RPIA

Looking Beyond the Headlines

Capturing the Momentum in European Credit

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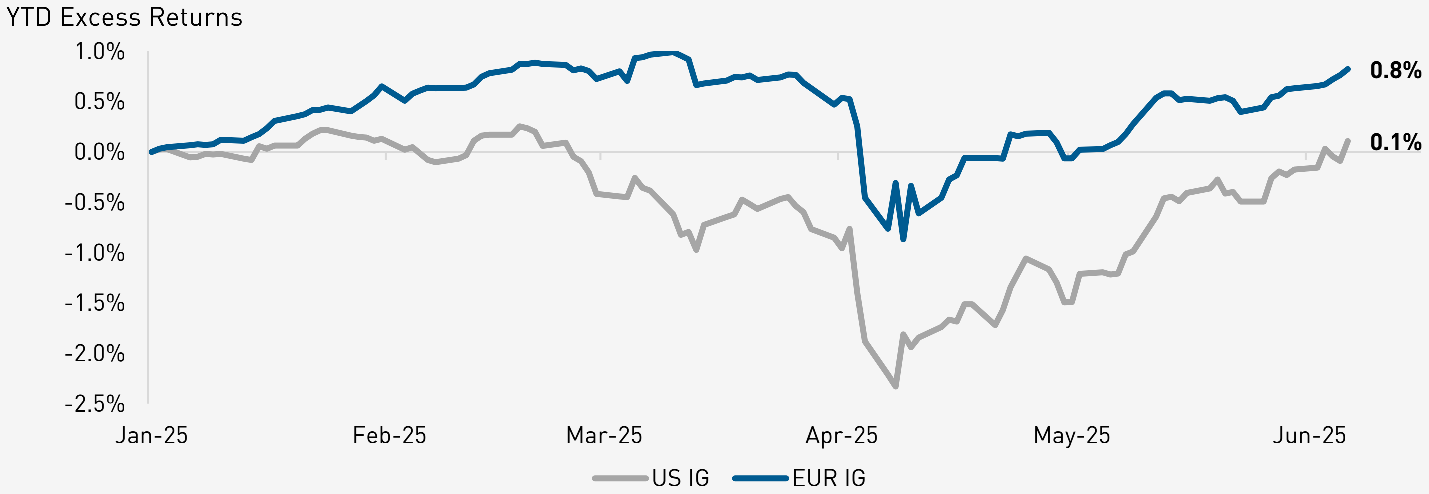
The unpredictable game of headline roulette has sparked volatility across interest rates and risk assets. Drawdowns in reaction to negative tariff-related news have been swift, yet the ensuing rallies after policies are walked back have been equally impressive, if not more so. Rather than attempting to front-run erratic headlines, we opt for a more disciplined approach to portfolio construction. Fortunately for us, the various market forces influencing valuations, warranted or not, create mispricing and opportunities that active managers can exploit.

This year, European credit markets have been one such opportunity in which we've been participating. In fact, within our alternative investment grade focused portfolios, European credit exposure currently stands at roughly 50%, nearly 30% more than the long-term average. Our global opportunity set and deep relationships with the major bond syndicates across the pond enable us to capitalize on dynamics and technical factors that may not be accessible to managers with a more constrained purview.

For context, European investment grade credit spreads have outperformed their US counterparts year-to-date. Multiple factors have driven this outperformance, primarily a supportive monetary and fiscal backdrop and robust demand.

European Investment Grade Credit Spreads Have Outperformed Year-to-Date (YTD Excess Return)



Source: Bloomberg. Data as of June 6, 2025. Excess Return refers to the duration-neutral return of an index. US IG = Bloomberg US Corporate, EUR IG = Bloomberg European Corporate.

Supportive Monetary & Fiscal Backdrop

The benign inflation backdrop in Europe has prompted the European Central Bank (ECB) to act swiftly, cutting its overnight rate four times this year by a total of 100bps, with its key deposit rate now sitting at 2.0% – a much more aggressive pace than its developed market peers. In contrast, the Federal Reserve has held rates steady at 4.5% since December as US policymakers grapple with a more nuanced interplay between growth and inflation.

With the ECB expected to deliver further cuts to the 1.0–1.5% range, the downward trajectory in rates continues to support a strong reach for yield in European credit. On the fiscal side of the coin, the potential for massive commitments to defense and infrastructure spending has buoyed the Euro Area growth outlook, which would support corporate fundamentals and lending conditions.

Favourable Supply & Demand

Flows into European credit have been quite impressive, mainly due to the ECB's supportive stance. In addition to the typical domestic-based supply and demand, the European credit market has enjoyed an uptick in foreign flows. Recently, Asian-based demand for corporate credit has been shifting away from US credit markets toward Europe as FX-adjusted valuations become more enticing and the force of US exceptionalism fades.

Additionally, the supply of Reverse Yankees (non-European companies issuing EUR-denominated bonds) is at all-time highs, reaching ~$100bn year-to-date. The increase in Reverse Yankee supply is mainly due to US companies borrowing in the European market to take advantage of lower all-in yields.

Live in Action

The tailwinds supporting valuations and rising two-way flow in European credit markets create compelling opportunities for global managers. For example, we've actively participated in the strong performance across the capital stack of European bank spreads – a theme we believe still has runway. Positions in UK-based financials like Lloyds Banking Group and global systemically important banks, including HSBC and Barclays, have performed exceptionally well in recent months.

We've also been involved in Reverse Yankees from US-based multinationals, which have benefited from the broad tightening in European spreads relative to the issuers' US-denominated bonds. For example, in mid-April, General Mills (GIS) issued 750 million in Euro-denominated notes. We participated in the deal after using our proprietary technology to identify +20 basis points of relative value (adjusted for currency hedging costs) compared to the GIS' outstanding USD bonds.

A nimble approach is essential in an environment marked by uncertainty. We firmly believe that our global expertise expands our opportunity set, enhances portfolio diversification, and sharpens our ability to identify relative value, ultimately contributing to stronger risk-adjusted returns for our clients.

Please feel free to contact us if you would like to discuss these themes further or learn more about how we could help you meet your investment objectives.

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