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Global Credit: Carry On

Amid a strong U.S. economy and potentially inflationary policies from the incoming administration, yields may remain higher for longer. High-income assets will likely benefit, but investors should avoid complacency, particularly given the unpredictability of macroeconomic factors.[1]

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Expectations for further cuts to the federal funds rate have moderated amid a remarkably robust U.S. economy and the prospect of inflationary policies from the incoming Republican administration. With credit spreads already on the tight end of the historical range, duration failing to be a reliable return-driver given the volatile interest rate environment, and Treasury yields remaining elevated, there has only been one sure game in credit: income. Assets offering high coupons – notably floating-rate instruments, such as senior loans and CLOs – have especially profited from this backdrop.

So, what's led to a more hawkish Fed, and may keep Treasury yields higher for longer?

1. The exceptional resilience of the U.S. economy:
   - U.S. GDP increased at a robust annual rate of 2.8% in the third quarter.[2]
   - Consumer sentiment hit a seven-month high in early November.[3]
   - Jobs data has been stronger than expected, with over 225,000 jobs added in November.[4]
2. The incoming Republican administration's potentially inflationary campaign promises:
   - Imposing steep tariffs could increase the cost of imported consumer goods.
   - Reducing taxes would add to the national deficit.
   - Restricting immigration could trigger higher wage growth and make job openings harder to fill.

However, these factors may not run a linear course. In a recent interview, Howard Marks reminded us that "probably 98% of the things Trump will do can't be predicted, and even the consequences of the things we know he'll do probably can't be predicted." The U.S. economy seems to be on solid footing, but data surprises could lead to volatility, and policies introduced by the Trump administration may have unpredictable second-order impacts.

Though it's difficult to predict macroeconomic factors, investors may benefit from focusing on yield and maximizing income to drive portfolio returns. Certainly, assets generally offer more income when they present more credit risk. Selecting for high income therefore isn't a panacea; it must be matched with diligent underwriting and robust downside protection.

ENDNOTES

[1] Source: ***The Roundup:*** Top Takeaways from Oaktree's Quarterly Letters – December 2024 Edition. The content is derived from or inspired by ideas in 3Q2024 letters or other materials sent to clients in 4Q2024; the text has been edited for space, updated, and expanded upon where appropriate.

[2] Bureau of Economic Analysis.

[3] University of Michigan Survey.

[4] U.S. Bureau of Labor Statistics.

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