The Big Picture

What's Next?

John Fekete, Head of Tradeable Credit, discusses the state of the U.S. economy and the outlook for debt markets.

January 2025

CRESCENT

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John Fekete
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Key takeaways:

- As expected, the Fed executed a quarter-point cut in December.
- Fewer cuts forecast for 2025 as inflation progress stalls.
- We are seeing attractive coupon income available for investors in syndicated loans and CLO debt tranches.

Crescent Capital is a leading alternative manager focused exclusively on corporate credit. We invest across the debt capital structure of companies of all sizes, in both private and tradeable markets, with a track record spanning more than three decades of market cycles. We target consistent, attractive returns with less volatility, lower default rates and higher recovery rates than the market average.

Inflation still a Fed concern

The U.S. Federal Reserve cut interest rates by a quarter-point on December 18, 2024, as expected, amounting to a cumulative full-point reduction since September 2024. Instead of celebrating, the market reacted like it received a lump of coal in its Christmas stocking, as Chairman Jerome Powell telegraphed a slower and shallower rate cut narrative for 2025. While the Fed had done a lot to support the economy over the last 90 days of 2024, policymakers wanted to see more progress on inflation before guiding to further reductions. The updated Statement of Economic Projections (SEP) is indicating only 50 basis points (bps) of cuts forecast for 2025. Inflation, as measured by the Personal Consumption Expenditures Price Index (PCE), is now forecast to be much higher at 2.5% in December 2025, up from 2.1% as previously thought, as disinflation has stalled. These data points are leading investors to believe that it may take until 2026 for inflation to approach 2%, pushing out the timeframe by a year for inflation to get back to the Fed's target.

Fed rate cutting cycles typically drive Treasury yields lower, but that has not been the case in 2024. Since the date of the first Fed rate cut on September 18, 2024, the 10-year U.S. Treasury yield has risen by 80 bps to 4.5%. This increase was driven by the fact that there had been no credible signs of an economic slowdown. The Fed deserves credit for executing a soft landing, in our view. Powell noted that "most forecasters have been calling for a slowdown in growth and it keeps not happening. There is no reason to think a downturn is more likely than it usually is."

Healthy activity levels in credit markets

The U.S. economy favorably contrasts with what is happening around the world, particularly in Europe, which is teetering near a recession. As we predicted in September, the Fed's rate cuts have been accompanied by looser financial conditions and strong credit growth. In the last 90 days, there have been near-record level of primary market issuance in the high yield, syndicated bank loan and collateralized loan obligation (CLO) markets. Strong investor demand for income enabled syndicated loan and high yield bond investors to earn attractive returns in the range of 8%–9% year to date through December 18.

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The road ahead

Investors are left to wonder what's next. Do we see 50 bps of cuts in 2025 or do we start the year with Treasury yields moving higher as they did in the first quarter of 2024? While many fear the new U.S. administration's policies could be inflationary, causing the Fed to stop cutting rates, many of the new policies being speculated about can take time to implement and work their way through the economy. As President-elect Trump walks into the White House, the central bank may take a pause, suggesting that Fed Governors may have pre-emptively considered the impact of Trump's tariff, tax, and spending proposals. Deregulation and tax cuts could potentially provide a boost to U.S. economic growth and benefit domestic companies, encouraging a risk-on environment for investing. For now, the economy remains resilient, with labor productivity gains providing a structural tailwind that supports growth. We believe this constructive fundamental backdrop, combined with a lack of material debt maturities for several years, should keep credit stress and default rates modest.

We expect 2025 to be similar to 2024 – with growth at 2.0% - 2.5%, inflation running close to 3% and the Secured Overnight Financing Rate (SOFR) base rate at or north of 4.0% – resulting in default rates remaining stable and concentrated in a small group of industries. We continue to favor floating rate assets such as syndicated bank loans and CLO liabilities, in which investors are earning high single-digit coupons that are more than 200 basis points higher than the average coupon in the U.S. high yield market. We see three tailwinds that should be favorable for syndicated loans and CLOs throughout 2025: 1) the resiliency of the U.S. economy; 2) potential inflationary pressure from tax cuts and deregulation following the November 2024 Republican sweep; and 3) attractive yields relative to other credit asset classes.

Sources: Bloomberg, U.S. Bureau of Labor Statistics, 2024–5.

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ABOUT CRESCENT CAPITAL

Crescent is a global credit investment manager with $43 billion of assets under management as of September 30, 2024. For over 30 years, the firm has focused on below investment grade credit through strategies that invest in marketable and privately originated debt securities including senior bank loans, high yield bonds, as well as private senior, unitranche and junior debt securities. Crescent is headquartered in Los Angeles with offices in New York, Boston, Chicago and London with more than 220 employees globally. Crescent is part of SLC Management, the institutional asset management business of Sun Life. For more information about Crescent, visit www.crescentcap.com.

LEGAL INFORMATION & DISCLOSURES

INDICES DISCLOSURES

Indices used as asset class proxies: Credit Suisse Leveraged Loan Index and ICE BofA US High Yield Index, with performance range based on data as of November 30, 2024. Public and private credit indices shown are widely used market benchmarks to generally assess the relevant risk profile of a particular investment strategy. Future fluctuations in valuations and performance may occur as a result of changing market conditions, among other variables. The comparison indices and asset classes presented set forth herein are provided for informational purposes only and should not be relied upon as an indication of Crescent's investment strategy or as an accurate measure of comparison, as there may be differences between the relevant Crescent fund and such indices due to varying fund vintages and strategies. The comparisons contained herein have inherent limitations and qualifications, such as limited sample size, imperfect access to information and other considerations. There are significant differences between the types of securities and assets typically acquired by a Crescent fund and the investments covered by the applicable index or benchmark. Certain indices may or may not reflect the reinvestment of dividends, interest or capital gains. Moreover, indices are unmanaged and are not subject to fees and expenses.

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