AXA WF US Credit Short Duration IG

Potential impact of Trump's recent executive actions in first weeks of office and announced tariffs.

Over the first weekend of February 2025, US President Donald Trump made good on his threat to impose tariffs on imports from Canada, Mexico and China.[1] At the time of writing (Monday, February 3), the dollar is up, oil prices are up, European and US stock futures are down, while an index of Asia-Pacific shares dropped the most in nearly six months in response to the punitive measures taken against some of America's biggest trading partners. In the bond market, yields at the front end of the US Treasury curve have risen and the overall curve has flattened.[2] The market is anticipating that the combined impact of Trump's agenda, not only around tariffs but also fiscal policy and immigration, could be inflationary, thereby limiting the Fed's ability to cut rates to the extent the market was previously anticipating.

Prior to the confirmation of tariffs over the weekend, Trump's early days in office had been received well by financial markets. After a tricky first few days of the year, both equities and bonds rallied, posting strong returns for January (US IG & US HY indices posted total returns of +0.61% +1.38% in Jan-25 respectively).[3] Trump's message of growth and wealth creation appeared to be welcomed, but there has been enough in the first weeks of Trump's new administration to suggest that, at some point, markets might react badly to something he says, or threatens to do. Trump's announcement of tariffs on major trading partners could signal such a shift in direction and it is hard to foresee good outcomes from this direction of travel. Trump himself admitted on Truth Social that there would "maybe" be "some pain" from his tariffs. "But", he said, "it will all be worth the price that must be paid".

The President is predictably unpredictable, but we know that. Investors also recognise his agenda is wealth creation and to use as many means as possible to remove obstacles to wealth creation. It is not an agenda grounded in university-taught economic theory but one that relies on the use of conflict and dealmaking to the benefit of "those on his side." It is clear who Trump does not want to benefit – immigrants in the US, foreign countries, those who voted against him or were close to the previous administration. It is not clear how the benefits of 'Trumponomics' will trickle down to low-income groups whose standard of living has been hit by three years of inflation. But his message so far has been enough to generate confidence and optimism in America. The market reaction to tariffs might be enough to change that, or it could simply reinforce the view within America that the US has more to gain than lose from potential trade wars and Trump's rhetoric will no doubt centre around the economic benefits of closing trade deficits and using tariffs as a bargaining chip to fulfil other election promises around immigration, border control, or potential deals to be done overseas with Denmark to secure greater US influence in Greenland – which Trump sees as a conduit to bolstering security against threats from Russia and China.

From a fixed income perspective, the fundamentals for credit markets continue to look positive and there is more acceptance of the fact that tight credit spreads reflect the strong fundamental position of bond issuers. The US economy continues to

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[1] NB – update as of February 10th, 2025: announced tariffs on Canada and Mexico have since been postponed for one month following negotiations with the respective administrations. No such agreement has been struck with China; hence tariffs are coming into force, with China retaliating by imposing tariffs of its own on imports from the US.
[2] Source: Bloomberg as of February 3rd, 2025.
[3] Source: ICE BofA Indices, as of January, 2025.

grow at a strong pace, posting 2.3% GDP growth for 4Q at the first estimate and 2.8% in 2024 as a whole.[4] This is underpinned by a resilient US consumer that continues to benefit from a healthy jobs market, growing real wages, and a substantial wealth effect. At least half the country's voters will be feeling extremely optimistic about the direction of political travel. On the corporate side, the new administration is very pro-business. Animal spirits are at large. Business investment spending on technology will remain a key driver. Borrowing costs might be higher than they were a few years ago but earnings for listed companies are growing at an expected 14%.[5] There is not much not to like about US companies.

As interest rates have fallen from their peak levels last year, income from holding cash is rolling over. Looking back over the last 12 months, cash income exceeded income returns from US credit, but that is changing as cash income returns move lower and bond income returns are higher, reflecting the higher level of coupons in the market. At the end of 2020, average coupons in investment grade markets were 3.8% in the US. Today, those average coupons stand at 4.3%.[6] The average will increase further as low coupon bonds mature. Looking at US dollar corporate bonds issued in January, the average coupon was 5.5%, which is 232bps higher than the average coupon of maturing bonds of 3.2%.[7] Clearly there is a price risk in bonds and concerns about inflation and the fiscal outlook could impact on prices through underlying rates, but the level of income is set to continue to gradually improve across credit markets.

US IG Credit Investment Team views & potential policy/sector impacts

We envisaged that the outcome of the US election in November would not have a significant direct impact on the fundamentals of US credit markets, irrespective of the winning candidate. That said, there are second order impacts to consider, as well as broader considerations with regards to inflation, GDP and monetary policy. Furthermore, with the deficit already running at a significant 6% of GDP, the increased borrowing required to support fiscally expansionary policies such as the planned extension of tax cuts could lead to swings in the US Treasury market, thereby impacting credit spread levels and overall risk premiums.[8]

Below are some of the potential impacts of Trump's recent policy announcements across US credit sectors, grouped into the major pillars of his agenda:

1. Tariffs / trade

- Trump's announcement of tariffs on imported goods from major trading partners (Canada, Mexico and China) – with more likely to come – risks creating domestic price inflation and threatens international supply chains. We have already seen countermeasures imposed by Canada and threatened by China and Mexico to combat Trump's tariffs.
- In terms of US IG sectors that might be more directly impacted, within Healthcare we are monitoring the impact of tariffs on China and Mexico as pharma and medical products companies import raw materials / components and finished goods from both countries. Given the margin profile and differentiated nature of these products, we do not expect tariffs to have a credit impact on IG Healthcare companies, although we could see them shift to alternative supply sources. We also are watching to see if there will be an impact on US Pharma and Medical Products companies ability to sell their products in China or if the Chinese government would apply retaliatory tariffs on their products.
- Railroad IG companies risk being impacted by tariffs, particularly those imposed on Mexico and Canada, as freight volumes could slow. Company management teams have highlighted the risk with limited guidance at this point, given the uncertainty of policy and ultimate demand shifts.
- Across Consumer Goods and Retail, US IG companies which rely on domestic manufacturing would be best positioned to mitigate the impact from tariffs; however, large IG companies in our coverage universe are well equipped to mitigate such risks given flexibility within their supply chains.
- In the Financial sector, the 25% tariffs on imports from Canada would indirectly impact Canadian banks, as banking services are not subject to tariffs. To the extent the Canadian economy weakens materially and impacts corporate and consumer spending / health, this would impact loan demand, asset quality and capital markets business. This would be more impactful for Canadian banks that are more domestically focused.

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[4] Source: Bureau of Economic Analysis.
[5] Source: Bloomberg as of January 31, 2025. Analyst expectations for S&P 500 Index Earnings Per Share Growth (YoY by 2Q 2026).
[6] Source: ICE BofA as of January 31, 2025.
[7] Source: JP Morgan Research, US Corporate Credit Issuance Review, as of February 5, 2025.
[8] Source: AXA IM Research, Congressional Budget Office (CBO), as of December 31, 2024.

- The imposition of a 25% tariff on imports from Canada and Mexico would be negative for the US Auto sector in our view, given the auto supply chain between the three countries is highly integrated. Overall, the US auto industry imports ~3.6m vehicles from Mexico and Canada, with GM and Ford being the largest importers. GM reported that it sold 2.7mm vehicles in the US in 2024 and estimates its US market share at 16.5%. GM imported ~750k vehicles from Canada and Mexico in 2024 equating to ~27% of sales with ~24% from Mexico and the balance from Canada. Ford sold ~2.1m vehicles in the US in 2024 giving it an ~13% market share. Ford produced about 15% of these vehicles in Mexico and about ~5% from Canada. In addition to the completed vehicles, both GM and Ford rely on parts made in Canada and Mexico for vehicles assemble in the US, which further increase their exposure to the proposed tariffs. According to S&P, the tariffs could add an additional $6,250 to the landing cost of a vehicle costing $25k.[9] Therefore, the impact would not be insignificant to the price of the vehicle, which may reduce demand, requiring the original equipment manufacturers (OEMs) to absorb the costs. At this point, we are monitoring the situation closely to see if special exemptions will be provided to reduce or eliminate the tariffs on autos. However, absent this, we view the 25% tariffs as directionally credit negative for the industry, although the magnitude of the impact depends on the length of time the tariffs remain in place and if the OEMs could shift production back to the US to reduce the tariff burden.
- We expect tariffs to have a largely neutral impact on more US centric sectors such as Telecom and Media, but we are closing watching any developments in the Tech sector, although a level of broad-range tariffs is already embedded in the growth expectation for 2025. Given the recent US equity wobble caused by the release of DeepSeek, the new Chinese AI model, an escalation of trade tensions with China could impact on AI supply chains, which in turn could have implications for capital spending on semiconductors, data centres and dedicated sources of energy.

2. Deregulation

- The expectation is that the move from a Democratic-led, stringent regulatory environment in terms of net neutrality, digital discrimination, data breaches (both in terms of reporting requirements and enforcement actions), as well as scepticism on the M&A front, to a Republican-led regulatory body, will bring a shift towards an environment where deregulation should prevail, albeit with some exceptions for the Tech sector.
- We are closely watching the appointments to regulatory bodies such as the Federal Trade Commission (FTC), Department of Justice (DoJ) and Federal Communications Commission (FCC) for insights in what might come. Already, Trump's nomination of Andrew Ferguson as the head of the FTC is significant. Ferguson has criticized the incumbent, Lina Khan, for opposing mergers and being "anti-business". A more favourable regulatory environment for the corporate sector should lead to increased M&A activity in 2025, following a muted period, although could lead to new potential supply that might impact on technicals.
- For US banks, the deregulatory push by the new administration should hold back indefinitely proposed Basel III Endgame / regional bank capital rules, which is supportive of lending and net interest income growth partially offset by greater shareholder remuneration. Increased M&A activity should benefit banks most exposed to investment banking fees.
- In the Energy sector, lighter regulation should reduce regulatory costs and ease domestic production restrictions, although we believe IG E&P companies will maintain production discipline to support current commodity prices. If that production discipline wanes, then then the lack of spare domestic refining capacity could create an oil supply glut in the US. Changes to flaring restriction could reduce excess natural gas supply (a byproduct of oil production) in oil producing regions and thus place upward pressure on natural gas prices.
- Within consumer-facing industries, we would highlight food and beverage sectors as being more susceptible to potential M&A given growth needs and the fact that balance sheets and leverage capacity are in strong positions. In addition, a regulatory crackdown or acceleration in GLP-1 (weight loss drugs) usage could further encourage M&A this year.

3. Immigration

- President Trump has been very clear in his first few days in office about his intention to fulfil his election promise to deport illegal migrants.
- Given how tight the US labour market has remained, we expect that this will create shortages and a pick-up in vacancies – particularly in agricultural industries.
- The most significant impact of this shift in labour market dynamics could be felt in higher pay feeding through into a broader pick-up in inflation, which ultimately could limit the Fed's ability to implement further rate cuts.

[9] Source: Standard & Poor's, as of February 2025.

- Immigration has been a decent growth engine for certain sectors (e.g. wireless telecom carriers) – both in the US and in Canada – which is weighing on investor sentiment despite no discernible impact feeding through yet from recent earnings calls.

4. Fiscal policy / tax cuts

- Trump's desire to reduce corporate tax rates to boost domestic production could be positive news for US companies. This should also be good news for US bank earnings given the industry's higher tax rates.
- Trump has been clear that he intends to extend the Tax Cuts and Jobs Act (TCJA), which his previous administration brought in effective 2018, that are due to expire. We would anticipate that a lowering of corporate tax rates would boost corporate investment, but its benefits need to be considered against further increases to the already significant federal debt burden.
- Away from the US domestic market, Trump has threated to double tax rates for foreign nationals and companies in the US to hit back at "discriminatory" levies on American multinationals. This seems part of Trump's "American first" rhetoric, preparing for a wide-ranging international tax fight, with digital services taxes against Big Tech groups and OECD-brokered minimum corporate tax regimes in his sights.

5. Other considerations

- We are closing watching issues that may impact access to and cost of healthcare in the US, including any changes to Medicare / Medicaid funding and out of pocket drug costs to seniors. Presently, no action taken by Trump has directly impacted access to and the cost of healthcare in the US despite headlines that may appear to the contrary.
- In Utilities, President Trump is ordering agencies to halt spending from the Inflation Reduction Act (IRA) implemented by the Biden administration, which may reduce renewable growth plans. He lifted the moratorium on new Liquified Natural Gas (LNG) export licenses and is championing fossil fuels, which will encourage more natural gas and nuclear, which can help utilities (although we believe the natural gas producers will show discipline). Lower taxes and a higher number of acquisitions will aid utility companies, although we do expect higher labor costs (due to the deportation of immigrants) and possibly higher supply costs for new utility plants under the new administration.
- In the Technology, Media & Telecom space, we are monitoring the impact of the newly created Department of Government Efficiency (DOGE). For example, it might be that funding for the Broadband Equity, Access, and Deployment Program (BEAD), which expands high speed internet access across the US, might be diverted away from Telecom/Cable industries to Satellite, potentially through the Starlink arm of Elon Musk's SpaceX.

Portfolio positioning

Although market reaction to Trump's tariffs is still evolving, a flatter US Treasury 2s10s curve means that the yield per unit of duration offered by short duration credit relative to further out the curve should increase from already attractive levels. Moreover, it confirms our view that rates markets may continue to be volatile as Trump's policy agenda continues to be unravelled over the year, with longer duration asset classes / strategies potentially more exposed to swings in the Treasury market. The most significant market impact will be played out through increased uncertainty regarding inflation and, ultimately, future interest rate policy by the Fed. Our US economist no longer expects a rate cut in March (the market has also moved to pretty much price this out) and has the Fed on hold for 2025, before re-commencing its easing cycle in 2026. We now expect four 25bps cuts in 2026 as Trump's policy agenda starts to weigh on growth, with the Fed Funds – Upper Bound finishing 2026 at 3.5%. For now, therefore, income and carry remain the name of the game with bond yields set to remain elevated.

At the portfolio level, we have not made any significant shifts in positioning and continue to target a yield advantage relative to the US Corporate 1-3 Year Index[10], meaning that the YTW on the AXA WF US Credit Short Duration IG fund has risen from 4.68% as of Sep-24 to 4.92% by Jan-25 (~15bps higher than the 1-3 Year Index).[11] These yield levels are above policy rates and well above prevailing and expected inflation rates. Whilst bond yields have been rising, cash rates have been declining due to 100bps of cuts by the Fed in 2024. As a proxy, the YTW of the ICE BofA 0-3M US Treasury Bill Index declined from 4.71% in Sep-24 to 4.30% as of Jan-25. Similarly, the overnight SOFR cash rate has also declined from 4.84% to 4.36% over the same period.[12] The fact that the Fed has declared that it is in "no hurry" to cut rates further should keep market expectations for

[10] The US Corporate 1-3 Year Index is shown for illustrative purposes only. The Fund is actively managed without reference to any benchmark.
[11] Source: AXA IM, FactSet, as of January 31, 2025. Portfolio data inclusive of cash.
[12] Source: ICE BofA, as of January 31, 2025.

further rate cuts limited, thus supporting bond yields at the front end of the curve.[13] This sets a backdrop for a healthy return environment for short duration credit in 2025, driven by a strong fundamental environment and improving income returns as bonds continue to roll over and coupons on new bonds increase.

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[13] Source: Chairman Powell's comments at the FOMC meeting of January 29, 2025.

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