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This section highlights the top-down views of Invesco Fixed Income's global strategists in the US, Europe and Asia.

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Global macro strategy

We've downgraded our 2025 US growth forecast - but no recession

Overview

- We have downgraded our growth forecast for the first half of 2025 from the mid-2% range to 1.7%. For the second half, we had already anticipated a slowdown, and we maintain that outlook. We now project 2025 GDP growth at 1.7%, down from our previous estimate of 2.0%. The primary reason for the downgrade is rising policy uncertainty and declining consumer and business confidence.
- We are not projecting a recession at this point. In this environment, we believe companies will be more likely to delay hiring and capital expenditure decisions than downsize. US household and corporate balance sheets and overall private sector financial conditions have been resilient, limiting the risk of a deep downturn, in our view.
- Recession risks remain elevated because restrictive and inflationary policies are likely to keep uncertainty high, markets uneasy, and hinder confidence. More aggressive trade, fiscal, and other policies could shift our baseline projection toward recession. The probability of our baseline growth view remains at 45%, while the alternative recessionary risk scenario still stands at 35%.
- For the Federal Reserve (Fed), policymaking will likely be challenging, given the risks on both sides of its dual mandate, including higher inflation and the rising risk of a slowdown. We expect the Fed, which already has an easing bias, to deliver three rate cuts in June,

September, and December. The reason for these cuts is a slowing economy.

- We expect inflation to rise in our baseline scenario, but, excluding the potential tariff impact, only modestly. This outcome could allow the Fed to look through any increase in inflation that does occur and place greater emphasis on growth. On the other hand, tariffs could be aggressive, causing a significant inflation impact. In that case, we would likely switch to our recession scenario. There is fluidity between these scenarios at this point due to the lack of policy clarity.

Why did we downgrade growth?

The primary reason for our growth downgrade is a shift in assumptions about economic policy. Initially, we expected a pragmatic and gradual, business-friendly approach to trade and fiscal policy. However, what we have seen instead is an unpredictable, front-loaded and confrontational policy stance, which has significantly increased uncertainty.

One of the key shifts has been in trade policy, where we originally expected tariffs to target China and specific sectors in other countries. Instead, they have been extended to key US trading partners, including Canada and Mexico, disrupting supply chains and business planning. Additionally, new tariffs and threats, including broad-based reciprocal tariffs, have been announced on and off. Often, these announcements are not implemented, but the on-again off-again nature of the announcements and threats keep uncertainty high.

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Fiscal policy uncertainty is another major factor in our growth downgrade. Initially we did not anticipate significant spending cuts, but have gotten some, and the uncertainty surrounding government contracts and grants is already having some tangible impact. Businesses that rely on these funds are exercising caution, holding back on hiring and investment due to a lack of clarity on future allocations.

This uncertainty has eroded business and consumer confidence, as reflected in recent surveys, reinforcing our expectation of weaker economic activity. Additionally, a slow start to the first quarter has contributed to our downward revision, though it is not the primary driver of our weaker projection.

Why we do not expect a recession

Despite the downgrade to our growth outlook, we do not expect the economy to tip into a recession. The primary reason for this is the resilience of private-sector balance sheets, which remain fundamentally strong across households, banks, and companies.

Households are in solid financial shape, with low leverage and manageable debt payments, reducing the risk of widespread financial distress. The banking sector is well-capitalized and not significantly exposed to housing-related risks or broader financial instability, further supporting overall stability. On the corporate side, balance sheets remain strong, as many companies took advantage of the low interest rate era to refinance their debt, leaving them in a favorable financial position. Additionally, corporate profits continue to grow, providing firms with the flexibility to navigate an uncertain economic environment.

The current expected slowdown is largely driven by uncertainty, which is leading businesses to delay hiring and investment decisions rather than initiate widespread layoffs or defaults. Unlike past downturns, which were often triggered by credit cycles and excessive leverage, this potential slowdown does not exhibit the conditions typically associated with a severe downward spiral fueled by financial distress.

On the fiscal side, headlines about some cost-cutting activity have led to growth forecast downgrades. However, large spending cuts have not yet been fully realized. February spending data reflected business as usual.

At some point, political pressure may grow, limiting spending cuts. For instance, Republican congresspeople have reportedly faced a backlash in town hall meetings. In polling averages compiled by RealClearPolitics, President Trump's approval rating turned negative very quickly, whereas President Biden maintained a wider approval margin at the beginning of his term and held a favorable rating until September of his first year.¹

Additionally, courts have begun to halt or reverse certain policy decisions, though it remains to be seen how effective these interventions will be. Fiscal spending exists at its current level for a reason – politically, it is not easy to cut.

While recession is not our baseline, the risks are rising

So far, the policies implemented by the new administration may not lead to a recession. However, fiscal spending could become more restrictive and tariff wars remain a persistent threat.

The president has made numerous announcements, some of which he has retracted or delayed, particularly regarding tariff implementation. A similar scenario could unfold on April 2, with potential room for delays and negotiations. If that does not happen, we may need to reassess our baseline. Even at this point, we continue to assign a significant probability to a sharp slowdown or recession, with the odds remaining high at 35%, in our view.

Fed likely to maintain an easing bias amid growth and inflation risks

Policymaking will likely be challenging for the Fed, given the risks on both sides of its dual mandate, i.e., higher inflation and the rising risks of a slowdown. We believe the Fed, which already has an easing bias, will deliver three rate cuts in June, September, and December. The rationale for these cuts is a slowing economy.

Inflation is likely to rise, but in our baseline scenario, the increase – excluding the tariff impact – should not be too severe, allowing the Fed to look through it and place greater emphasis on growth. On the other hand, tariffs could be aggressive, and the inflation impact significant. In that case, we would likely turn to our alternative recessionary scenario, where the Fed would likely cut rates by 200 basis points.

1. Source: RealClear Polling. Data as of March 18, 2025.

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Interest rate outlook

US: Overweight. We anticipate heightened rates volatility in the near term, driven by the new administration's policies, but in the longer term, we expect the rates market to deliver strong excess returns compared to cash. We have moderated our expectations for strong growth in the first half of the year and risks to the downside have risen. US rates have adjusted by bringing forward expectations of Fed interest rate cuts. In addition, significant increases in Treasury duration supply are unlikely until early 2026. Over the long-term, US Treasuries appear undervalued relative to fundamental drivers, with any substantial yield increases likely spurred by debt concerns. However, the narrow Republican majority in the House may impede legislation that significantly raises the debt/GDP ratio. Overall, we maintain a positive outlook on long-term rate returns, based on current valuations.

Europe: Overweight. We anticipate that the European Central Bank (ECB) may be compelled to implement deeper cuts than currently expected, potentially lowering rates to 1.5% or even further, as the immediate effects of tariffs become apparent. Ultimately, European yields should probably be structurally higher, given a higher potential growth profile, higher inflation expectations and much higher levels of borrowing. However, the longer-term impact of a more relaxed fiscal policy is likely to be considered a future concern for the ECB, rather than influencing near-term policy decisions.

China: Neutral. Strong economic activity and relatively resilient stock market performance in the first quarter have led to an adjustment in the long end of the Chinese yield curve, in line with the central bank's warning in mid-2024. Though the front end is expected to remain anchored by accommodative monetary policy, moves at the long end of the yield curve are likely to be subject to US-China trade negotiations and the tariff situation. If the tariff decisions surprise on the downside, this could cause the yield curve to move further in the same direction, and vice versa. (BoE)

Japan: Underweight. Japanese government bond (JGB) yields have trended higher over the last month, driven by domestic and international factors, with 10-year yields up 10 basis points to 1.52%.² Domestically, core inflation has accelerated, and early indications are that the spring wage round will see a record increase in base wages. The Bank of Japan (BoJ) did not hike rates in March, but Governor Ueda acknowledged rising global

uncertainty due to US tariffs and reiterated that rate hikes would continue if the BoJ's forecast realises. He also opened the door to faster hikes if inflation accelerates beyond the BoJ's projections. The market is only pricing the next 25 basis point hike by September, but there is a meaningful risk of a hike in July and a further two 25 basis point hikes in 2025. The BoJ also seems relatively unconcerned by the rise in long-term rates, suggesting that quantitative tightening plans will continue to push maturities, particularly around the 10-year point higher. Meanwhile, international factors related to the rise in yields in Europe is also influencing the Japanese markets, as it is possible that Japan, like Germany, will be pushed toward additional fiscal spending, because of a reduction in the US's defense commitments.

UK: Overweight. Gilt yields are little changed over the last month, lagging the rally in US Treasuries but outperforming German bunds. Overall, economic data have been consistent with gradual Bank of England (BoE) rate cuts. GDP data and business surveys have continued to paint a weak growth outlook. The labor market has been mixed: survey data suggest loosening, but official data show resilient employment growth. Wage growth remains strong but momentum is starting to wane and forward-looking indicators show softening. Core inflation has rebounded and is likely to be resilient due to several administered price changes and some rebound in goods prices. Unlike Germany, the UK is not easing on the fiscal front beyond announcements made in October. In fact, the government has committed to funding increased defense spending and fiscal slippage from spending cuts. The UK will likely benefit from some positive spillover from better eurozone growth, but this is likely to be relatively modest.

Australia: Overweight. Australian interest rate markets have been relatively range bound over the last month. Domestic data have been mixed overall, limiting their relevance for the monetary policy outlook. Australian government bonds have lagged the rally in US Treasuries, with the 10-year spread widening by 20 basis points.³ However, they have outperformed European markets in the wake of the announcement of German fiscal easing. Current short-term valuations look roughly fair, in our view, but the Australian yield curve remains steep. We think long-term yields are attractive, with 30-year Australian government bond yields trading at 4.91%, which is attractive on an outright basis and relative to US Treasuries, in our view.

2. Source: Bloomberg L.P. Data as of March 21, 2025.

3. Source: Bloomberg L.P. Data as of March 20, 2025.

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Currency outlook

USD: Neutral. We maintain a neutral view on the US dollar, as we await the full scope of the new Trump administration's policies regarding trade, immigration, and government efficiency measures. Due to prevailing uncertainty and its impact on business and household confidence, we now expect US growth this year to be lower than initially projected. However, the range of potential outcomes remains broad.

Despite the administration's rhetoric, we believe it would favor a weaker US dollar. Nonetheless, calibrating policy to prevent a significant devaluation may prove challenging, particularly if the US enters a recession while economic prospects in Europe and China begin to improve.

EUR: Neutral. Last month, we adopted a neutral stance on the euro in anticipation of a more supportive fiscal environment in Germany. However, the scale of the fiscal announcements exceeded our expectations. The subsequent rapid rally was both understandable and justified. Further upward movement will likely depend on the pace of fiscal expansion and whether the ECB will be comfortable reducing rates below neutral, given the substantial fiscal boost on the horizon.

Given the current uncertain macroeconomic backdrop, we maintain a neutral position on the euro. Nevertheless, in the longer term, we anticipate European growth to be structurally higher than previously expected prior to the German election, leading potentially to increased European yields and a stronger euro.

RMB: Overweight. Although we remain overweight the renminbi, we expect the upcoming dividend payment season and US-China trade negotiations to inject volatility into the USD/RMB exchange rate's performance in the months ahead. In the medium term, however, strong dollar holdings by Chinese corporates, accumulated through a substantial trade surplus, improvement in economic activity and supportive macro policy measures are expected to support renminbi's performance.

JPY: Overweight. The divergence of the BoJ's monetary policy from other central banks continues to pressure interest rate differentials tighter at the short end of the yield curve. In addition, risk aversion is creating a flight-to-quality bid for the yen. Looking ahead, the combination of weaker US growth expectations and a still hawkish BoJ should support yen appreciation. There has been limited Japanese repatriation of

foreign assets to date but the geopolitical environment and the reduced cost of currency hedging could lead to a repatriation of assets or a rise in hedge ratios. The selloff in US tech stocks could also reduce Japanese outflows into foreign equities, which have been very strong over the last two years.

GBP: Underweight. The British pound trade weighted index is up 1% over the last month and close to its highest level since September 2024, which itself was a high in the post-Brexit referendum era.⁴ The pound has largely tracked the appreciation of European currencies in the wake of the German fiscal announcement. However, this trend has probably gone as far as it can. UK fiscal policy is not easing relative to expectations and the government acknowledges it has limited fiscal space at present. Growth remains lacklustre and, while inflation remains sticky, we expect the BoE to continue cutting interest rates, reducing pound interest rate carry, particularly versus low yielding currencies, such as the yen.

AUD: Neutral. The Australian dollar is modestly weaker over the last month on a trade-weighted basis. It is little changed versus the US dollar but has weakened by 5% against the euro and 2.7% against the yen over the month.⁵ Trading doesn't really reflect Australian fundamentals, in our view, but more a reappraisal of European growth in the wake of Germany's fiscal announcements. We believe the Australian dollar is starting to look cheap relative to interest rate differentials and commodity prices, which might support valuations going forward. Also, April seasonals and positioning appear supportive. However, it is hard for us to identify an idiosyncratic factor that would drive the Australian dollar to significantly outperform the broad US dollar trend.

4. Source: Bloomberg L.P. Data as of March 20, 2025.

5. Source: Bloomberg L.P. Data as of March 20, 2025.

This section highlights the views of Invesco Fixed Income's credit analysts across a broad range of fixed income assets managed by Invesco.

Global credit strategy

Not your grandfather's high yield market – why that's a good thing!

We believe income is a very attractive source of total return in the current environment, especially risk-adjusted. The evolving macro backdrop and uncertainty surrounding trade policies, geopolitical conflicts, and deficits have led to greater price volatility across both equity and bond markets. Income, however, is far less volatile and is higher today than most of the periods over the past two decades. High yield, as is often the case, offers one of the most attractive levels of income.⁶

High income does not come without risk. This paper aims to put that risk into historical context. High yield has experienced

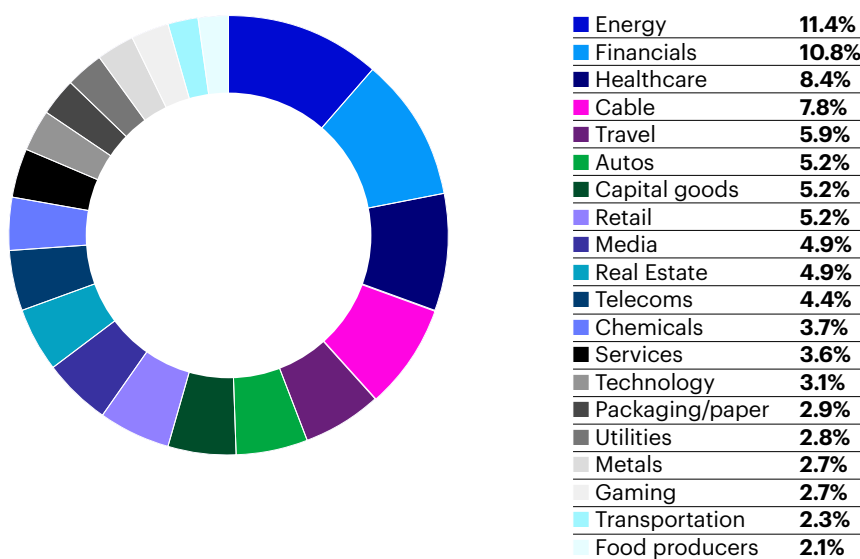
a handful of large drawdowns throughout history and feels the impact of losses through defaults and restructurings. The magnitude of the drawdowns is often a function of the make-up of the market.

Below, we explain why today's high yield market provides us with greater comfort that the downside risk is lower than it has been historically.

Sector composition

The high yield index is far more diversified across sectors than it has been in the past (Figure 1).

Figure 1: Highly diversified market



Source: BofA Global Research, ICE Data Indices LLC. Data as of Feb. 28, 2025.

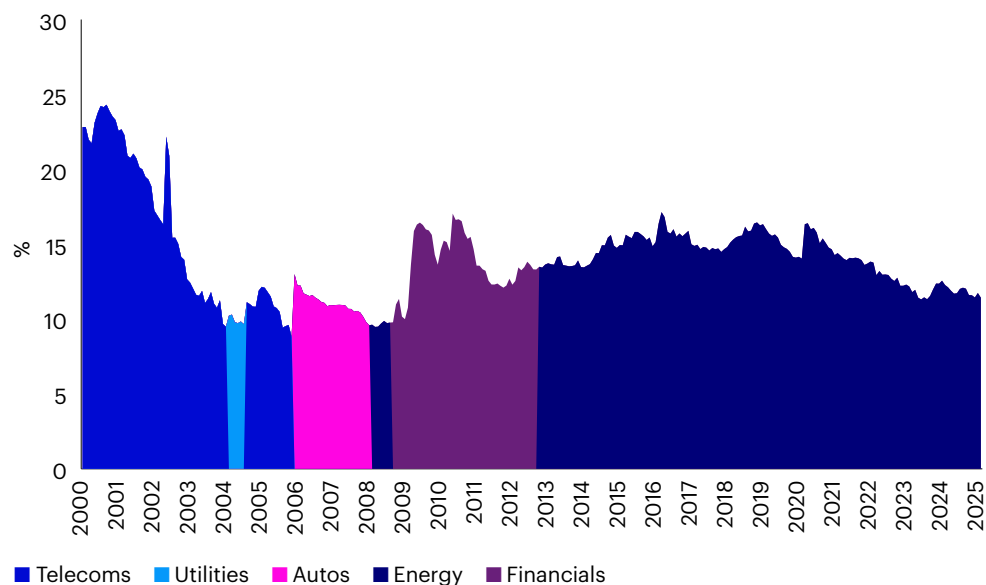
Today's index better represents a cross-section of today's economy, as opposed to mainly sectors undergoing secular challenges or areas favored for leveraged transactions. This is important because defaults have typically occurred among overleveraged companies or companies within sectors undergoing massive fundamental shifts.

This was most evident during the drawdowns experienced in 2000 and 2015 when telecom and energy issuers defaulted in large numbers. Not coincidentally,

those were the largest sectors in the index at those times.

Today, the largest sector is still energy, but it represents only 11% of the index, which is far lower than the 17% it represented when the sector collapsed on the back of precipitously falling oil prices in 2015. The telecom sector comprised nearly 25% of the index in the early 2000's.

6. Source: High yield market is represented by ICE BofA U.S. High Yield Index. Data from Jan. 1, 2003 to Dec. 31, 2024. From 2003 to 2024, the income contribution of high yield to total return has remained relatively steady. The yield on the high yield index today of 7.6% is relatively high compared to its average yield of 6.2% since 2013.

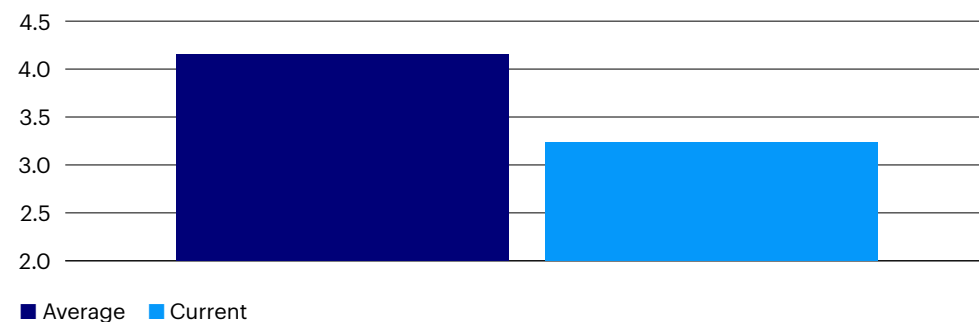
Figure 2: Less concentration risk – Largest sector

Source: BofA Global Research, ICE Data Indices LLC. Data as of Feb. 28, 2025.

Duration profile is shorter

High yield's duration has averaged about 4.2 years since 1996 (Figure 3). Today, the duration of the index is 25% lower, at around 3.2 years (Figure 3). The implica-

tion is that price volatility from sources unrelated to credit concerns, such as US Treasury volatility, should have less impact at this lower level of duration.

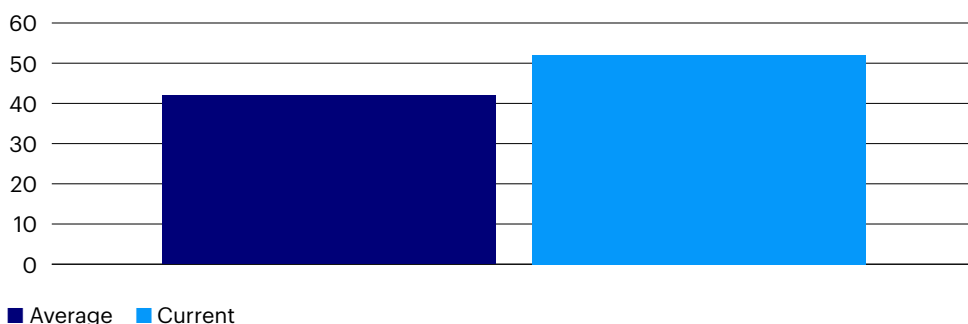
Figure 3: Duration of high yield market (modified duration-to-worst)

Source: BofA Global Research, ICE Data Indices LLC. Duration is monthly, since 2000. Data as of Feb 28, 2025.

Quality profile has improved

The average proportion of BBs in the high yield market averaged 42% from 1996 to the end of February (Figure 4). Today that figure is 52%. Once again, the implica-

tion is for potentially less overall market volatility, because the index represents less credit risk and default risk, given the current cohort of issuers.

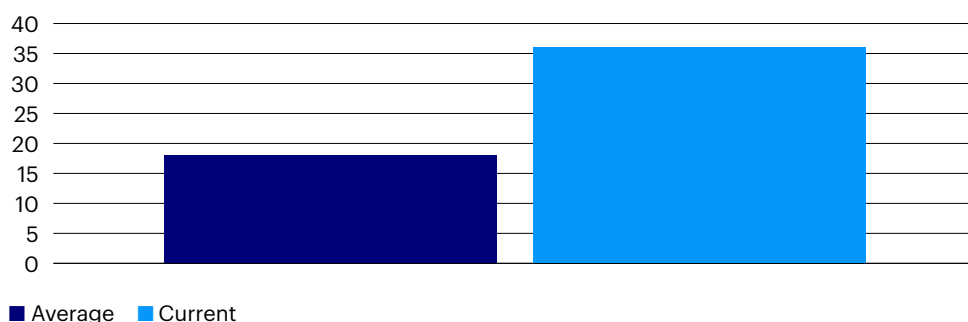
Figure 4: BBs as % of high yield market

Source: BofA Global Research, ICE Data Indices LLC. BB% data is monthly, since 1996. Data as of Feb. 28, 2025.

Seniority profile

High yield has generally been populated by senior unsecured bonds since 2000. The average exposure of the index to senior secured bonds, on the other hand, has historically been only around 18% (Figure 5). In the past few years, a large number of secured bonds have been

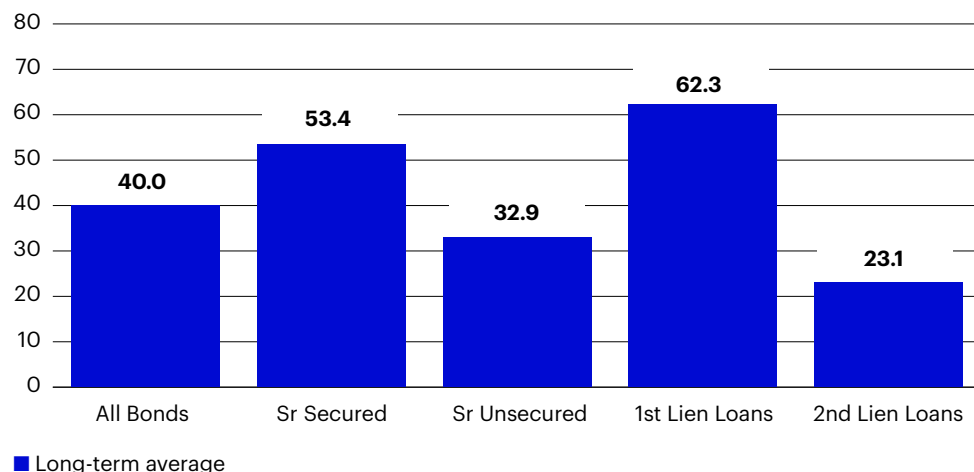
issued in the high yield market. Most were issued to refinance senior secured bank loans when it was more challenging to refinance in that market at attractive terms. As a result, today, nearly 36% of the high yield index is comprised of senior secured bonds (Figure 5).

Figure 5: Secured bonds as % of high yield market

Source: BofA Global Research, ICE Data Indices LLC. BB% data is monthly, since 2000. Data as of Feb. 28, 2025.

The implication of a higher proportion of secured bonds is that recovery rates in the case of default should be higher in the next default cycle. The average recovery rate for senior secured bonds has

historically been 53% (Figure 6), which is comparable to first lien loans. This compares to a historical recovery rate of 33% on a typical high yield senior unsecured bond (Figure 6).

Figure 6: Average recovery rates

Source: JP Morgan. Data as of Feb. 28, 2025. Long-term average is over last 25 years, as of Dec. 31, 2024.

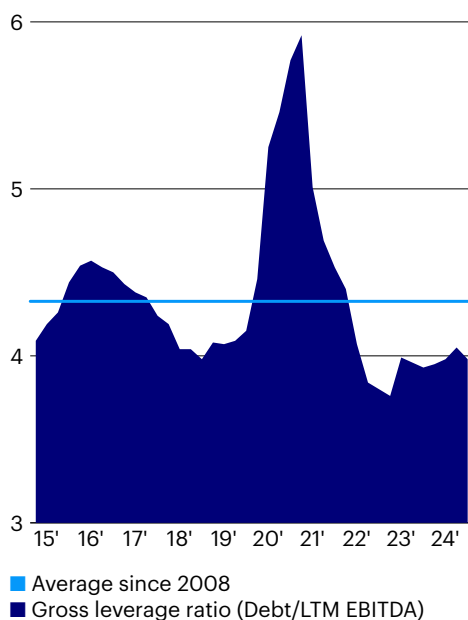
Healthy fundamentals

We feel current credit metrics provide a cushion to absorb a potential economic

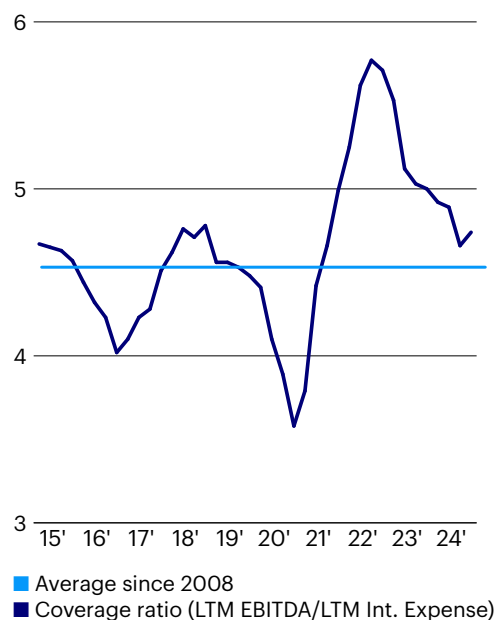
downturn. Credit metrics are on solid footing, with leverage below the historical average and interest coverage ratios well above the historical average.

Figure 7: Credit metrics

Leverage



Coverage ratio



Source: BofA Global Research, ICE Data Indices LLC. BB% data is monthly, since 1996. Data as of Feb. 28, 2025.

Conclusion

Compared to the historical make-up of the high yield market, today's market is higher credit quality, shorter duration, more senior, better diversified and on better fundamental footing.

While this doesn't guarantee protection from large drawdowns, it gives us consid-

erably more comfort that this cohort of high yield issuers increases the probabilities that favor outcomes of less volatility, lower defaults and fewer realized losses. High income with potentially less erosion from defaults, and less volatility...what's not to like?

Panelists



Matt Brill
Head of North America
Investment Grade



Todd Schomberg
Head of Investment Grade
Portfolio Management



Craig Altholz
Client Portfolio Manager

The bottom line: Rates have lifted performance but what else is driving investment grade?

Investment grade is up 2.34% so far this year, with much of its solid performance driven by a rally in intermediate yields.⁷ But there's been a lot going on under the hood, so we talk to Matt Brill, Head of North America Investment Grade, Todd Schomberg, Head of Investment Grade Portfolio Management, and Craig Altholz, Client Portfolio Manager, about the various market drivers year-to-date and where they think investment grade is headed in the coming months.

Craig: Let's start with rates since they have been the biggest driver of returns this year. Rates moved late last year, reflecting uncertainty over what the new Trump administration's policies could mean for inflation. What is your view on rates in the coming months?

Matt: The market started the year very concerned about inflation driven by animal spirits as the new Trump administration was sworn in. We did have a hot CPI print in January, but since then, inflation has slowed and the focus has shifted toward future growth. Markets are concerned specifically about tariffs and their potential negative impact on the economy. There is also some concern around immigration policy, which could be growth-negative. Whether tariffs are inflationary or just one-time price resets is debatable, but the Fed will likely need to navigate the price impacts of tariffs at the same time that the US economy may be slowing. Given a slower growth outlook, we would expect the Fed to look through the inflationary impact of tariffs, allowing rates to go lower.

Craig: With bank earnings strong in February, it doesn't seem like we are in a low growth environment. How have earnings been for industrials? Is credit expansion continuing to drive growth?

Matt: We've seen strong earnings from industrials so far this year. Utilities have had somewhat more mixed performance. But if you look at traditional US industrials, they've done well. The outlook going forward may be more negative or mixed, however. As earnings reports have come out, a lot of companies have beat expectations but then guided forward expectations down, particularly companies who are consumer-related.

That being said, corporate balance sheets are still in very good shape overall. There has been a fair amount of issuance in the

investment grade market and some in the high yield market, but it's been very well received. Some companies are taking on debt to pay down debt coming due from previous years, but they appear to be aimed at not leveraging up at this point.

Craig: Bonds have been negatively correlated to equities in recent selloffs, such as January's DeepSeek-related sell-off. There was another equity correction in March. What did bonds do this time around?

Todd: Bonds performed as you would have expected - they were inversely correlated to equities in these risk-off events. Whenever we have had a selloff this year, interest rates have fallen and bonds have rallied. That is exactly why bonds can be beneficial in a mix of assets, in our view, for that inverse correlation.

Given that we are in an environment of so much uncertainty, especially around growth, we think this negative correlation will continue throughout the rest of the year. Also, many investors have been yield buyers, so any upward correction in yields has the potential to draw buyers back into the market, so bonds could perform well in different situations.

Craig: Investment grade rating upgrades have outstripped downgrades, but a couple of names were recently downgraded to high yield, namely Celanese and Nissan. Do you think these names are symptomatic of broader trends or are they idiosyncratic? Also, are there any changes to your bull and bear cases for credit spreads this year?

Todd: The ratio of investment grade credit upgrades to downgrades has risen sharply since the COVID crisis in 2020, to a record 4.7 in 2024.⁸ But recently, we have seen a couple of important downgrades from investment grade to high yield.

Two that are top of mind are Celanese, a global chemical company, and the car-maker Nissan. In our view, these are two one-off situations in which the companies were poorly run and the downgrades were not related to broader fundamental concerns, such as tariffs.

At the end of the day, we still expect more upgrades than downgrades going forward. Of course, if tariffs cause economic activity to slow sharply in the second half of the year, fundamentals could be more challenged, but that is not our base case.

7. Source: Bloomberg US Credit Index. The index is up 2.34%, Jan. 1, 2025 to March 21, 2025.

8. Source: JP Morgan, JPM Daily Credit Strategy & CDS/CDX am update, Jan. 7, 2025.

In terms of our spread expectations, our bull case (15%-20% probability) was for a 55 basis point spread on the investment grade index. That was predicated on a high all-in yield, say 4.5% or more on the 10-year Treasury, but without exceeding 5%. In other words, our bull case was dependent on being in the sweet spot of the high four percent level in rates, but without the fear of blowing through the high end of the recent trading range, which might cause panic.

We believed that the high end of the range would likely attract yield-based buyers, such as insurance companies, annuities and pension plans. Now that we are trading in the low four percent range on the 10-year Treasury, we are less optimistic about how much tighter spreads can go.

On the other hand, our bear case was a widening to around a 120 basis points spread on the index, which has a very small probability, in our view. A key tail risk would be a serious policy misstep, for example. But though there is much volatility and noise around policy, we don't believe economic outcomes will be drastically negative.

Craig: We've had spirited debates about the consumer in our investment discussions lately. It seems like there is some softness at the lower end of the consumer spectrum, which has yet to show up in the macro numbers. Have you made any shifts in portfolio positioning, or are you thinking about any new risks based on divergent consumer strength and behavior?

Matt: We recently did a deep dive on the on the consumer within our platform. The general conclusion was that there are segments of the consumer market that are getting squeezed, especially on the lower income end.

The question is, is the squeeze big enough to have an impact on the trajectory of the economy and potentially widen credit spreads? Our answer is, we don't think so. We expect some economic slowing this year, so we want to be cautious on certain areas of the economy that could be impacted, like subprime auto loans and subprime credit card loans. The auto companies could also be susceptible, including foreign auto companies that could be hit by tariffs. So, we have favored being cautious on those areas that could be impacted by a pullback from lower-end consumers. But by and large, we don't expect the current consumer dynamics to change the direction of GDP or the overall economy at this juncture.

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Investment risks

The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested.

Fixed-income investments are subject to credit risk of the issuer and the effects of changing interest rates. Interest rate risk refers to the risk that bond prices generally fall as interest rates rise and vice versa. An issuer may be unable to meet interest and/or principal payments, thereby causing its instruments to decrease in value and lowering the issuer's credit rating.

Non-investment grade bonds, also called high yield bonds or junk bonds, pay higher yields but also carry more risk and a lower credit rating than an investment grade bond.

The risks of investing in securities of foreign issuers, including emerging market issuers, can include fluctuations in foreign currencies, political and economic instability, and foreign taxation issues.

The performance of an investment concentrated in issuers of a certain region or country is expected to be closely tied to conditions within that region and to be more volatile than more geographically diversified investments.

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