A barrage of decrees and announcements from the new Trump administration has defined recent weeks, upending the world order and compelling many European countries to commit to increased defence spending. But for discerning, active credit investors, the spike in uncertainties – geopolitical, growth, policy – has created one of the best credit-picking opportunity sets in years.

Three credit portfolio managers from across Generali Investments – Aperture Investors, Generali Asset Management, and Lumyna Investments – shed light on how they're balancing dispersion opportunities with the increasing risks of a constantly shifting macro landscape.

Simon Thorp
CIO Credit Opportunities.
Aperture Investors

TRUMP, TARIFFS, AND CREDIT: MORE OPPORTUNITY THAN THREAT, FOR NOW

An obvious question to ask following the credit market volatility of the past few weeks is: *"Has the 18-month credit bull market come to an end?"*

Market strength was characterised by expectations of falling inflation and rate cuts combined with a goldilocks economic backdrop.

Since the inauguration of the new US President, new factors have been taken into consideration, namely tariffs, European rearmament, and a perceived slowing of the US economy.

When we assess markets, we look at three broad areas:

- MACRO: Clearly less certain than in recent months, although European (and perhaps Chinese) growth potential has improved since late 2024. Investors will need to keep a very close eye on US data at a time when the Atlanta Fed GDP tracker has fallen precipitously.
- MICRO: The overall picture (how well companies are performing) remains benign, though weakness often follows macro deterioration.
- MARKET TECHNICALS: Also remain strong with robust demand for credit products from investment grade bonds through to private credit, whilst supply is limited.

Net-net, we think it's too early to call for a credit bear market but that would change if a US recession became a probability.

Looking through 2025, we believe that:

1. Uncertainty will increase the overall credit opportunity set for the discerning, fundamental investor.
2. Spread dispersion will remain elevated.
3. Thematic and sectoral opportunities (long and short) will increase.
4. Credit will continue to perform well assuming there is no US recession or sudden rise in the term structure of interest rates.
5. For portfolio construction, we will selectively add convex opportunities as dispersion remains elevated whilst using spread-based hedges (to protect against increased default risk on a macro slowdown).

Fabrizio Viola
Portfolio Manager, Active Fixed Income
Generali Asset Management

CAUTIOUS OPTIMISM IN EUROPEAN INVESTMENT GRADE

The first part of 2025 has seen cautious optimism in euro investment-grade corporate bonds, with strong inflows supported by positive returns, despite a challenging economic backdrop. Returns then moved slightly negative with the violent sell-off in rates that occurred in the first part of March. Despite this, excess returns, carry plus spread performance, remain positive given a sort of complacency around the higher quality part of the credit spectrum. Non-financials outperformed financials in this first part of the year, with utilities benefiting from a shift toward assets perceived to be safer. Subordinated bonds performed well, with hybrids slightly outpacing subordinated financials.

Total euro investment grade gross issuance reached €250bn, with net issuance of €50bn after redemptions. Following its rate cut in early March, the ECB may remain on the sidelines, awaiting further clarity on many aspects of the economy – particularly on inflation. A ceasefire in Ukraine could offset the negative impact of U.S. tariffs on corporate spreads, though yields may stay wider than expected due to rising defence spending. Despite the complexity of the current environment, high-quality, diversified corporate bond baskets remain attractive in our view.

Investment yields for senior bonds average between 3.3% and 3.8%, making them a strong fit for target yield buyers. In the senior space, we continue to favour financials, where robust balance sheets are better positioned for economic contraction. While non-financials have recently outperformed, they remain highly exposed to external factors.

In the subordinated space, we maintain a preference for corporate hybrids, which offer a better yield differential relative to senior non-financials. This positioning provides a relative advantage over bank Tier 2 debt, with yields approaching 4.5% without the need to move into high yield or AT1 instruments.[1]

Domenico Lia
Partner and Global Investment Committee Member,
King Street Capital Management for Lumyna Investments

NAVIGATING CREDIT DISPERSION: OPPORTUNITIES FOR ACTIVE PRIVATE CREDIT INVESTORS[2]

Despite tight spreads across global credit markets, significant dispersion is creating investment opportunities in public and private markets. With the new Trump administration driving policy changes and the Federal Reserve signalling limited rate cuts, the backdrop remains attractive for active and opportunistic investors like King Street Capital Management, who manage a private credit strategy available through the Lumyna liquid alternatives platform.

Higher rates are straining issuers with floating or near-term refinancing debt, many of whom structured their capital for a low-rate environment. This has led to unsustainable cash burn and rising U.S. bankruptcy levels, which hit a 14-year high. However, many opportunities will arise outside traditional bankruptcy, including capital solutions and liability management exercises (LMEs). In 2024, King Street tracked three dozen such transactions, leading or participating in twelve. These deals offer compelling returns and structural protections relative to loan-to-value estimates, screening favourably relative to other primary opportunities in corporate credit.

The “higher-for-longer” rate environment, alongside a $1.5 trillion broadly syndicated loan market with many issuers facing negative free cash flows, presents continued attractive opportunities to provide capital solutions in 2025.

In Europe, credit markets have expanded 3.7x since 2008, outpacing GDP growth of 12.5%. While recent small rate cuts have improved sentiment, borrowing costs remain historically high. LMEs are not prevalent in Europe, but we expect demand for flexible, non-traditional capital solutions as macro pressures intensify. Declining PMIs and potential recessions in core European markets like Germany and France highlight a growing opportunity set for creditors. While the maturity wall has been partially extended, complex restructurings will increase, an area where skilled private credit investors should have a competitive edge.

Additionally, asset- and real estate-backed securities offer compelling opportunities as global growth and geopolitics influence capital flows. At Lumyna, we believe today’s environment presents one of the best credit-picking opportunities in years, where deep research, strong sourcing, and active portfolio management across public and private markets will drive differentiation.

[1] Source for all data: Bloomberg as at 19 March 2025.

[2] Source: King Street Capital Management. This market characterisation reflects King Street’s beliefs as of the date hereof and is subject to various risks and assumptions that are subject to change. King Street’s market characterisation is based on subjective determinations that it believes are reasonable, and information herein includes third-party data that King Street believes is reliable but has not been independently verified. The investment strategy is subject to significant risks and there is no guarantee that the strategy will achieve its investment objective or avoid losses. The strategy does not benefit from any guarantee to protect the capital.

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