GS Credit MarketStrats | De-anchoring risk (again)

FICC and Equities | 17 March 2025 | 7:50AM UTC

(Re-sending, hopefully with all the charts this time around).

For the last 2y, the credit market has been anchored (at tight levels) by the supportive technicals; the risk of de-anchoring and moving to levels more commensurate to economic/fundamental metrics is increasing. It's not a done deal, technicals can still hold … but the upside/downside trade-off to position for the technical anchor to hold is not good. We remain bearish; more so (our view has been that the probability of going wider increases as we start going wider, and we still think that's the case: there is decent reflexivity between levels and technicals/fundamentals).

MOVES AND FLOWS

20y percentiles of credit valuations have moved from below 7% in mid-Feb to 30% now (aggregating bonds/CDS/iVols across HY/IG and Europe/US). Implied vols have moved the most, from 3% to 42% percentiles. Bonds the least (still at their 15% percentile). See point 1.

There has been a move already, but it doesn't feel "enough" or the "right nature" to fade. Our feeling so far is that the de-risking has been very much macro/tactical/overlay/derivs driven, and not "forced": i.e. investors have de-risked and hedged voluntarily (based on views) – more on this later but when bonds move a lot less than implied vols, it clearly tells you the hedging is higher than the bond selling (i.e. the concerns are higher than the need to sell). Credit hasn't broken yet … but clients are worrying it does.

The beta of credit to equities is starting to move higher from the lows (point 2), but more so the "implied" (i.e. option pricing driven) than the realised: in other words, the expectation of credit to underperform equities is moving higher more than the realised moves. The degree of bearishness is still higher than the degree of forced-selling. But if equities keep going lower, we know what's the most likely outcome for credit betas.

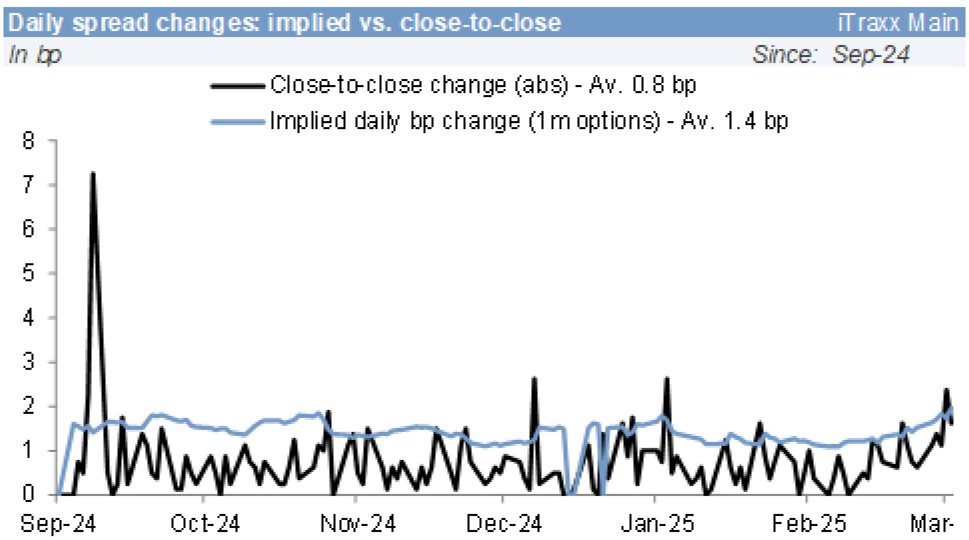
Rates are moving wider in Europe and financial conditions tightening in both regions; point 3. Money is becoming more expensive.

Last week was the first one in months where bonds underperformed CDS in Europe; maybe it's just a blip but one should always be more worried about widenings in bonds than in CDS indices. Point 4.

And beta-type products are underperforming: IG investors are trying to get rid of beta products (AT1, corp. hybrids, BBs – points 5-6), judging from their underperformance, and that's in an environment of no generalized outflows yet. Maybe they're being too prudent? But they're certainly behaving as if outflows could easily come (hedging with options, trying to sell bonds – especially high beta ones – but without pressing a lot yet, i.e. not forced). With EUR IG YtD total returns having moved to negative territory, the fears are understandable (point 7). Though one can counter-argue that USD IG saw plenty of that negative total return in Q4 and outflows never appeared. Will the "yield buying inflows" remain higher than the "negative return outflows"? I.e. will the technical anchor to credit stay?

One can argue that the market has moved already more on sentiment than on forced-de-risking, i.e. that the technical anchor is still holding; and that a sentiment-driven squeeze is on the cards; and that's probably right. But again, the move if the technical anchor goes can be much larger than a sentiment-driven squeeze in our view.

The move wider so far is, following the pattern we have had, reasonably "controlled", i.e. around 1.5bp/week in Main over the past month. Our base case is still a similar type of move wider in the next months … with risks of going faster. Daily realised moves are having a hard time to go above option implied break-evens:

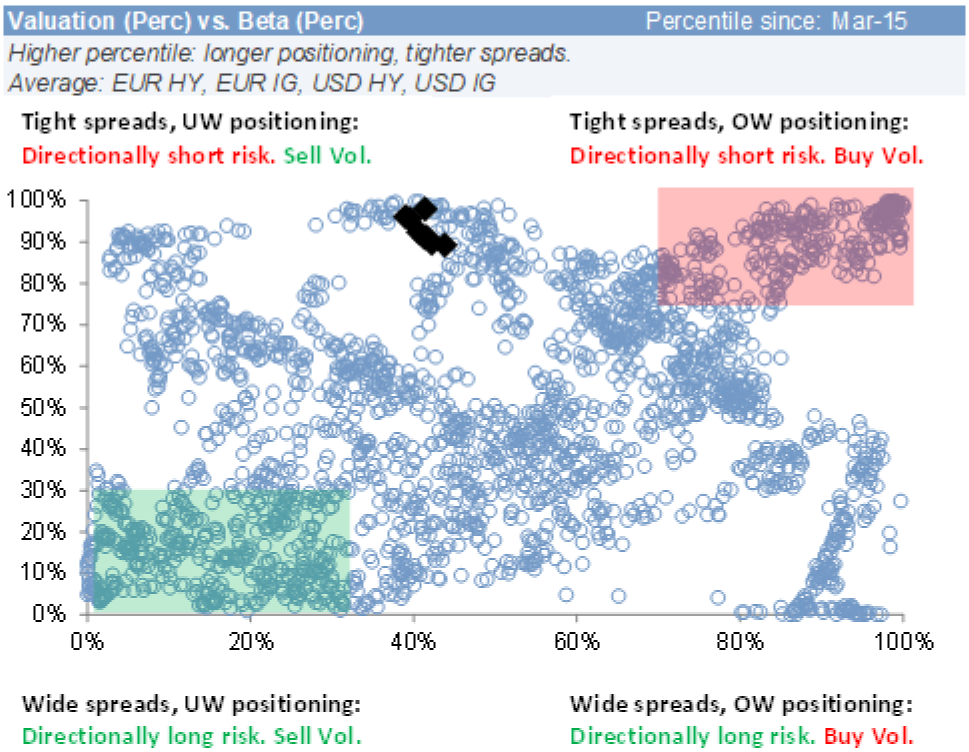


Also … the appetite to buy bonds is very low: people might not be forced-selling yet … but at least in credit (maybe away from iVol) the chances of investors "buying the dip" are … very low.

DE-ANCHORING (from technicals) RISK

CTAs seem to have fully de-risked (and more) in equities, but that's not the case in credit. Our numbers would indicate they're still decently long risk and need to keep de-risking in CDS indices (point 8). The real technical risk in credit is not CTAs though, it is real money investors in the bond market; we saw that in all 3 widenings last year. If real money investors actually buy de dip, they can take the CTA length very easily in credit.

Our sense, which tie up with the numbers below, is that real money investors in credit are still not forced-sellers; they're bearish for sure and trying to hedge/lighten up. But the "flows" have turned a bit negative: first week of outflows in EUR HY, and – according to [this](#) also in broader IG and HY funds globally; net supply moving above those flows (point 9). Fund betas are still close to "neutral/median" but they keep moving higher (driven by HY); point 10. With bond valuations still pretty expensive and betas moving higher … our simple matrix below is moving away from the "directionally short, sell vol" corner to the "directionally short, buy vol" one. Essentially the risk of the move wider gathering speed is not to be taken lightly.



And if, maybe big if, spreads de-anchor from the technicals … where can they go? What's the economic/fundamental/sentiment anchor? Using a mixed bag of "valuation-vs-other metrics" relationships in point 11 below … one can argue growth levels would call for a 10% drop in equities and a good 40-50% widening in credit spreads. If we go there we probably overshoot but the point is that if the technical anchor in credit goes, we can see a decent move.

VISIBLE NEAR TERM RISKS

Still remain: US equity weakness on the back of economic uncertainty (this one is too consensus in our view), Russia-Ukraine (this one is only now starting to be recognized in our view … and we remain very concerned), higher deficit projections in Europe pushing back-end rates higher (and counter-balancing the positive expected growth impact of those deficits; [example](#)).

Longer term, we still believe we are in a multi-year trend of private sector deleveraging (paying down debt): how fast or slow that goes depends on unemployment, equity prices and rates.

EUROPE VS US

Something we are on the extreme opposite than consensus is: we are getting increasingly worried that the higher deficit projections in Europe are going to be very damaging to the market (via higher rates well before any fiscal-delivered growth appears); and we don't think the US economy goes anywhere near a recession given that unemployment is unlikely to increase. We would start buying US risk vs European risk.

POSITIONING

Remain underweight, but would reduce vol selling and add taily-type hedges such as: OTM payer spreads, 5s10s iTraxx flatteners, bond-CDS basis trades (examples here in European HY and here in the US via STS).

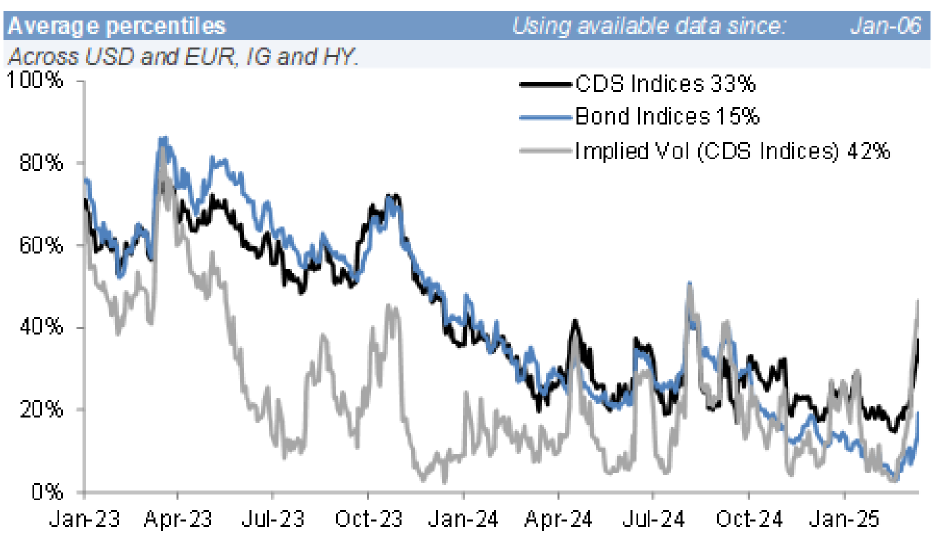
We would still be short risk GBP IG credit (economy not looking good), short risk IG beta (AT1/Corp hybrids/BBB) vs banks SP & IG illiquids.

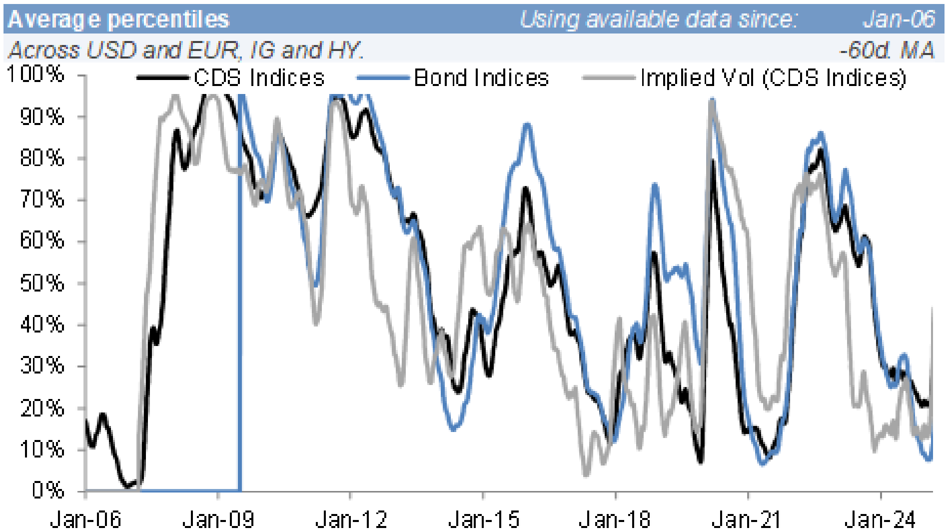
Max loss: notional.

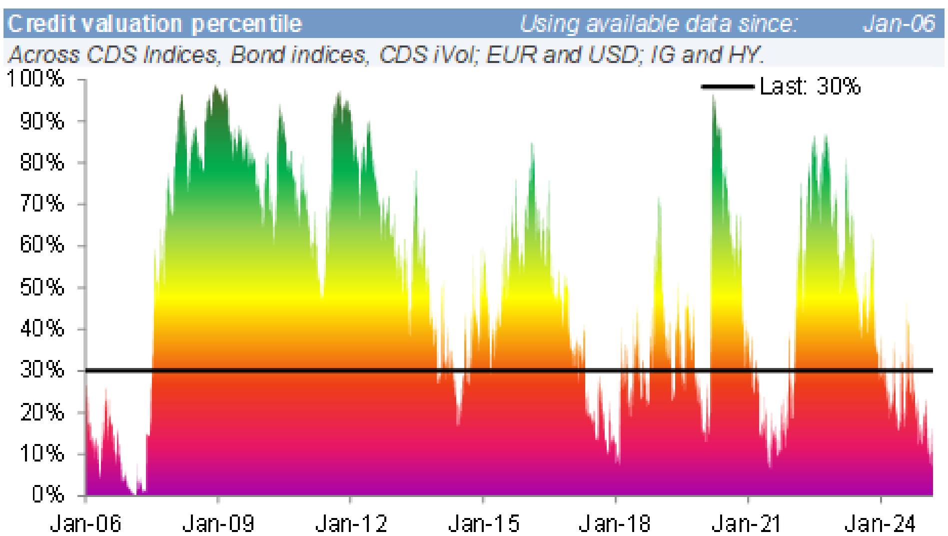
Credit ***MarketStrats*** Team.

CHARTS

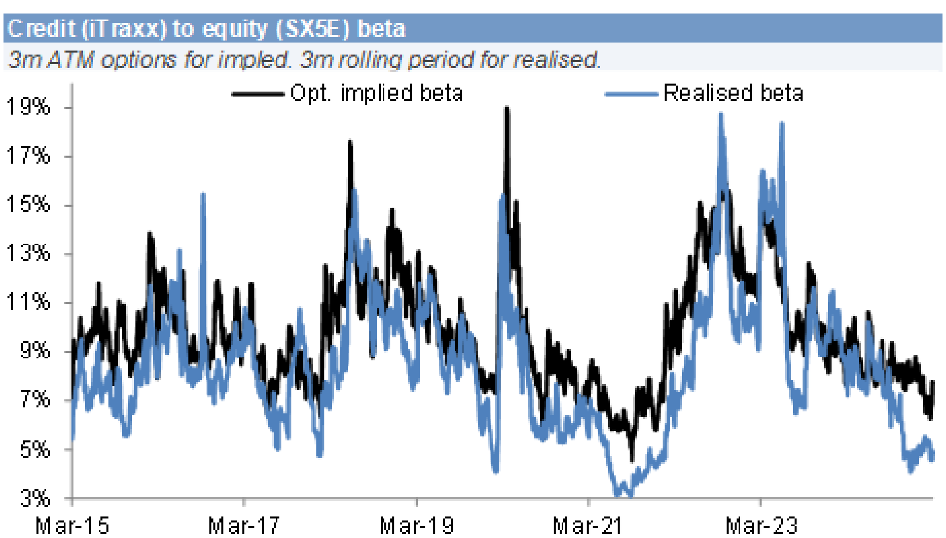
1. Credit valuation percentiles.





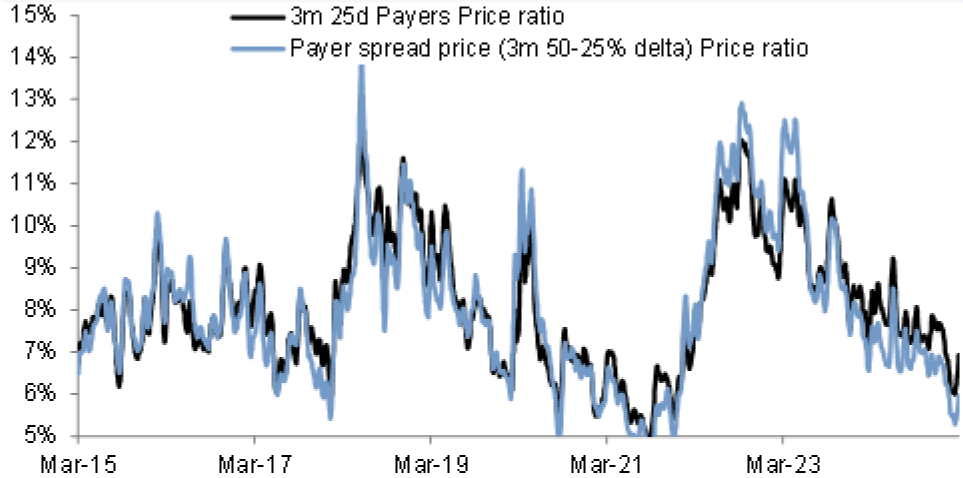


2. Credit beta to equities. iTraxx vs. SX5E top, CDX vs SPX bottom; right charts show ratio of option hedge pricing.



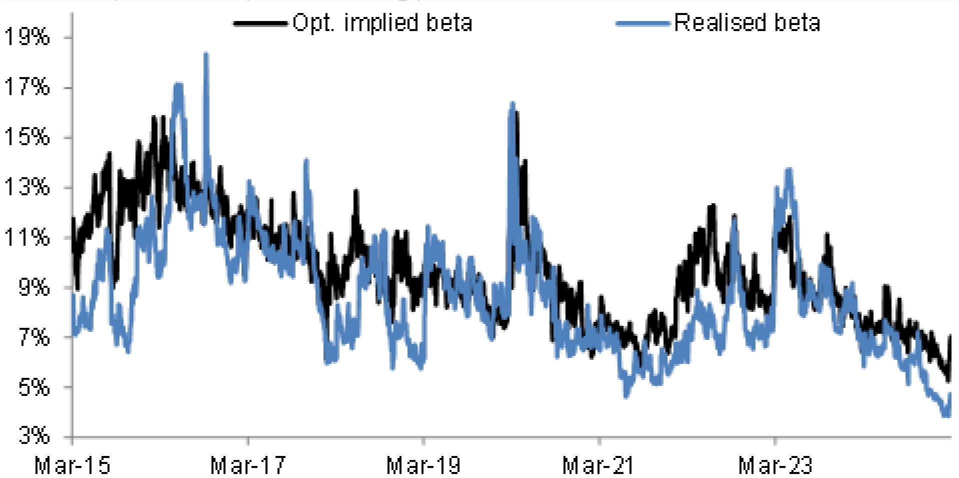
Price ratio credit / equity options

Main / SX5E *-10d MA*



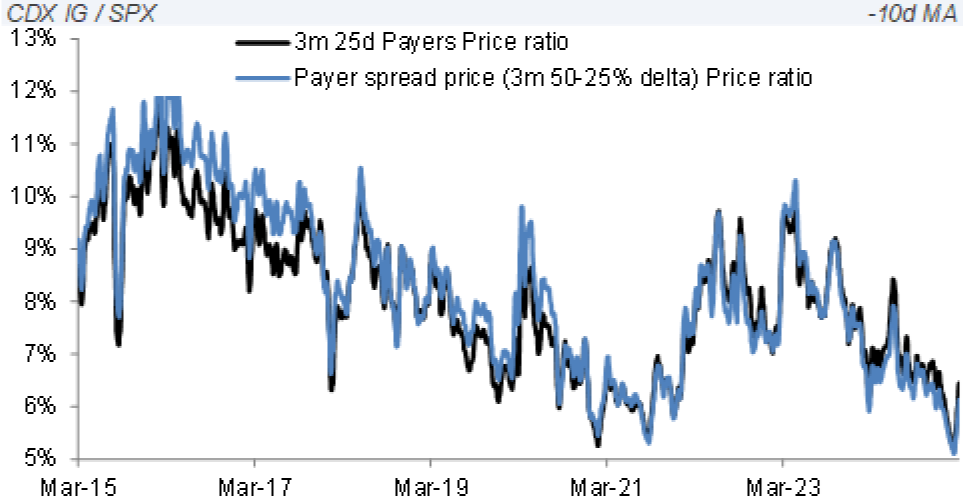
Credit (CDX IG) to equity (SPX) beta

3m ATM options for impled. 3m rolling period for realised.



Price ratio credit / equity options

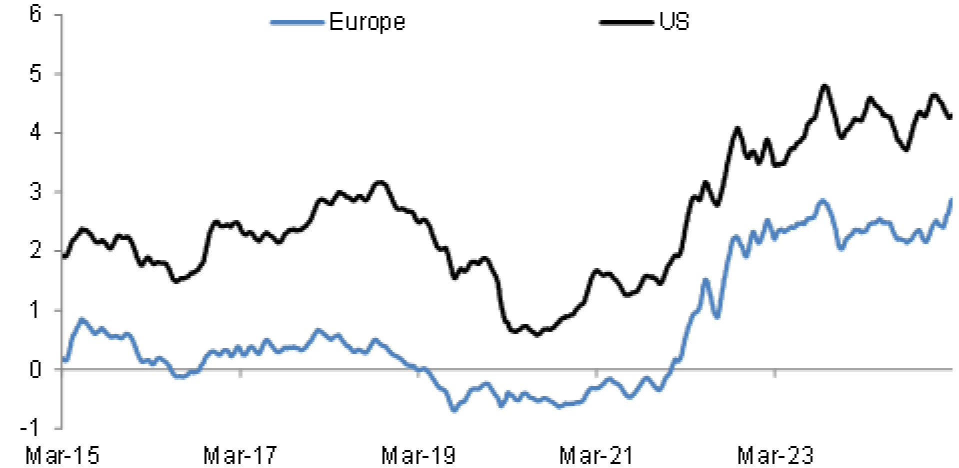
CDX IG / SPX *-10d MA*



3. Rates and financial conditions.

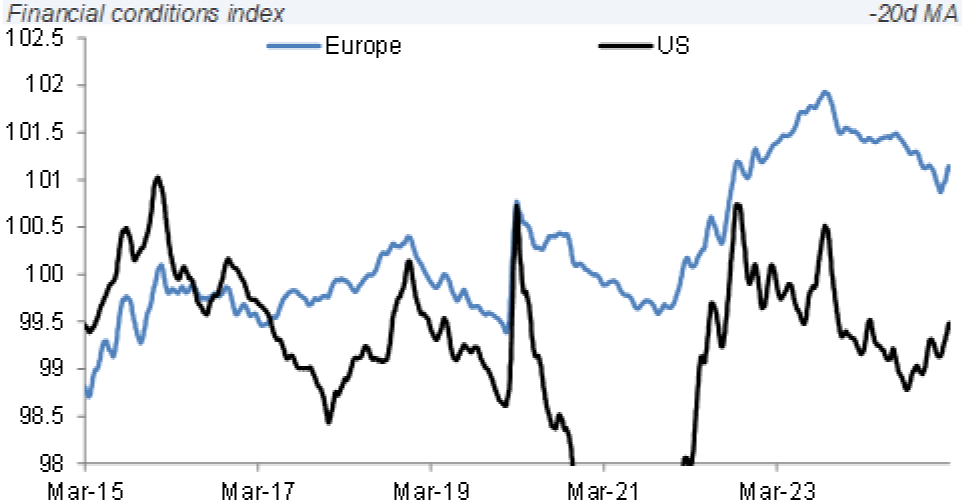
10y Rates

-20d MA



FCI

Financial conditions index -20d MA



4. Bonds vs CDS.

iBoxx HY (MJA) vs. iTraxx Xover

In bp.

	Current	1w chg	1m chg	3m chg
iBoxx HY (MJA)	357	23	26	8
iTraxx Xover	309	13	30	9

iBoxx IG (QW5A) vs. iTraxx IG*

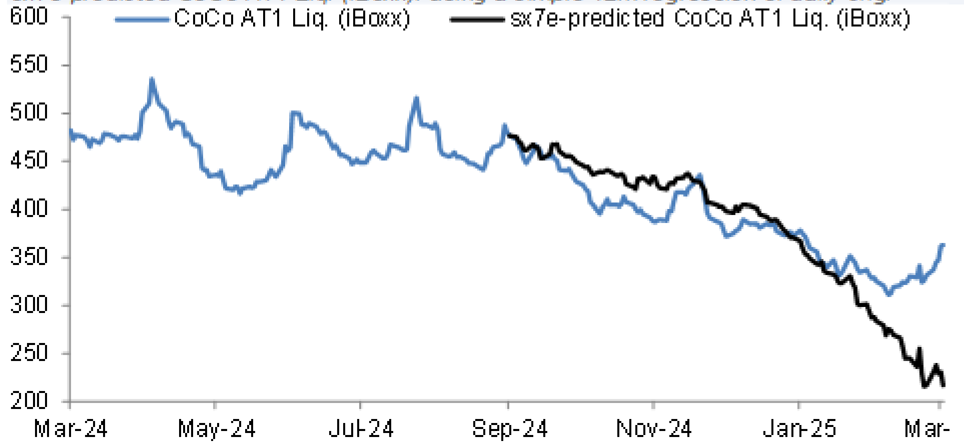
*In bp. *: 60% NonFin, 30% SenFin, 10% SubFin*

	Current	1w chg	1m chg	3m chg
iBoxx IG (QW5A)	120	6	10	3
iTraxx IG*	58	2	6	2

5. AT1 struggling.

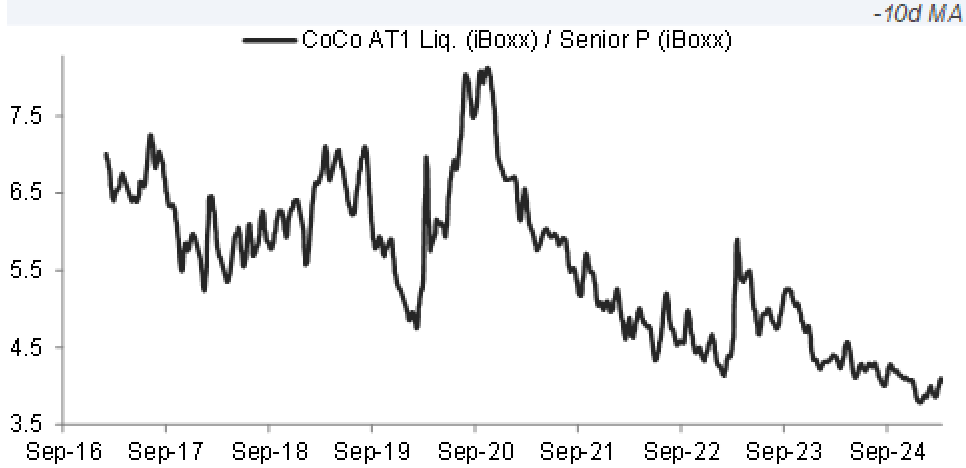
CoCo AT1 Liq. (iBoxx) vs. sx7e-predicted 6m

sx7e-predicted CoCo AT1 Liq. (iBoxx): using a simple 12m regression of daily chg.



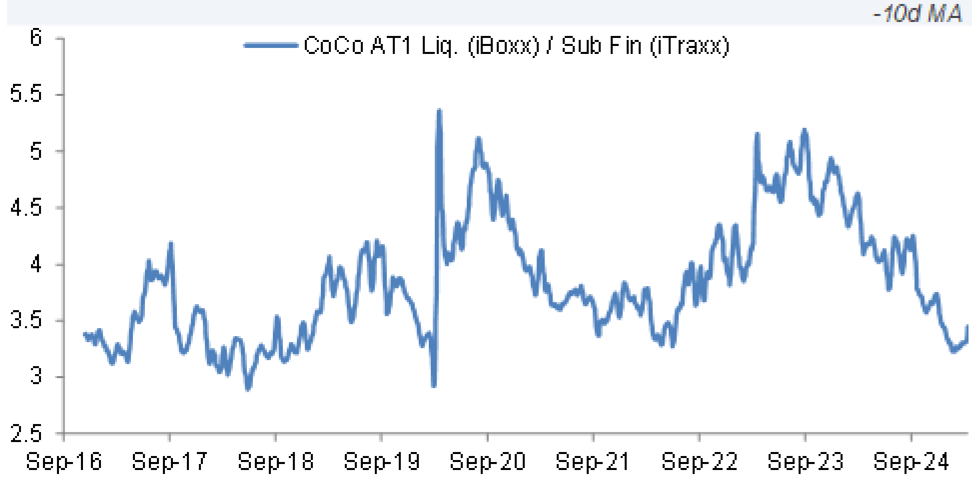
Ratio of Spreads

-10d MA

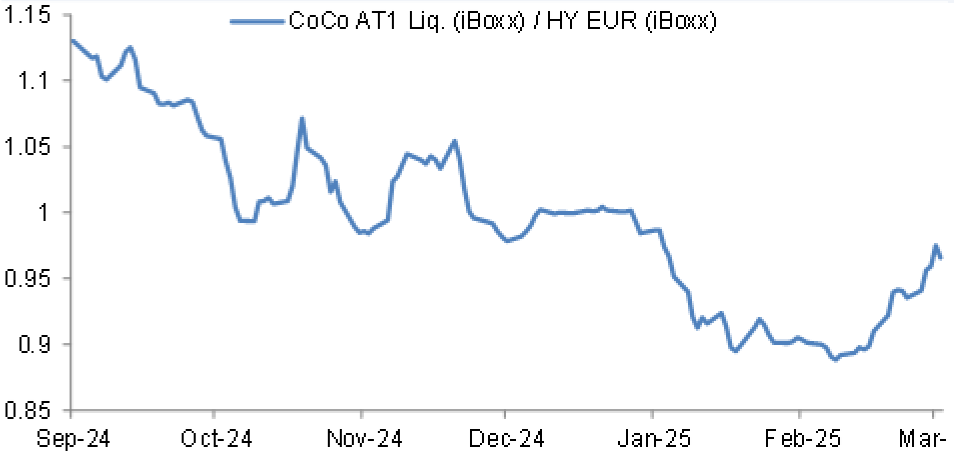


Ratio of Spreads

-10d MA

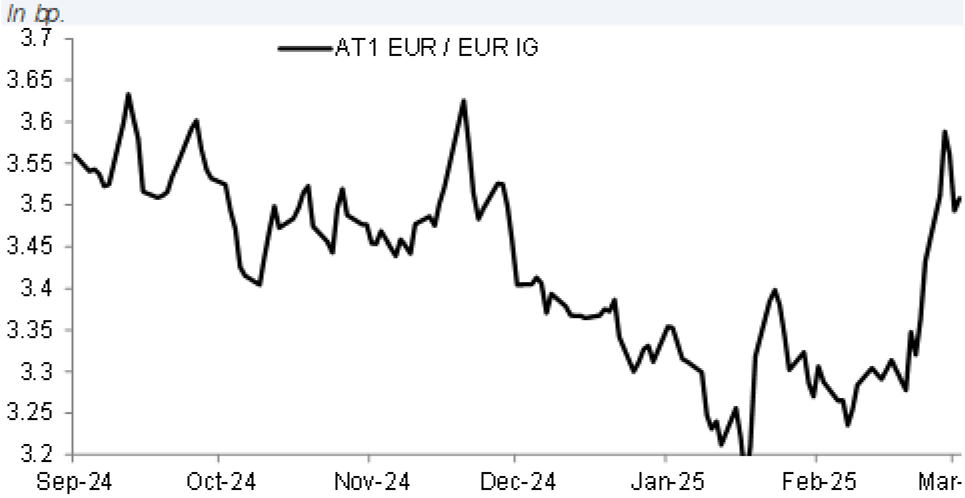


Ratio of Spreads



Spread ratio

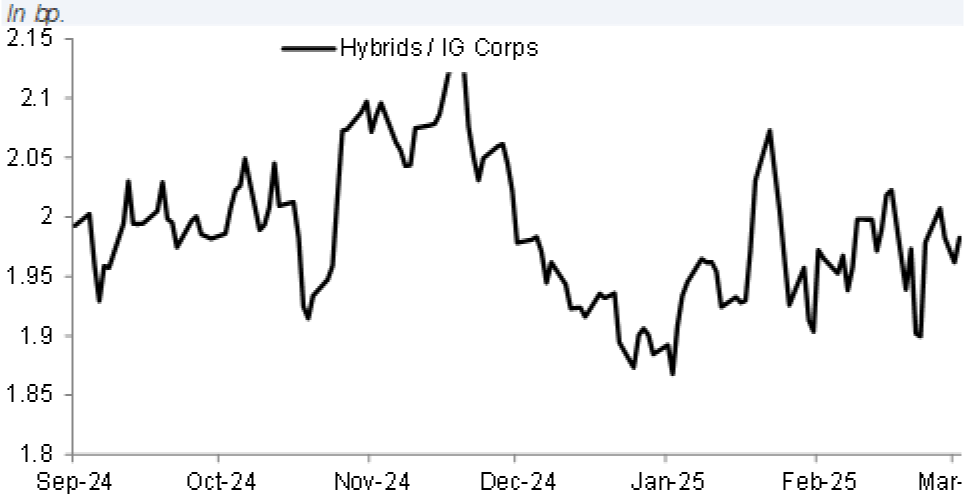
In bp.



6. Corp Hybrids & BBs struggling.

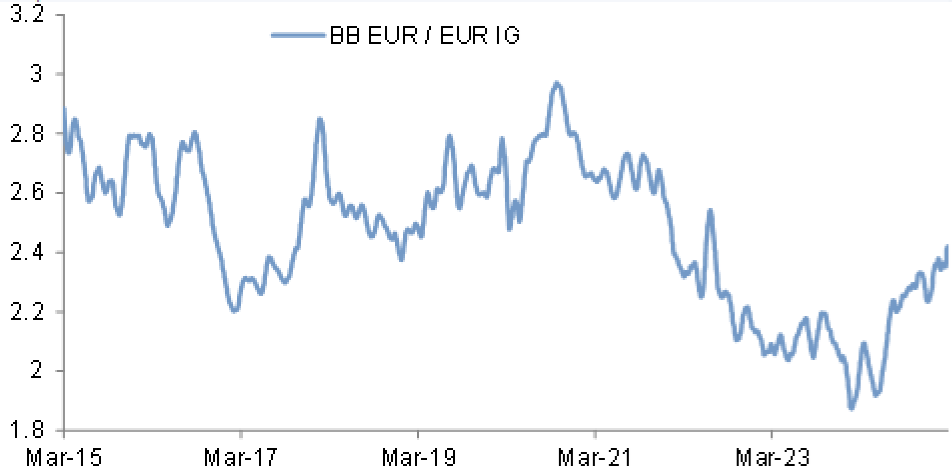
Spread ratio

In bp.



Spread ratio

In bp. *-20d MA*

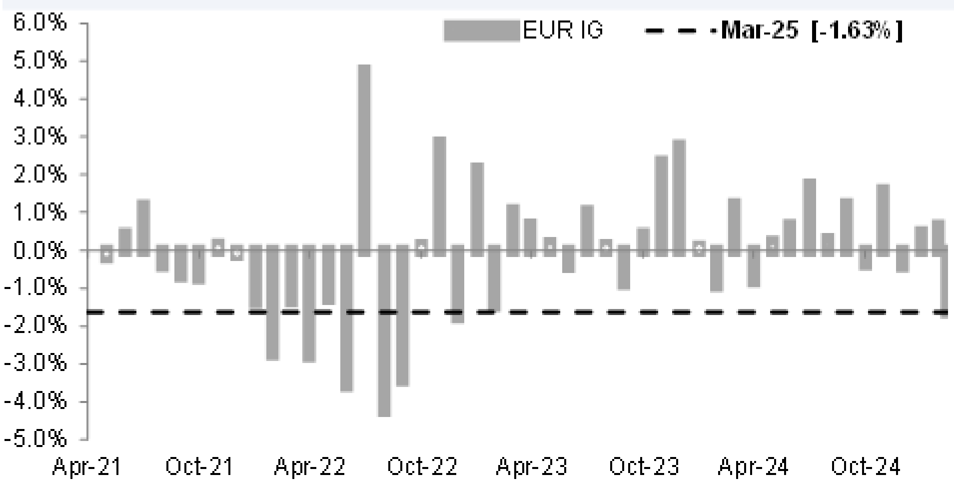


7. Total returns.

Total return

	YtD	1m	3m	1y
EUR IG	-0.5%	-1.3%	-1.2%	4.0%
BB EUR	0.2%	-0.7%	0.1%	5.8%
AAA EUR	0.0%	0.0%	0.0%	0.0%
AA EUR	-0.8%	-1.3%	-1.5%	3.2%
A EUR	-0.6%	-1.4%	-1.4%	3.6%
BBB EUR	-0.4%	-1.2%	-1.0%	4.6%
AT1 EUR	0.8%	-1.3%	0.5%	10.4%
Hybrids	0.2%	-0.9%	-0.1%	5.9%
SX5E	10.3%	-1.5%	9.0%	11.3%
IG USD	1.6%	1.6%	-0.6%	4.2%
AA USD	1.7%	1.6%	0.1%	4.0%
A USD	1.6%	1.5%	0.1%	4.7%
BBB USD	1.5%	1.3%	-0.1%	5.4%

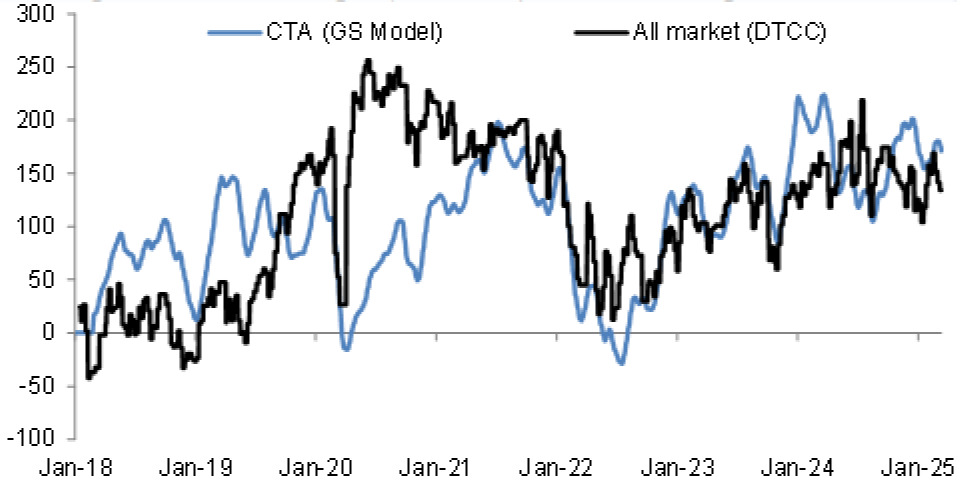
Monthly total return



8. CTAs in CDS indices.

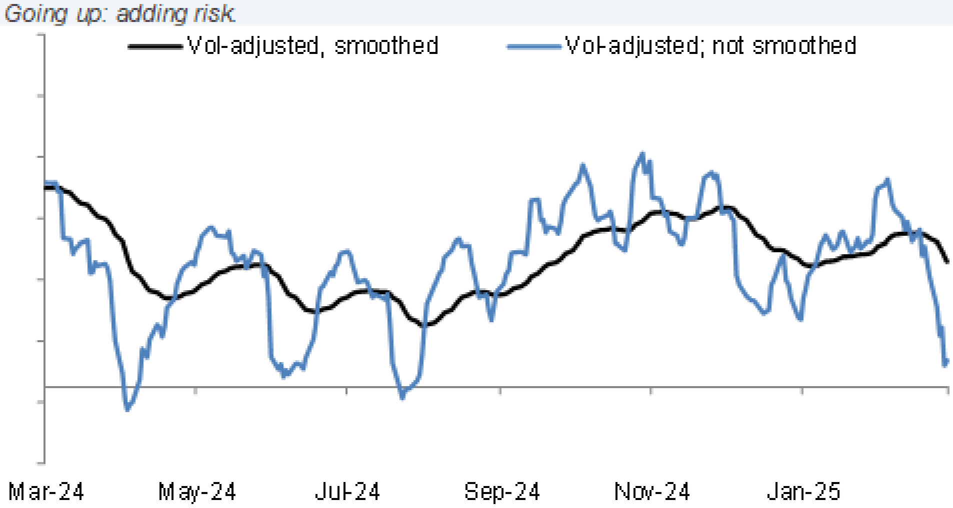
Global aggregated CDS index positioning — Posit. In USD bn.

Xover signals for CTA model signals; All Main equiv. for model sizing



CTA model - Xover — Trend following model: cumulative net risk positioning

Going up: adding risk

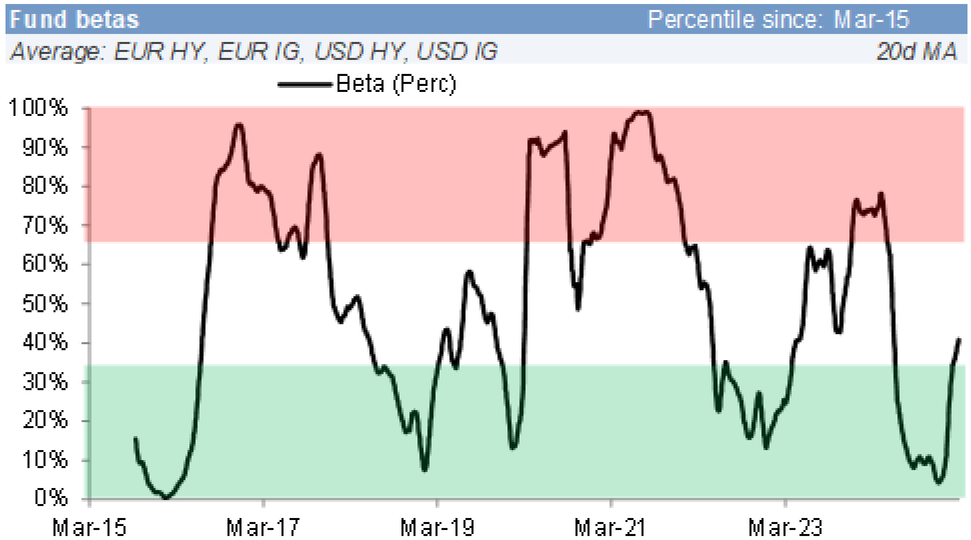


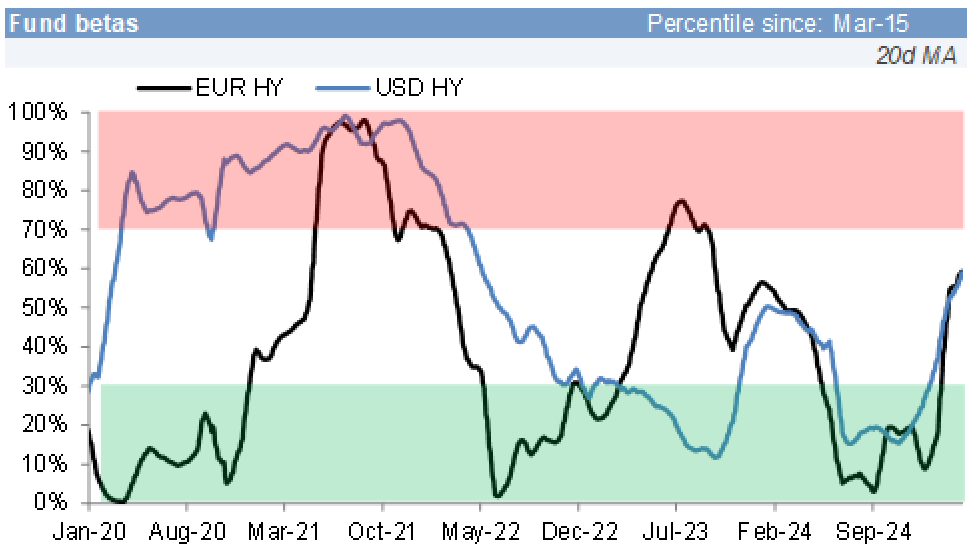
9. Fund flows and net issuance.

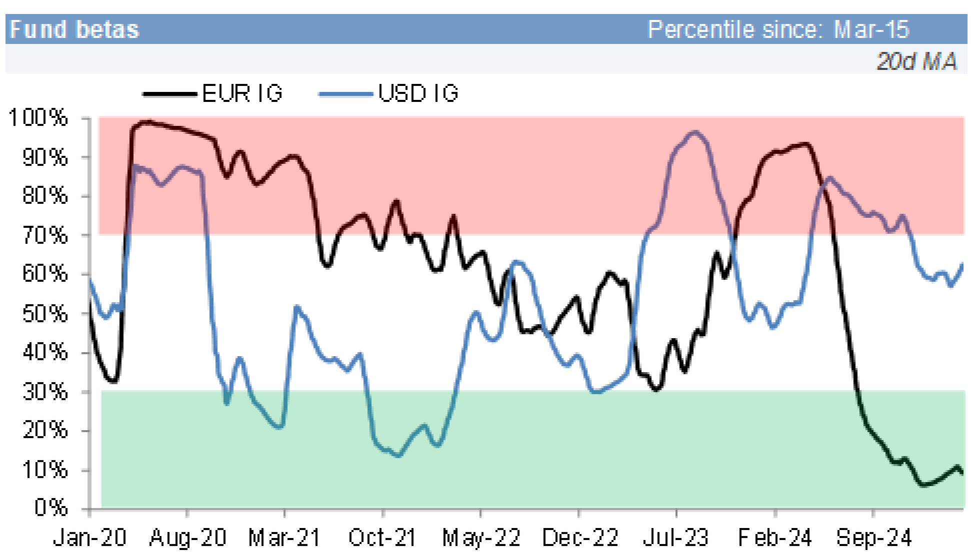
	Fund flows (% AuM)			Net Issuance (% AuM)		
	Past 1m	Past 6m	YtD	Past 1m	Past 6m	YtD
EUR IG	1.0%	5.2%	2.5%	0.2%	1.4%	1.2%
EUR HY	0.5%	6.3%	1.6%	1.7%	3.7%	-0.1%
USD IG	0.4%	2.0%	1.9%	1.4%	2.5%	2.3%
USD HY	0.9%	2.8%	2.4%	1.4%	2.3%	2.1%
Average	0.7%	4.1%	2.1%	1.2%	2.5%	1.4%

	Fund flows - Net Issuance (% AuM)		
	Past 1m	Past 6m	YtD
EUR IG	0.8%	3.8%	1.3%
EUR HY	-1.2%	2.6%	1.6%
USD IG	-1.0%	-0.5%	-0.4%
USD HY	-0.5%	0.6%	0.3%
Average	-0.5%	1.6%	0.7%

10. Fund betas.



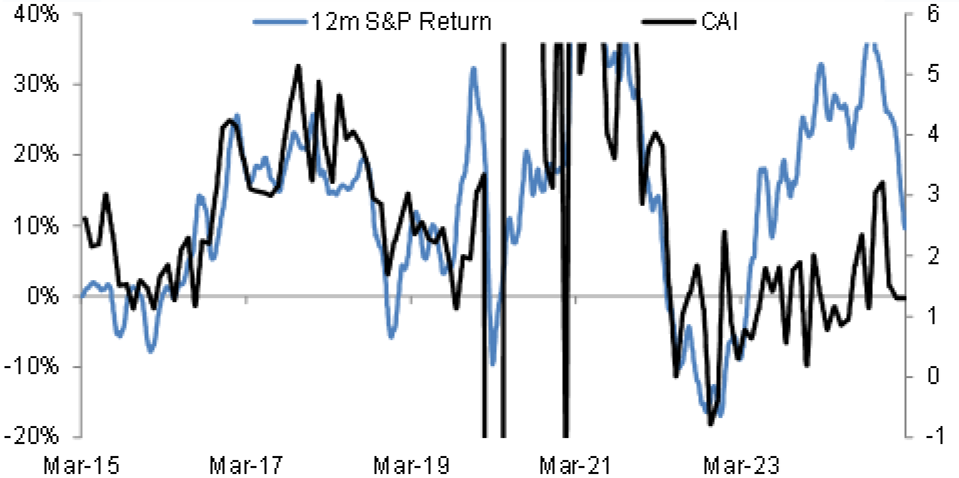




11. Valuations vs other metrics.

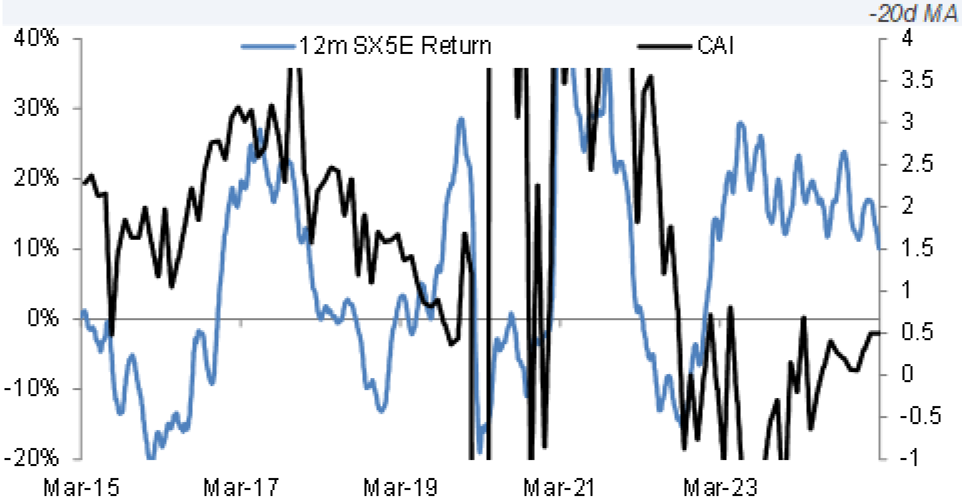
12m S&P Return vs. CAI

-20d MA



12m SX5E Return vs. CAI

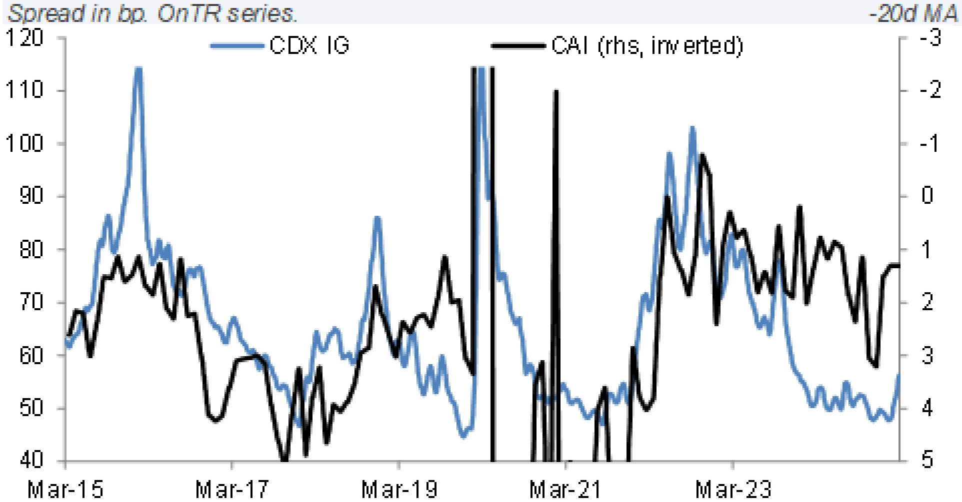
-20d MA



CDX IG vs. CAI (Current activity indicator)

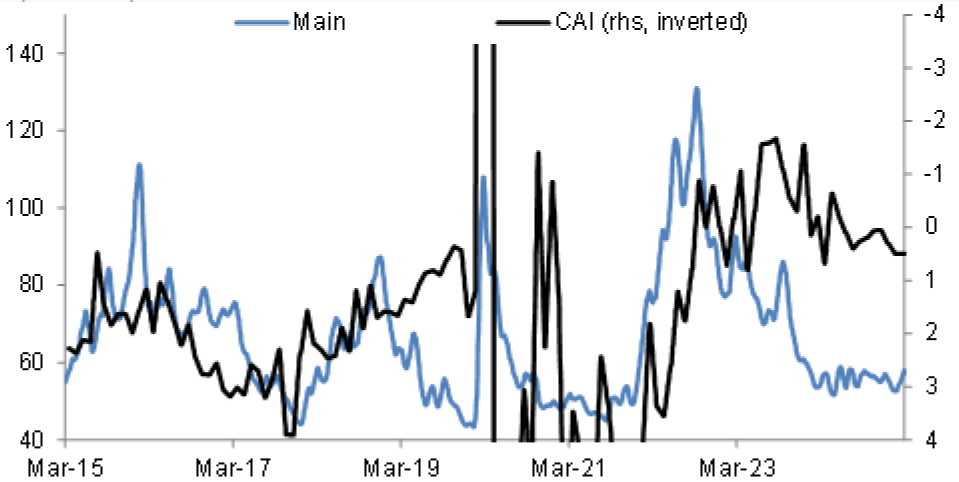
Spread in bp. OnTR series.

-20d MA



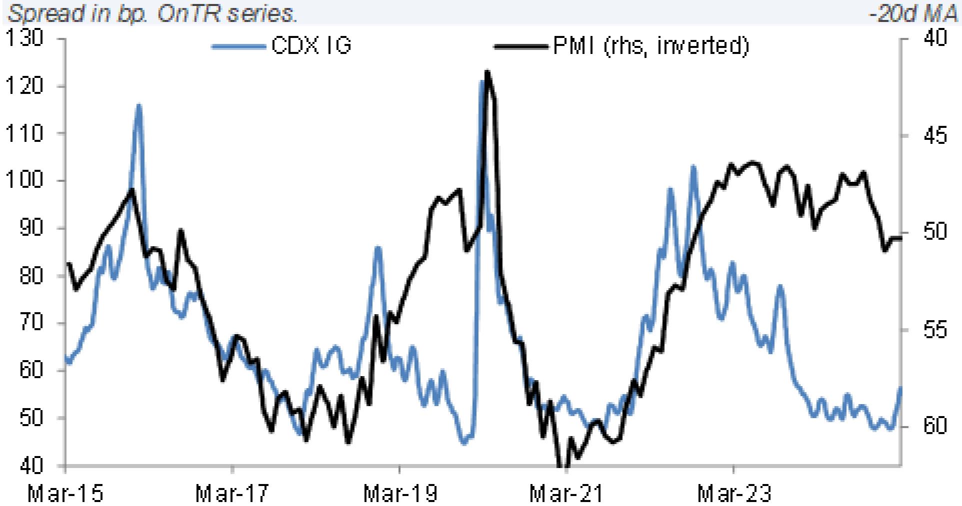
Main vs. CAI (Current activity indicator)

Spread in bp. OnTR series. *-20d MA*



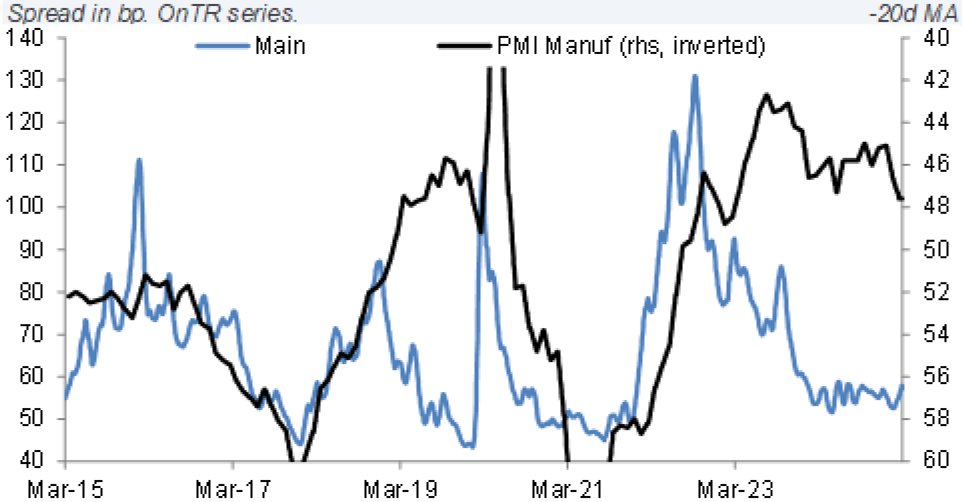
CDX IG vs. PMI

Spread in bp. OnTR series. *-20d MA*

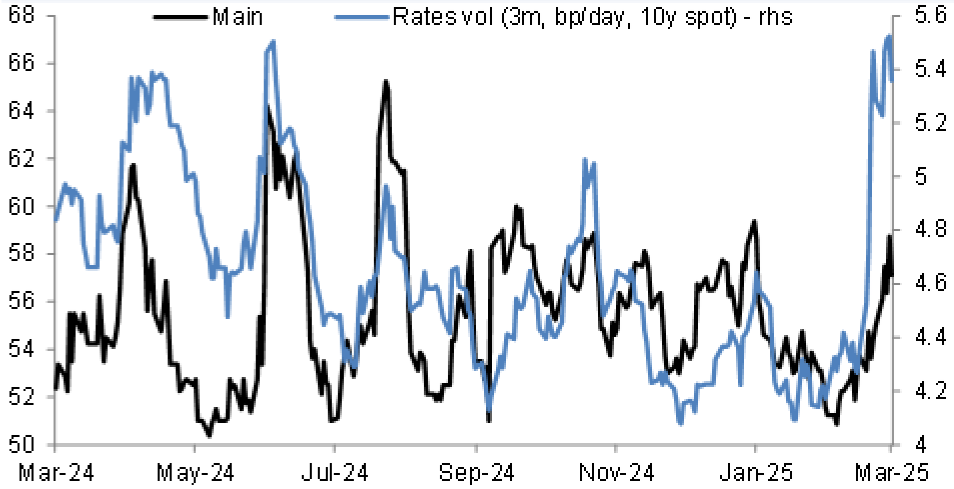


Main vs. PMI Manuf

Spread in bp. OnTR series. *-20d MA*

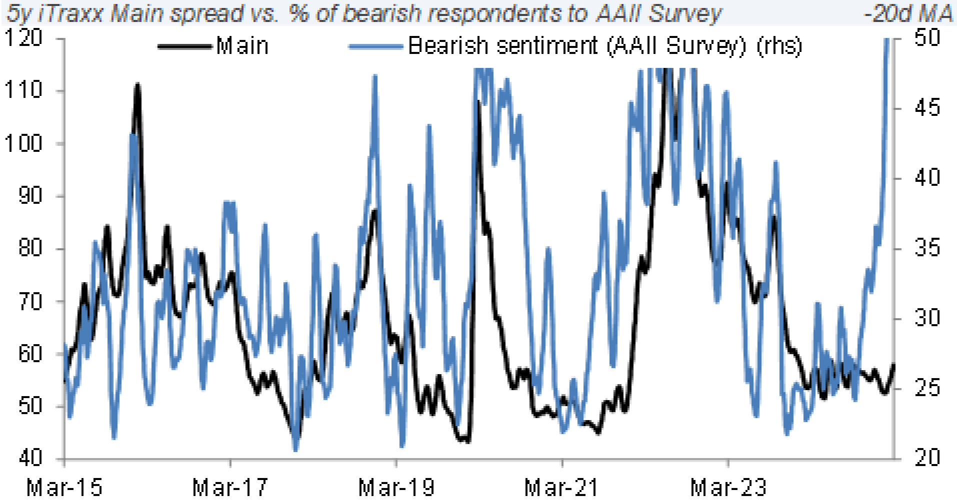


Spreads vs. rates vol



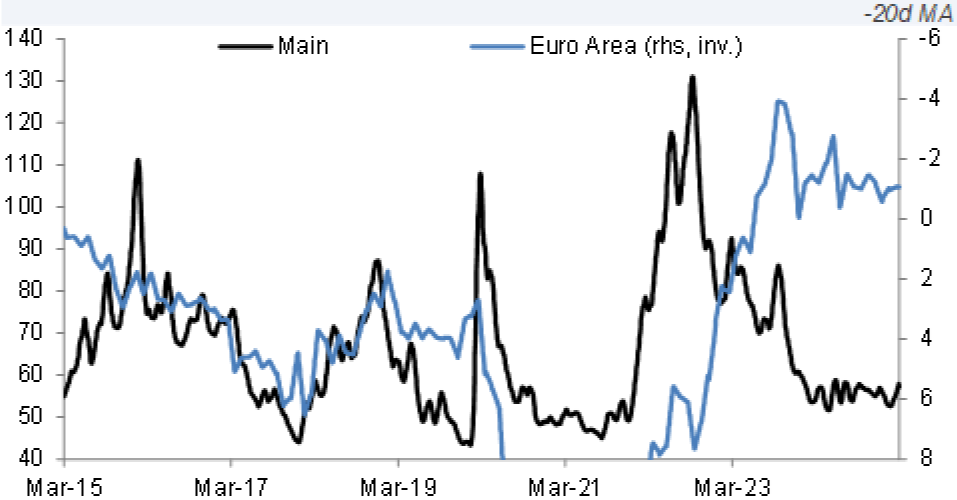
Spreads vs. bearish sentiment

5y iTraxx Main spread vs. % of bearish respondents to AAII Survey *-20d MA*

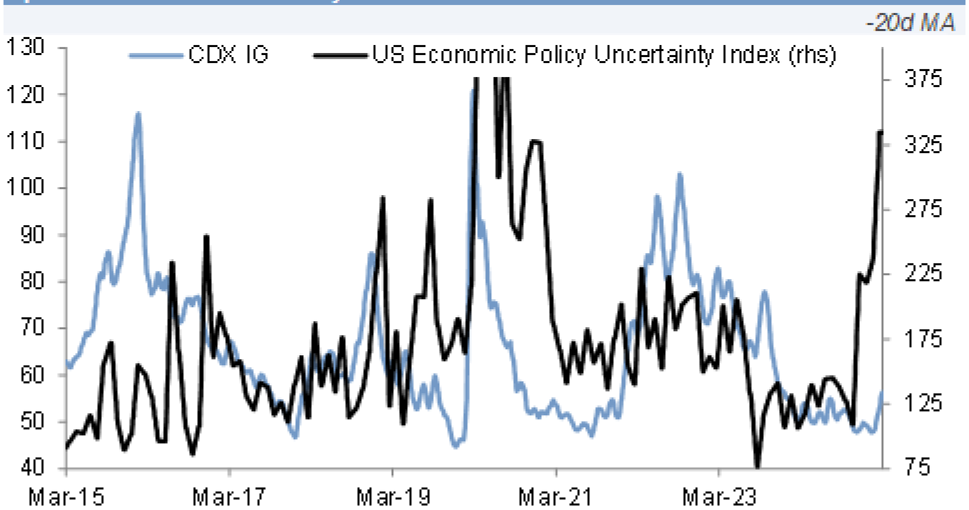


Spreads vs. Bank credit (% YoY)

-20d MA



Spreads vs. trade uncertainty



Paper Beta Portfolio. Details [here](). Beta range [-1,3] to EUR HY.

Changes

	14-Mar	16-Mar	Chg. Pos.
Rates dur. (theor.)	1.1	1.8	0.7
Carry (%)	3.8	5.4	1.6
Beta (12m of 20d MtM)	-0.5	-0.6	-0.1

Reference asset	Spread	Duration	Yield	Carry (%)	Rates dur. (theor.)
EUR HY Bonds (iBoxx)	353	2.5	5.7	5.7	2.5

Tail (realised) beta	-0.4
DxSprd Portf / EUR HY	-0.5

Latest alloc. change: 16-Mar-25

Current portfolio		Carry (%)	Rates dur. (theor.)	Beta to EUR HY Bonds (iBoxx). Range: -1 to 3 (12m of 20d MtM)
Portfolio latest (size-weighted)		5.4	1.8	-0.6
	vs ref asset:	5% UW	30% UW	78% UW

14-Mar	16-Mar	Chg. Pos.	Chg. Beta Contr.
-0.30	-0.30	0.00	0.00
0.60	0.30	-0.30	-0.06
-0.11	-0.11	0.00	0.00
-0.30	-0.30	0.00	0.00
0.23	0.15	-0.08	-0.07
0.34	0.34	0.00	0.00
0.58	1.50	0.93	0.05

Portfolio constituents

Asset	Positioning	Spread	Duration	Yield	Carry (%)	Portfolio Contribution	Rates dur. (theor.)	Portfolio Contribution	Beta to EUR HY Bonds (i 12m of 20d MtM	12m of 20d MtM Beta contribution Positioning x beta
EUR HY Bonds (iBoxx)	-0.30	353	2.5	5.7	5.7	-1.7	2.5	-0.8	1.0	-0.30
USD Loans (iBoxx)	0.30	297	0.5	7.3	7.3	2.2	0.5	0.2	0.2	0.06
USD HY CDS (CDX 5y OnTR)	-0.11	346	4.0	7.5	5.2	-0.6	0.0	0.0	1.4	-0.16
EUR HY CDS (Xover 5y OnTR)	-0.30	309	4.1	5.5	4.6	-1.4	0.0	0.0	1.7	-0.51
Vol Carry Credit STS (gsvikg3e)	0.15			0.0	0.0	0.0	0.0	0.0	0.9	0.13
EUR Rates (3y DE)	0.34	0	2.9	2.2	2.2	0.8	2.9	1.0	0.4	0.13
USD Rates (1y)	1.50	183	0.9	4.1	4.1	6.2	0.9	1.4	0.1	0.08

For all charts unless otherwise stated. Source: GS FICC and Equities. As of 16-Mar-2025. Past performance not indicative of future results.