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Corporate Bond Market Insight | April 2025

An American Economy Being Redefined Amid Uncertainty

Key takeaways

- Skepticism around tariff policy and selling in the technology sector led to the S&P 500® suffering a 10% correction, despite most large-cap indexes setting all-time highs in mid-February.
- Consumer confidence is the lowest it's been in 12 years at 65.2% in February, and it's well below the 80 threshold that often signals a recession.
- Business confidence is also softening, with the Beige Book providing anecdotal information that there's growing caution due to tariff and policy doubt. However, the sharp declines in survey data haven't led to weakness in the hard data yet, with a solid employment economy and wages growing at 4% year over year.
- The Fed is waiting to see how the economy and inflation react to the new tariffs and regulatory environment, and chair Jerome Powell suggested that the inflationary impact of tariffs is likely to be a one-time event rather than the beginning of a sustained period of price increases.

Recap

Sharply higher economic uncertainty while the new administration moved rapidly to redefine the American economy characterized the first quarter of 2025. An onslaught of cabinet level actions, executive orders and proposals targeted trade, regulation and governance. Consumer and business confidence declined, and a steady stream of economists and strategists have reduced their 2025 economic and market outlooks as a result. Economically, moderating growth and stubbornly high inflation best described the quarter.

Most large-capitalization equity indexes set new all-time highs in mid-February. However, the S&P 500® index suffered a 10% correction from the high. General concern, particularly around the selling in the technology sector related to the announcement of a more efficient artificial intelligence engine and tariff policy, drove the correction. The correction leaves the index 4.5% lower than where it began the year. Credit spreads widened moderately in sympathy, but they're still near all-time tights. The widening has generally been very orderly and demand for credit has remained strong.

March saw increasing chaos around delayed or changed proposals, plans for new tariffs and some tariffs that got implemented. While it's unclear what tariff policies will eventually be implemented, it's clear that the lack of clarity is creating massive wariness for both business and individuals.

Consumer confidence declined significantly over the quarter. The Conference Board's Consumer Expectations Index fell 9.6 points to 65.2% in February. This is the lowest level in 12 years and well below the 80 threshold that often signals a recession. Consumer stress can also be seen in rising auto delinquencies. Currently 6.6% of subprime borrowers are at least 60 days delinquent. This is the highest rate in nearly 30 years.

A softening in business confidence is also developing. The Fed's Summary of Commentary on Current Economic Conditions, known as the Beige Book, provides anecdotal information on current economic conditions across the 12 Federal Reserve districts. A recurrent theme throughout the March edition was one of growing caution due to tariff and policy anxiety. Many consumer-facing businesses, particularly in the retail and transportation sectors, cut their forward guidance on earnings calls.

While the decline in the soft data of confidence surveys is troubling, it's yet to be reflected in the hard data. Prior to the COVID-19 pandemic, sharp declines in survey data generally led to weakness in the hard data. The relationship between soft and hard data has been tenuous post covid. The employment economy is still solid, wages are growing at 4% year over year, and after retail sales slipped in January, they rose in February. The control group, the portion of retail sales that flows through to GDP, rose a solid 1% in February.

Inflation continues to remain stubbornly above the Fed's 2% target. Monthly Consumer Price Index (CPI) was a bit weaker than expected, and core CPI is the lowest since April 2021 at 3.1% year over year. However, the US Personal Consumption Expenditures headline price index rose 0.3% month over month. The core rate, the Fed's preferred inflation measure, also increased 0.4%. The increase was the highest since January 2024 and brings the year-over-year core rate to 2.8%, which is still 0.8% above the Fed's target.

The Fed left rates unchanged at its March meeting but made a significant reduction in its quantitative tightening program. The revised quarterly Summary of Economic Expectations (SEP) saw the Fed lower its estimates for growth even while it raised expectations for inflation. The SEP continues to suggest two interest rate cuts this year.

We believe that the Fed is waiting to see how the economy and inflation react to new tariffs and changes in the regulatory environment. In early March, chair Jerome Powell said "We do not need to be in a hurry and are well-positioned to wait for greater clarity." He went on to say that "the cost of being cautious is very, very low. The economy is fine, it doesn't need us to do anything, really, so we can wait and should wait." In the press conference following the March meeting, Powell suggested that tariff related pressures would quickly abate and reintroduced the word "transitory" to the inflation dialog. He went on to suggest that the inflationary impact of tariffs is likely to be a one-time event rather than the beginning of a sustained period of price increases.

The Fed also reduced the number of government securities it's allowing to roll off the balance sheet each month. Because more maturities are being kept on the balance sheet as opposed to rolling into the market, the reduction should decrease the upward pressure on rates. The Fed has reduced their balance sheet 25% from its peak so far. At $6.7 trillion it's now the smallest it's been since May 2020, just prior to the pandemic. Treasury secretary Scott Bessent made it clear that the new administration's priority was to lower 10-year Treasury rates via fiscal policy rather than by pressuring the Fed.

Against this backdrop, the 10-year Treasury yield was unchanged for the month and fell 36 basis points (bps) for the quarter. Credit spreads widened nine bps on the month and 13 bps on the quarter. The ICE BofA/Merrill Lynch 1–10 Year US Corporate Index returned 0.25% for the month, 2.3% for the quarter and 6.51% for the trailing one year as a result. Credit spreads in all sectors widened moderately over the month and quarter. The automotive, leisure and real estate sectors performed the worst over the quarter, while banking and healthcare performed best. Generally speaking, higher quality outperformed lower quality.

Looking forward

Credit strategists are downgrading their outlooks and calling for spreads to widen, but we expect that any widening will be modest. Investment-grade (IG) corporate spreads and demand for credit product remain strong, and earnings continue to produce strongly positive cash flows. However, economic and policy uncertainty are likely to widen spreads and accelerate downgrades. If this occurs, fundamental credit research will provide an important layer of risk mitigation. Avoiding names in danger of being downgraded by the ratings agencies, particularly from investment grade to high yield, will be particularly important if the cycle changes. Higher-volatility tends to result in more dispersion in returns for individual credits and sectors which makes credit research invaluable.

Given the high-starting-yields available in IG ladders, we believe there's enough carry available to sufficiently offset widening. If the economy is going into a slowdown or recession, falling rates should provide a significant positive tailwind to returns.

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Parametric is headquartered at 800 Fifth Avenue, Suite 2800, Seattle, WA 98104. For more information regarding Parametric and its investment strategies, or to request a copy of Parametric's Form ADV or a list of composites, contact us at 206 694 5500 or visit www.parametricportfolio.com.

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