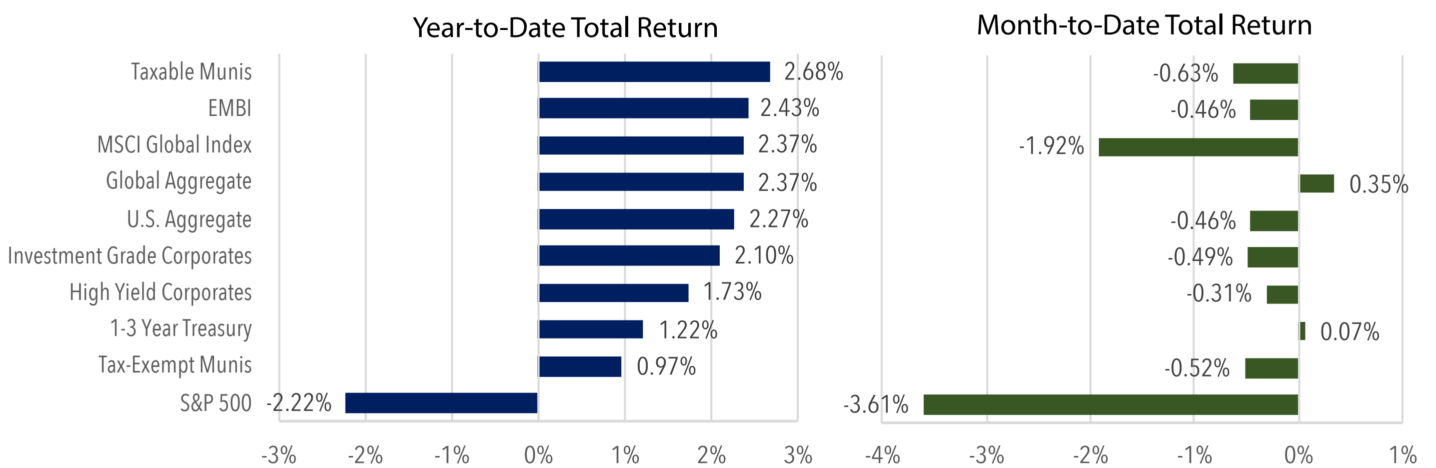
Week Ending: **March 7, 2025**

Exception To The Rule

Economic Overview:

This week, German 10-year bund yields surged 43 basis points, the biggest one-week rise since German reunification in late 1990. What drove the sudden move? Newly elected Chancellor Friedrich Merz said Germany would boost defense spending and unshackle fiscal policy from debt limits, or in his words, Germany is willing to do “whatever it takes," echoing former ECB President Mario Draghi’s 2012 pledge to preserve the euro amid the European debt crisis. But, German equities also surged and are handily outperforming the U.S. year-to-date—a rare occurrence in recent years. Could the fiscal policy shift end the U.S. exceptionalism of economic growth, equity outperformance, and USD strength in recent years? While the European economy could benefit in the near term from fiscal expansion, the key ingredients of U.S. economic outperformance remain —innovation, plentiful venture capital financing, faster productivity growth, better household income growth, fewer regulations, etc.—leaving us to wonder whether this week's market moves signal an enduring inflection point or a short-lived sentiment shift.

Total Returns by Asset Class



Source: Bloomberg

Highlights of the Week:

High Yield: Since the S&P 500 peaked on February 19th, equities are down -6.5%, while high yield is up +0.1%. This relationship is consistent with high yield performance in years past. High yield benefits from coupon income and interest rate exposure, so when risk markets are selling off, high yield investors typically enjoy more downside protection compared to equities.

Corporates: After gapping wider last week, corporate spreads have held in this week and remain unchanged at an option-adjusted spread (OAS) of 87 basis points (bps) despite the heavy new issue supply volume of $73 billion—highlighted by a $26 billion Mars, Inc. deal to fund their acquisition of Kellanova. The new supply was met with investor appetite, as most deals performed tighter post-issuance.

Municipals: The Bloomberg Municipal Index recorded a 1% total return for February, underperforming the High Yield Muni Index's 1.3% return and the Taxable Muni Index's 2.9%. Muni fund inflows totaled a healthy $2.7 billion.

Equities: The U.S. equity market fell sharply during the week as slower growth concerns and fiscal policy uncertainty drove the risk-off sentiment. Nearly all sectors posted losses, with financials, consumer discretionary, and technology leading markets lower, while healthcare, consumer staples, and materials were the best-performing sectors.

Securitized Products: Spreads in the auto asset-backed securities (ABS) market have been stable amidst tariff headlines and macro volatility. Issuance continues at a healthy pace, and consumer performance has been resilient, heading into the typically stronger tax refund season. The Manheim Used Vehicle Index released this week was largely unchanged month over month, sitting about -25% below the peak in 2022 but still +30% above pre-Covid readings.